Uganda Country Brief
December 2019

Introduction

The Republic of Uganda is a landlocked country located in East Africa, bordered by Kenya to the east, South-Sudan to the north, the Democratic Republic of the Congo to the west, Rwanda to the south-west and Tanzania to the south. The capital and largest city is Kampala.

Measuring 241,038 square kilometers, Uganda is the 33rd largest country in the continent by area. Its population of about 35 million makes it the 10th most populous nation in Africa. Like most countries in the region, several different languages are spoken. English and Swahili are the two official languages. Runyoro, Runyankole, Rukiga, Luo, Lusoga and Luganda are other widely spoken languages.

Uganda is known as “the pearl of Africa” due to its natural resources, which include fertile soils, landscapes, fauna and flora and geography. Uganda’s economy is overwhelmingly driven by its agricultural sector, which contributes 25 percent to GDP and accounts for about 69 percent of total employment. Uganda's exports are dominated by traditional cash crops such as coffee, cotton, tea and tobacco and mineral resources like gold. The services sector accounts for 47 percent of GDP, while manufacturing and other industries account for 8 percent and 20 percent respectively.

Political Environment

Uganda is a presidential republic with an executive President elected every five years by popular vote. The Executive consists of the President, the Vice-President, the Prime Minister and the Cabinet of Ministers, appointed by the President. The judiciary operates as an independent branch of government. The present constitution took effect in 1995.

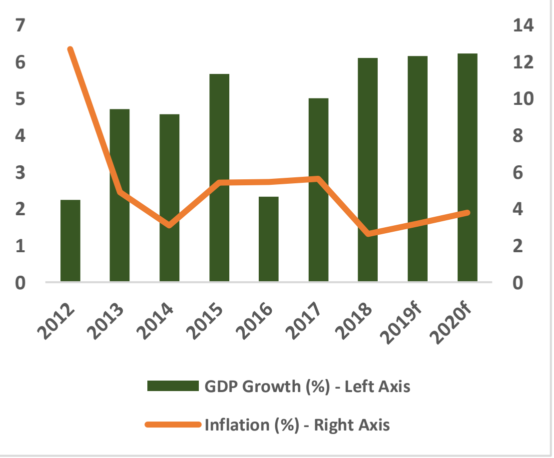
The current President is Yoweri Museveni, who has served since 1986. The last presidential election was held in February 2016. The next general election is scheduled for 2021.

Economic Overview

GDP: Uganda has been one of the fastest growing and most resilient economies within the continent. After a sharp drop in GDP growth following the synchronized global growth deceleration in 2016 and lingering effects of the end of the commodity super-cycle, aggregate output expanded by 5 percent in 2017, up from 2.3 percent in 2016. GDP growth strengthened further in 2018, expanding by over 6 percent. Growth forecasts point to further strengthening with aggregate output expanding by 6.2 percent in 2019 and 2020.

The growth resurgence is largely driven by development in information and communication technology (ICT) services, increased infrastructure investment, expected foreign direct investment in the oil and mining subsectors. It has also been driven by favorable weather conditions especially for the agricultural sector, and successful implementation of reforms to improve the business environment.

Figure 1: Uganda GDP Growth and Inflation (Percent)



Source: IMF World Economic Outlook (2019)

Notwithstanding the positive outlook, downside risks remain including slow implementation of infrastructure projects and adverse weather shocks. Agriculture, which is the main source of foreign exchange earnings and account for a sizeable share of GDP remains largely rainfed.

Inflation: After reaching 12.7 percent in 2012, inflation has subsequently eased, falling to an estimated 2.6 percent in 2018, compared to 5.6 percent in 2017. The fall was driven mainly by lower food inflation in a context of favourable weather conditions, prudent monetary policy, and relatively lower global oil prices.

In the short term, inflation will remain subdued, albeit, edging up to 3.2 and 3.8 percent in 2019 and 2020, respectively. In the medium-term headline inflation is projected to remain stable within single digits and core inflation is expected to edge closer to the Bank of Uganda's policy target rate of 5 percent. The projected developments in inflation is anchored on expectations of rising food prices and a slight depreciation of the domestic currency, Ugandan Shillings, against the major trading currencies. Furthermore, the country's macroeconomic policy stance remains focused on containing inflationary pressures and enhancing exchange rate stability.

Exchange Rate: The Ugandan Shilling has come under pressure in recent years depreciating against the US dollar by over 5 percent since June 2018 to Ush 3664. The depreciation of the shilling is largely due to developments in the balance of payments which determines the demand and supply of US dollars. The current account deficit widened by an estimated USD1.8 billion by close of 2018/19, to about USD3.037 billion.

The deterioration of the current account was exacerbated by two unfavorable factors—falling exports of goods and services and increasing imports partly because of higher government spending on imports related to infrastructure projects but also because of strengthening demand from the private sector. As a percentage of GDP, public investment increased from 7.8 percent in 2016/17 to 9.6 percent during 2018/19 and is projected to exceed 12 percent during 2019/20.

Fiscal Balance: The government of Uganda has embarked on an expansionary fiscal policy during the last five years as part of its strategy to implement its second National Development Plan (NDP II) and support growth and structural transformation. This initiative puts significant pressure on the fiscal deficit which has been widening consistently since 2016 from 4.5 percent of GDP in December 2016 to 4.9 percent in 2017 and reached 5.1 percent of GDP in 2018. While reforms in tax administration, including an expansion of the tax base will raise government revenue, the fiscal deficit is expected to widen to 7.5 percent of GDP in 2019/20, driven by expenditure on large infrastructure projects related to transport, electricity and telecom under NDP II. The deficit has been largely financed by external debt on both concessional and non-concessional terms.

Overview of trade, reserves and financial sector

Total Trade: Uganda was the 122nd largest export economy in the world and the 27th largest export economy in Africa in 2018. It exported USD 3.1 billion and imported USD 6.7 billion worth of goods that year, resulting in a trade deficit of USD 3.6 billion (Figure 2). This large deficit, which has been trending upwards, is mainly due to a marked increase in imports of refined petroleum, electrical equipment and vehicles, and a decline in coffee exports.

While Uganda's export basket includes gold, grains and fish, coffee remains the primary source of foreign exchange earnings, accounting for over 14 percent of total exports. Its top export destinations are Kenya, the United Arab Emirates, Sudan, Rwanda, and the Democratic Republic of Congo (DRC) which together accounted for around 64 percent of total exports in 2018.

Uganda's top imports include refined petroleum, but also, capital goods such as machinery, electrical equipment, and vehicles. Its top import origins are China, India, United Arab Emirates, Saudi Arabia and Kenya, which together accounted for more than 58 percent of total imports in 2018.

While African markets are the main destination for Uganda's exports, they are not the primary sources of imports. Asia and Europe accounted for over 62 percent of total imports of goods in 2018. African markets were the source of about 20 percent of total imports during that period.

Figure 2: Uganda total trade (USD thousands)

Source: ITC Trademap, Afreximbank Research

Intra-African Trade: Uganda's total trade with other African countries amounted to approximately USD2.99 billion in 2018, accounting for 30.5 percent of its total trade, significantly above the regional average of 16 percent. Kenya, Sudan, Rwanda, DRC and Tanzania are the top destinations for Uganda's exports within the region, accounting for around 92 percent of its total exports to other African countries. However, Uganda's exports to other African countries remain largely concentrated within the East African region, which accounts for over 95 percent of total intra-African exports. The main export products include cereals, coffee, vegetables and sugar.

The source of Uganda's imports is more diversified with trade partners not just in East Africa but also Northern and Southern Africa. Uganda's largest African import partners are Kenya, South Africa, Tanzania and Egypt, which together accounted for about 86 percent of Uganda's total imports from the rest of the continent in 2018. It imports mainly mineral fuels, vehicles, precious metals, iron and steel, and plastics.

Foreign Reserves: Uganda's stock of reserves has gone through several episodes over the last few years, reflecting the challenging domestic and global macroeconomic environment of contracting global trade and heightening global volatility. After rising from USD2.9 billion in 2015, foreign reserves increased to USD3.1 billion in 2016 and USD3.7 billion in 2017, before declining to USD3.4 billion in 2018. The decline in the country's reserve position was mainly due to a slowdown in export growth and strong recovery in oil prices (which raised the oil import bill) and widened the current account deficit. The deficit was further exacerbated by imports of capital goods for infrastructure projects in the context of NDP II and intervention by the bank of Uganda to mitigate excessive exchange rate volatility.

As of end of December 2018, Uganda's total reserves covered about 4.4 months of imports, which is higher than the IMF's threshold of 3 months and marginally below the East African Community's (EAC's) convergence target of 4.5 months. Looking ahead, the level of reserves is expected to pick up gradually to USD3.7 billion in 2019, and reach about USD4 billion in 2020, driven largely by strengthening exports on account of rising world prices of key exports such as coffee, increased tourist arrivals and FDI inflows as economic activity improves on the back of implementation of infrastructure projects in several strategic sectors.

Current and Capital Account Balances

Uganda's current account deficit, deteriorated further in 2018 widening to 8.9 percent of GDP from 5.0 percent in 2017. The deterioration of the current account was largely due to weak export growth which was outpaced by rising imports of capital goods alongside high oil-related services debits. the deficit is set to widen further and reach 11.5 percent of GDP in 2019. It is expected to reverse thereafter, narrowing steadily throughout the next few years as rising coffee prices increase exports and the pace of import growth abates due to a slowdown in capital imports as infrastructure projects progress towards completion.

The current account deficits were financed by surpluses in the capital account which improved markedly, boosted on account of strong economic activity led by progress on infrastructure development which attracted foreign direct investment, portfolio investment and tourist receipts. Continued inflows of remittances and loans also supported the capital account.

Overall, Uganda's capital account is expected to continue strengthening as infrastructure projects improve the economic environment and oil sector projects, including the development of oilfields to make the country more attractive to foreign investors.

Financial Sector: Uganda's financial system comprises formal, semiformal and informal institutions. The formal institutions include banks, microfinance deposit-taking institutions, credit institutions, insurance companies, development banks, pension funds and capital markets. The semi-formal institutions include Savings and Credit Cooperative Associations (SACCO) and other microfinance institutions, while the informal sector consists of mostly village savings and loans associations. Formal institutions are less prominent in rural areas than urban areas and they only serve 14 percent of the rural population, with informal institutions playing a more important role in the provision of financial services in underserved rural areas.

About 85 percent of Ugandans have access to financial services, including through mobile money with authorities implementing a five-year financial inclusion strategy to improve financial literacy, develop the credit infrastructure and promote formal savings, investment, and insurance, while ensuring consumer protection. In 2018, access to financial services benefited from the introduction of agency banking. Uganda has recently issued regulations for Islamic banking and one bank has launched its first Islamic financial products. Authorities are working towards adopting the National Payments System Act, which will provide a legal basis for Bank of Uganda (BoU) to supervise the mobile money sector.

The banking sector is tiered into commercial banks, credit institutions and microfinance deposit-taking institutions. As at June 2019, commercial banks accounted for 95.2 percent of the banking sector total assets, with aggregate assets of the industry increasing by 10.5. Loans and advances, investment in government securities, balances with BoU, and placements with non-resident banks respectively accounts for the largest proportion of the industry total assets. The foreign currency denominated component of total assets fell from 33.1 percent to 29.4 percent, reducing the exposure of banks' balance sheets to foreign exchange rate risk.

The ratio of non-performing loans to gross loans (NPL ratio) reduced during the year. Asset quality, as measured by the NPL ratio improved to 3.8 percent from 4.4 percent. The improvement is largely attributed to the significant reduction of 5.2 percent, in the industry's stock of NPL's.

While aggregate profitability of the banking industry is healthy, driven by the resilience and profitability of the larger banks which enjoyed greater access to cheaper funding, diversified earning assets, and often sizeable alternative income streams, the challenges faced by loss-making smaller banks remains a concern. The banking sector's aggregate net-after-tax profit increased by 5.3 percent in June 2019, largely driven by interest income on advances and treasury securities. Improvement in asset quality also contributed to strengthening profitability through a lower increase in provisions.

Liquidity risk in the banking system remains low, as banks maintain liquidity buffers well above the prudential minimum requirements. However, stress tests indicate that banks' resilience to liquidity shocks has weakened somewhat in the face of reduction in liquidity buffers. While deposits increased by 8.8 percent, liquid assets increased at a slower pace of 6.3 percent due to a shift towards longer-term and less liquid assets. Notably, the stronger growth in banks' lending to the private sector, 11.2 percent, claimed an increasing proportion of deposits, 64.7 percent. Furthermore, the faster growth, of banks' investment in government securities (14.7 percent) was skewed to more long-term government securities, which are less liquid. Consequently, the liquid assets-to-total deposits ratio declined from 46.6 percent in June 2018 to 45.5 percent in June 2019—more than double the regulatory minimum requirement of 20 percent. However, Uganda's banking and financial system is deemed sound and stable overall.

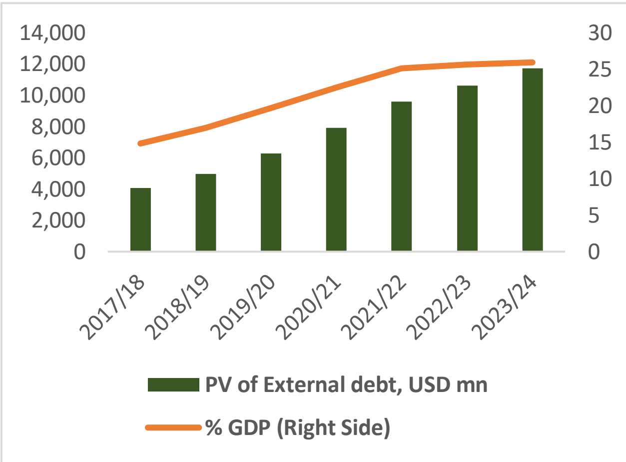
Debt Sustainability

Uganda scores 3.7 in the 2018 World Bank Country and Policy Institutional Assessment (CPIA) score—up from 3.6 in 2017.[1] This is above the IDA borrowers average of 3.1, and is indicative of medium quality in policy management for the country.[2] Among the four components that make up the CPIA, the quality of economic management is the strongest at 4.2 above the peer average of 3.1; while the public sector management score of 3.2 is the weakest.

The overall CPIA score of 3.7 is indicative of the following thresholds for debt sustainability: Present value (PV) of external debt-to-GDP of 40 percent; PV of total debt to GDP of 55 percent; PV of external debt service to exports of 15 percent; PV of external debt/exports of 180 percent; PV of external debt service/revenue of 18 percent. Uganda's debt sustainability is assessed against the aforementioned benchmarks.

Uganda's public debt reached USD11.3 billion at the end of the 2017/18 fiscal year with two-thirds of public debt (USD7.9 billion) owed to external creditors. Domestic debt amounted to about USD3.5 billion, with most of this issued as Treasury Bonds with a marginal amount being short-term Treasury Bills. Most of Uganda's debt is on highly concessional terms although around one quarter of external debt is on semi-concessional or non-concessional terms, largely from bilateral creditors and directed towards infrastructure financing.

Figure 3: Evolution of Uganda's external debt composition (USD million)



Source: IMF, Afreximbank Research

(i) PV of external debt/GDP

Uganda's solvency and liquidity indicators remain well below their indicative thresholds over the medium term. Expressed as a share of GDP, the present value (PV) of public and 'publicly guaranteed' external debt was 14.8 percent in FY2017/18 and is forecast to peak at 25.9 percent in 2023/24 as the government continues to borrow heavily to finance growing infrastructure investment.

[1](1=lowest, 6=highest); Debt thresholds corresponding to strong performers are highest, indicating that countries with good macroeconomic performance and policies, can generally handle greater debt accumulation.

[2] There are currently 75 borrowing IDA countries spread across Africa, Asia, Latin America and the Middle East

(ii) PV of total debt /GDP

Estimated at 27.2 in FY2017/18 the PV of public debt-to-GDP is projected to reach around 39.3 percent in FY 2023/24 before declining to 29.9 percent by FY2028/29 as oil export receipts improve. This compares to an indicative benchmark of 50 percent for countries with medium debt-carrying capacity and is indicative of low risk of debt distress.

(iii) PV of debt service /revenue

Estimated at 11.4 percent in FY2017/18 the PV of public debt service-to-revenue is set to decline to 7.7 percent in FY2019/20 before plateauing at around 11 percent in the long term. This compares with the threshold of 18 percent for countries with a medium CPIA score and is indicative of low risk of debt distress. This risk is set to decrease even more in a context of a gradual increase in government revenue, especially in the era of oil production and export.

(iv) PV of external debt/exports

The estimate for PV of external debt to exports is put at 75.6 percent in FY2017/18 and set to rise gradually over the medium term to reach 134.7 percent in 2022/23, but still below the debt sustainability threshold of 180 percent. Longer term projections see this ratio falling 94.7 percent in 2028/29, reflecting both a relative decline in external debt and an improvement in export receipts. Overall, the dynamics in external debt-to-exports ratio are consistent with a low risk of debt distress.

Opportunities for Bank Support

Since 2015, the government of Uganda has been implementing its second National Development Plan (NDP II) which covers the period 2015 -2020 and builds on the achievements, challenges and lessons learnt during the implementation of the first National Development Plan (NDP I) which covered the period 2008-2014, in line with the country's Vision 2040 themed "A Transformed Ugandan Society from a Peasant to a Modern and Prosperous Country within 30 years". Under that vision, the government aspires to transform the country from a low-income, to a competitive, upper-middle income nation with a per capita income averaging USD9,500 by 2040.

The government has prioritized five key areas for investment, namely agriculture; tourism; minerals, oil and gas; human capital development; and infrastructure Development under NDP II. This includes road and railway networks; airports; development of energy infrastructure, especially the construction of geothermal energy plants and a 600 MW hydropower plant as well as projects on communication infrastructure. The objectives of NDP II include increasing sustainable production, processing and value addition through industrialization to diversify the sources of growth and exports.

These align with the Bank's strategy of promoting industrialisation and export development and intra-African trade. They offer opportunities for the Bank which recently established its East African office in Kampala to support the country's development agenda.

Table 1: Uganda: Selected Macroeconomic and Financial Indicators

	2012	2013	2014	2015	2016	2017	2018	2019(f)	2020(f)
Real GDP, %	2.2	4.7	4.6	5.7	2.3	5.0	6.1	6.2	6.2
Inflation, %, Annual average	12.7	4.9	3.1	5.4	5.5	5.6	2.6	3.2	3.8
Exports of Goods and Services % y/y	18.5	4.8	-5.1	6.3	12.5	9.8	10.2	9.8	9.4
Current Account (% of GDP)	-6.7	-7.2	-8.1	-7.3	-3.4	-5.0	-8.9	-11.5	-10.5
Total Reserves (USD billion)	3.2	3.33	3.32	2.9	3.1	3.7	3.4	3.7	4.0
Gross Reserves (months of imports)	4.5	4.9	4.4	5.1	5.1	5.5	4.4	5.1	5.2

Sources: IMF, *World Economic Outlook (10/19)*