STATE OF THE UGANDAN ECONOMY – July, 2009

A. Introduction

A review of the major economic developments for the second quarter 2009 reveals that; the cost of doing business in Uganda has continued to rise steadily. This is on account of the global financial crisis, increasing prices of food items, soaring transport costs and cross boarder trade activities; which are trickling down into Uganda's domestic inflation reflected in the above parameters. It should however be noted that, the business climate in the period *eased* a bit, though rising again. Notwithstanding, Bank of Uganda continues to attempt to ensure price and macro economic stability using its stringent monetary policy to manage liquidity in the market. Import and Export performance in the period analysed indicates that, there has been a significant decrease in export performance particularly for coffee. There is also a clear indication that the 2009/10 budget priorities[1] are in line with the private sector concerns though we are not yet certain of the budget impacts on the business community. However, the underlying challenge lies with the *implementation* process of the planned activities.

B. Price and Market Developments

Inflation:-

The Annual Headline Inflation rate for the month of May 2009 dropped to **12.4%** from **13.4%** in April 2009, on account of a slow down in food crops inflation. The main Inflation driver remained increase in food prices due to high transport costs, seasonality and continued robust regional demand for food items from Uganda. Food crops inflation reduced from **26.0%** in April 2009 to **23.8%** in May 2009. The Annual Core Inflation rate[2] decreased to **10.3%** in May 2009 from **11.1%** in April 2009[3]. During the month, prices of (fuel) petrol, diesel, paraffin, charcoal and firewood continued to decline. Cement, household items and other scholastic materials went up. It is estimated that over all headline inflation is slowing down at a *slower* rate as shown by the trend for the months of April, May and June 2009 (reported at 12.0% by the press[4]) though with increasing pump fuel and food prices especially in Kampala[5].

The inflation has particularly eroded disposable income, which translates into reduction of the purchasing power of Ugandans; this implies a significant loss of the market by the business community. This further acts as a disincentive to production especially for commodities produced by farmers

The table/graph below presents the trend of inflation in the second quarter (April and May 2009) and three selected inflation indicators meant to provide a clearer understanding of the above inflation developments.

INFLATION TRENDS FOR THE SECOND QUARTER OF 2009

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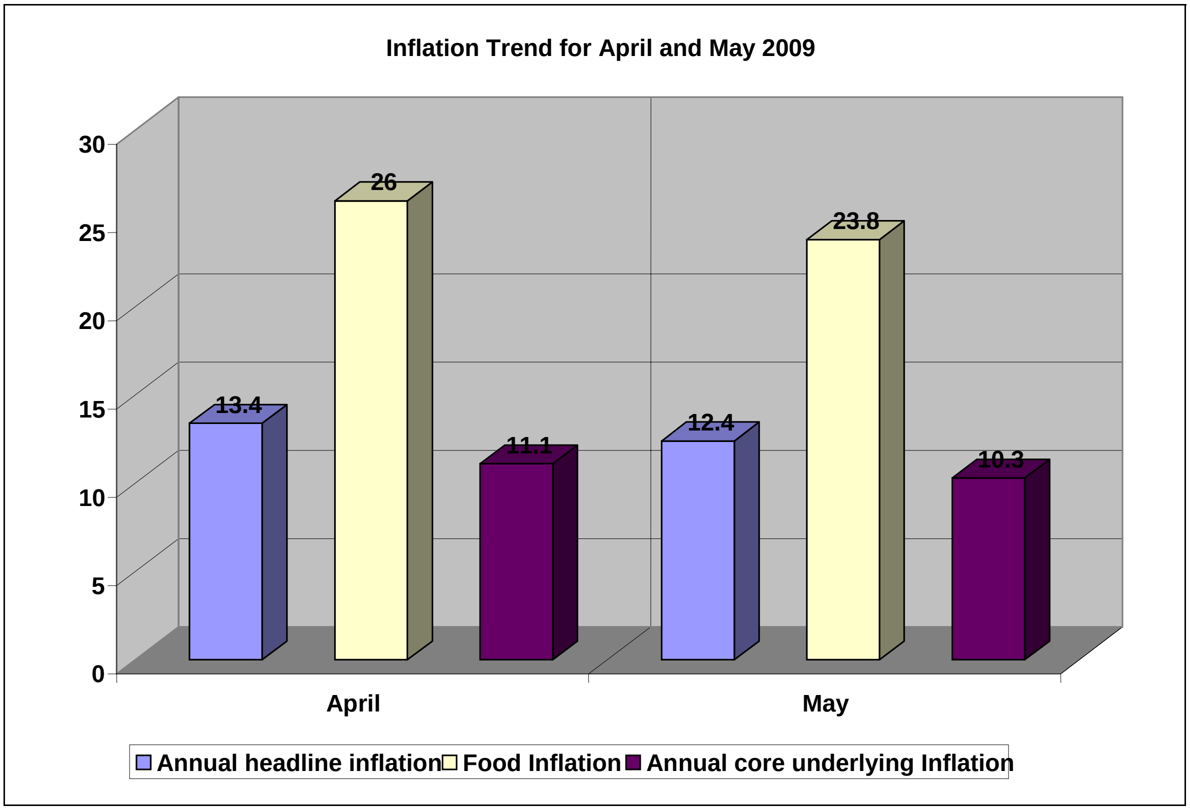
1 Agricultural production and Value Addition; Transport Infrastructure; Energy Infrastructure; Human Development & Peace, Security and Good Governance.

2 Excludes food crop items, fuel, electricity and metered water

3 Uganda Bureau of Statistics-consumer Prices May 2009

4 See The New Vision Wednesday, July 1, 2009; Page 3

5 UBOS to confirm with detailed figures for June 2009



Source: UBOS, 2009

Foreign Exchange:-

The US$ which is Uganda's major trading currency has been strengthening against all major currencies around the world including the Euro which is used by Uganda's major export destinations. Between April 2009 and May 2009, the Shilling depreciated against the US dollar by 0.7% from an average of Shs. 2,222.49 per US$ to an average of Shs.2,234.91 per US$. The depreciation is attributed to increased demand for foreign currency from both corporate and offshore players, declining export earnings and reduced remittances. In the middle of June, the US$ slowed down a bit and has gone up again as of early July[6].

The depreciation of the Shilling has had multiple effects on the cost of doing business such as increased import costs of raw materials, merchandise and capital equipment. The cost of services charged in US$ such as transport from Mombasa has also increased in real terms.

Uganda Revenue Authority's exchange rate in April 2009 was Shs. 2,023.71 per US$ and Shs.2,169.95 per US$ in May 2009[7]. The implication of this is that there has been a 7.2% increase in real taxes on imports between April 2009 and May 2009. However, URA is working to harmonize/reduce all customs and excise duties in order to mitigate the high costs of doing business in Uganda. (For instance the URA exchange rate had increased to 2,252.21per US$ in June 2009, but has reduced back to 2,169.95per US$ in July, just as it was before in the month of May 2009).

Cost of Fuel

[6] Figures to be confirmed

[7] Uganda Revenue Authority Monthly Reports May 2009

According to the International Energy Agency, in spite of the substantial decline (more than 70%) in global oil prices in 2008, the cost of fuel in Uganda has persistently remained high. For example, average pump prices in Kampala for petrol and diesel remain high at Shs. 2,400 and Shs. 1,900 respectively, compared to Shs. 2,320 and Shs.1, 630 in March 2009[8].

These persistent high fuel costs have led to increased costs of doing business through; increased costs of transport and production. This in turn has led to increase in commodity and food prices for final consumers.

Interest rates:-
Commercial banks raised their lending rates by between 1 and 3 percentage points during the first quarter of 2009 but some have started re-adjusting their base lending rates downwards[9] following BOU's reduction in the Bank Rate from 15.88 percent to about 10.59 percent. Despite this reduction in Bank Rate by BOU, many commercial banks have not responded and thus kept their lending rates up and are instead introducing yet new products for their clients (i.e. School fees, housing, e.t.c) at even much higher rates.

The implication of this is that the finance costs for firms have increased so has their indebtedness. Secondly, because of the uncertainty in the movements of interest rates, planning becomes difficult for the business community.

C. Emerging issues from the 2009/10 FY Budget

Ban of Plastic Bags, old Computers, Freezers and Refrigerators
Government has slapped a total ban on plastic bags used for conveyance of goods and liquids; it has also pronounced a total ban on the importation of used computers, freezers and refrigerators citing environmental concerns. Polythene bags are a key raw material to many sub-sectors e.g. flower Industry that import the bags for the green houses and water reservoirs. Following this pronouncement therefore, the business community is of the view that the ban has come too soon thus leaving no room for transition to other alternatives.

There's increasing panic in the business community where over 15 companies are threatened to close if the ban is in place. This further implies a loss of revenue equivalent to US$ 60million. Also, Over 10,000 Jobs in Uganda are to be lost, compared to other EAC countries (such as Kenya and Tanzania) without the same ban. Therefore, to address the environmental protection need, policy emphasis should be on the supply side other than production side. (i.e. disposal sensitization of the general Public).

D. East African Issues
There's a threat that Kenya is planning for an expansionary monetary policy; devaluing its shilling! This would destabilize Ugandan business and may bring in imported inflation and Kenyan imports would become much cheaper[10].

This would further stress our business community in Uganda especially manufacturers of similar or substitute products to the affected items.
Sources:
1. ***Bank of Uganda (BOU) Monthly Economic and Financial Indicators***
2. ***Uganda Bureau of Statistics (UBOS) -— Statistical Abstracts, Consumer Prices***
3. ***Uganda Revenue Authority (URA)-Website***

[8] From local survey of Kampala pump stations
[9] This is happening in the second quarter of 2009. A few banks e.g. DFCU Bank, made the first move 1st April 2009 and borrowers are hopeful that other commercial banks will do the same.
[10] Move though not yet in place