The State of the Economy for the Second quarter 2022/23

Presented

to

The Private Sector Foundation Uganda Advisory Council

Prepared

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TABLE OF CONTENTS

1. Introduction

The current business environment shows further improvement and promising amongst the business community and the citizenry. The outlook of Uganda's economic growth is projected to grow **5.5% in 2023 up from 4.7% in the previous financial year and further predicted to hit 6% in 2024.**

2.0 MACRO-ECONOMIC POSITION

2.1.1 Economic Activity

Globally, the economic situation is complex, due to the high persistence of global inflation and aggressive monetary policies by the main central banks. According to the IMF report, October 2022 there is a projected global (including advanced economies, Europe, and Emerging economies) output slowdown to **2.7%** in 2023 from **3.2%** in 2022 which is a further downgrade from **6.1% in 2021** as most economies have undergone significant slowdowns.

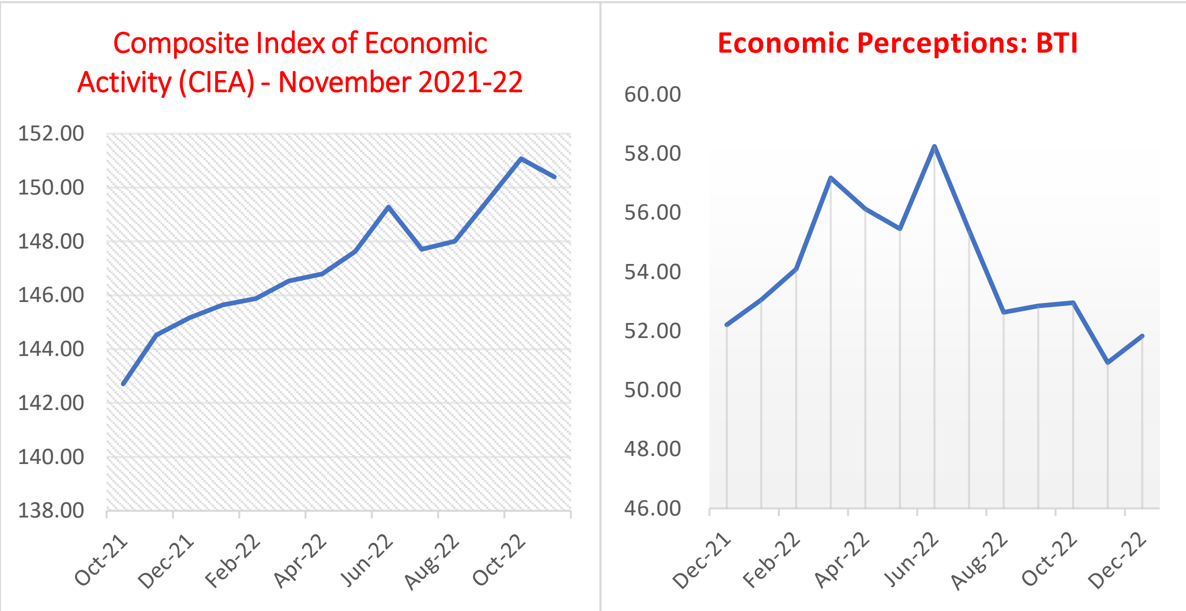
In Sub-Saharan Africa the growth outlook shows a decline from **4.7%** in 2021 to **3.6%** and **3.7%** in 2022 and 2023, respectively. **This downward revision reflects lower trading partners' growth, tighter financial and monetary conditions, and a negative shift in the commodity terms of trade.** ***This outlook foretells a reduction in demand for Uganda's exports while the slowdown in China and tightening global financial conditions means reduced financial support and debt distress to Emerging Markets and Developing Economies (EMDEs), and depreciation pressures on currencies of these economies.***

Domestically, economic activity has continued the upward trajectory since the start of FY 22/23 peaking during the festive season due to the stronger purchasing power especially for the agriculture, industry and services sectors. Both the Composite Index of Economic Activity (CIEA), Purchasing Managers Index (PMI) and Business Tendency Index (BTI), indicators of economic activity all confirm to the strengthened performance of the economy (see figure 1 below) and are positive about doing business.

However, the projected slowdown in the global economy, financial support and exports, lower excise duty and Value Added Tax (VAT) collections especially in manufacturing sector and increased prices of inputs (cement & electricity) are expected to complicate both fiscal

and monetary policies Uganda. None the less, the private sector remains optimistic that output will further improve over the course of 2023.

Figure 1: showing Composite Index of Economic Activity & Economic Perceptions Trend



Source: Bank of Uganda - January 2023

To sustain the existing positive trajectory, and stimulate effective demand with in the economy, economic policy measures need to focus more on the right monetary – fiscal policy mix with succinct concertation on interventions aimed at prioritization of investment in value chain development, in order to deliver quick benefits to the economy. Some of the critical interventions to pursue include.

i. Consider structuring demand for goods and services through well-regulated and administered buffer stocks for products such as fuel, critical food products- as per the basket of goods defined by UBOs, and key industrial seasonal crops to build the resilience of the economy against external shocks and better manage excessive increase in prices. More concertation should go to proper management system to achieve efficiency.

ii. Prioritize investment in the selected production sectors to excessive increase food supply which will eventually contribute to the reduction of inflation, spur exports thus checking the foreign exchange volatility. This if implored to support Government generate more tax revenue used in meeting existing debt obligations.

iii. The interventions above should be based on a value chain basis and at sector level but driven by leaders in the chain (facilitate business linkage among big and smaller enterprises including informal producers) and supported by both Government and development partners in such a way that will be sustainable.

iv. During policy implementation more attention, should be put to ensure that at least 80% of the resources reach and directly benefit the producers and service providers. This however must be done in such a way that enables sustainable results.

v. Align the review of the NDP III priorities to interventions with higher rate of return to support the economy generate the much-needed growth which generates tax revenue that can be used to ensure debt sustainability.

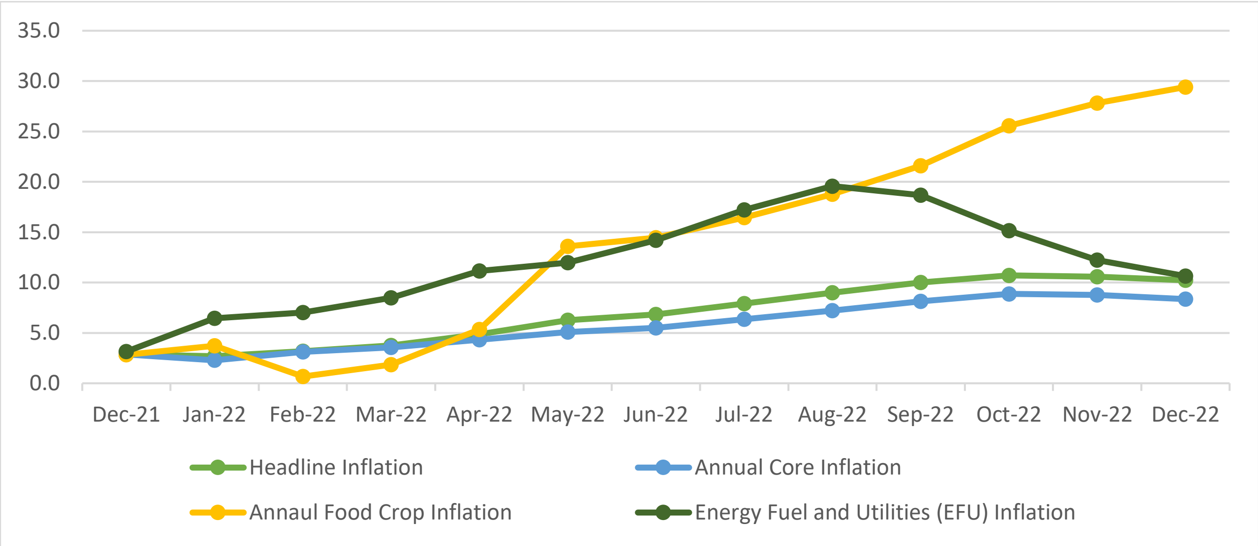
2.1.2 Inflation and outlook

Global headline consumer price inflation is forecast to rise from **4.7%** in 2021 to **8.8%** in 2022, gradually ease to **6.5%** in 2023 and **4.1%** in 2024. Across the EAC region, the headline inflation in Kenya and Rwanda decreased to **9.1%** and **31.7%** in December 2022 from **9.5%** and **33.8%** in the previous month. This was partly driven by tightening of monetary policy by the respective Central Banks to control a rapidly increasing inflation throughout 2022. On the other hand, Inflation in Tanzania remained unchanged at **4.8%.** The **persistently high commodity prices** which have been the main cause of the inflationary pressures, are **easing particularly for energy** and **food and the tight monetary policies** will fasten the disinflation process as demand (MoFPED report, 2022).

Domestically, the headline inflation for the year ending December 2022 was registered at 10.2%, down from 10.6% registered the previous month. **This was mainly driven by a slowdown in the increase of prices for commodities mainly under the core and the energy, fuels & utilities inflation baskets.** Annual food crop and related items inflation increased to 29.4% in December 2022, compared to 27.8% in November 2022. This followed increases in prices for commodities such as matooke, cassava, beans, tomatoes, and egg plants among others during the month. Prolonged draught, festive season, and regional demand for Uganda products.

Annual Energy, Fuel and Utilities (EFU) inflation was registered at **10.6%** in December 2022 compared to **12.2%** registered for the previous month mainly on account of a reduction in the prices for liquid energy fuels particularly petrol and diesel during the month. This followed the continued decline of global crude oil prices in the 3 months leading to December 2022. Pump prices for petrol (per liter) averaged at **Shs 5,532** in December 2022 compared to **Shs 5,828** in November 2022 making a difference of **5%** percentage points. Similarly, pump prices (per liter) for diesel averaged at Shs **5,505** in December compared to Shs **5,571** in November 2022.

Figure 2: Headline, Annual Core, Annual Food Crop, and Energy Fuel and Utilities Inflation



Source: Bank of Uganda, January - 2023

The PSFU proposes the following short term, medium term, and long-term proposals which Government should consider addressing the issues of rising commodity prices. They include:

i. Through the Parish Development Model (PDM), integrate an emergency plan to support farmers to grow more fast-growing food products such as grains and oil seeds to cushion off food security and safeguard the standards of living of the people.
ii. Use the PDM to develop value chains and market linkages especially for farmers in rural Uganda.
iii. Refocus trade development policies on innovation to spur import replacement for products that are directly affected by global politics such as wheat, oil seeds, and grains among others.

iv. Prioritize investment for infrastructure for water for production to improve access to water required for irrigation amongst the population. Other affiliated services such as commercialization, water testing and extension should also be aligned.

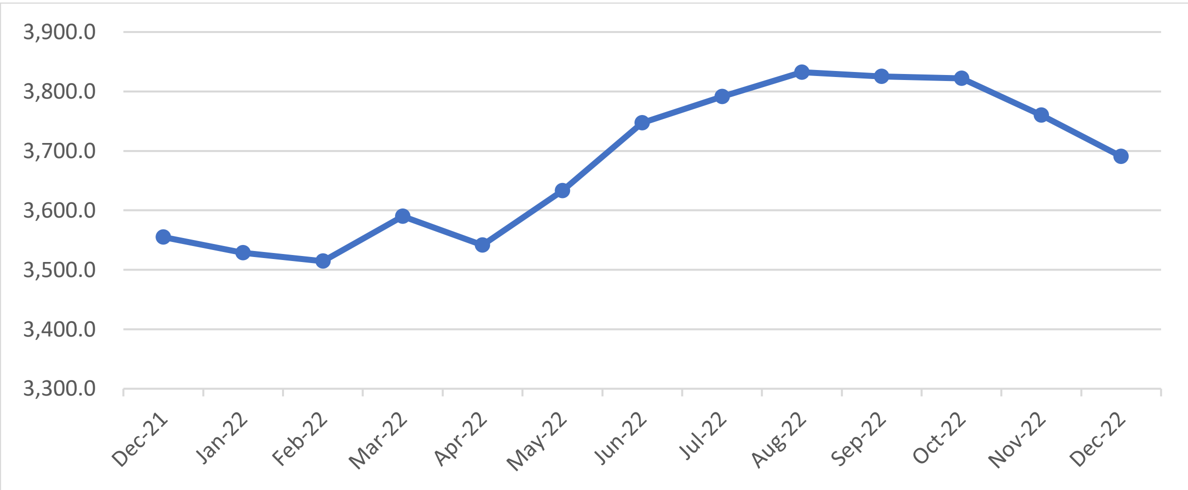
v. Prioritize import replacement for goods and services with potential to be produced locally to reduce the forex hemorrhage and curb imported inflation.

2.1.3 Exchange Rates

At EAC level, the Kenyan shilling, Rwandan and Burundian Francs registered depreciations of **0.9%, 1.1%** and **0.3%** respectively against the US Dollar during the month of December 2022. However, the Tanzanian shilling remained largely unchanged during the month, trading at **TShs 2,308.7/USD** in December compared to **TShs 2,308.4** in November 2022.

The Ugandan shilling traded at an average rate of Shs **3,688.16 US$** in December 2022, posting a **1.9%** appreciation against an average rate of Shs **3,760.23/US$** in November 2022. This appreciation was mainly on account of increased dollar inflows **in form of remittances as Ugandans abroad sent funds back home while others returned for the festive season, Inflows from offshore investors, and Foreign Direct Investments (FDI) from the Oil and Gas sector.**

Figure 3: showing the UGX V.s USD Exchange Rate for the last 12 Months.



Source: Bank of Uganda, January – 2023

As evidenced in the graph above, the shilling volatility continues to be influenced by our higher import bill against the exports, the implications of investments in the oil sector on the exchange rate. This implies that the economy continues to be affected by the heighted levels of capital flight to stronger economies hence growing levels of poverty. This however, presents an opportunity for Uganda to export more since it favors export promotion, if we are able to be competitive in production of these products. Unfortunately, according to EPRC study, the depreciation is not expected in the future due to the remittances from oil sector and the positive trend of FDI inflows which undermines the export promotion policy of the country.

Uganda therefore needs to **implement an import substitution and export promotion strategy** which focuses of promoting exports to benefit from the depreciating shilling and reduce imports to strengthen the shilling. This should be focused on a mix between required policy and business development measures. Specific recommendations include;

i. Promote and enforce National Local content law in the oil and gas sector to secure support for companies with have the requisite capacities both in quality and quantities to benefit from the exploration. However, given the high standards in the oil and gas sector, there is need to deliberately support companies especially MSMEs and young entrepreneurs to build joint ventures/ linkages with more successful ones to build their capacity to participate in the sector. The Lead firm structure approach[1] can provide a solution to this.

ii. Ensure the implementation of the local content development fund especially for local suppliers of goods and services within the oil and gas sector. This should be fast trucked by the Petroleum Authority and Ministry of Energy and Mineral Development.

iii. Government to address the issues which affect the competitiveness of the private sector companies to improve their capacity to compete favorably with imported products. This will enable local companies reduce their cost of production to match the expected production bases for the countries where the imported products are coming from. PSFU has commissioned a study to appreciate critical cost drivers and how they can be managed to address competitiveness.

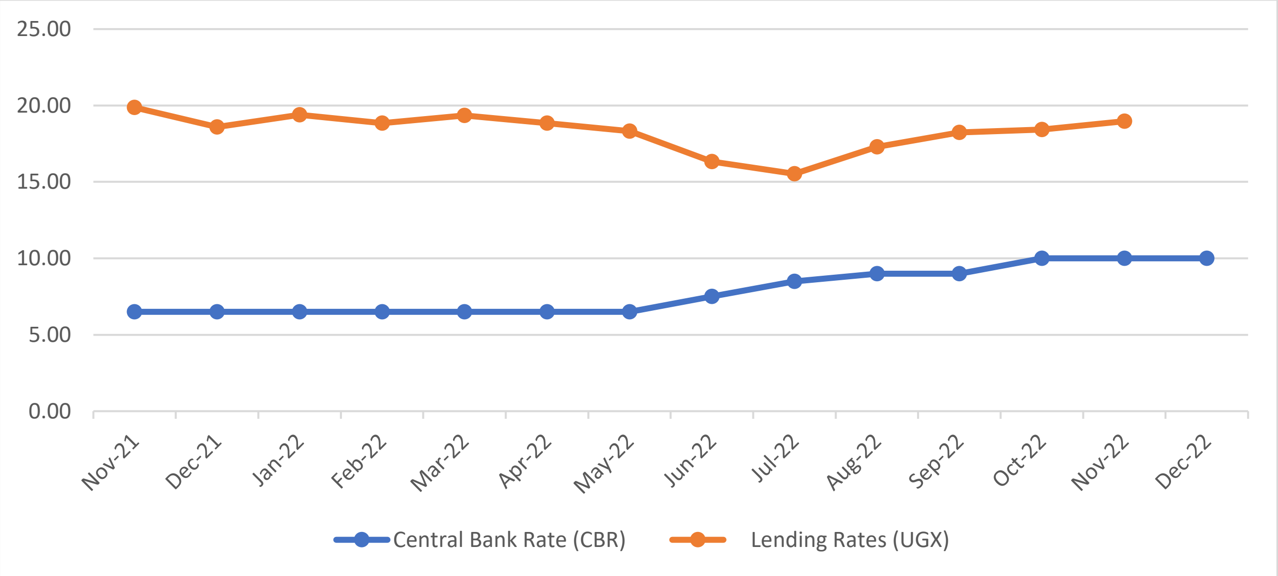
[1]

2.1.4 Commercial Banks Lending rates:

Commercial banks' shilling denominated rates edged upwards to a weighted average of **18.98%** in November 2022, from a weighted average of **18.42%** in October 2022. This was partly on account of the tight monetary stance that has seen BOU raise the CBR from **6.5%** in the earlier months of 2022, to **10%** that still prevails up to date. Similarly, foreign currency denominated rates increased to a weighted average of **8.13%** from a weighted average of **7.71%** over the same period.

Despite the increment in lending rates during November 2022, there was growth, albeit slight, of **0.4%** in the stock of outstanding private sector credit. The stock of outstanding private sector credit was recorded at **Shs 19,886.4 billion** in November 2022 compared to **the Shs 19,827.4 billion** recorded in October 2022. Of this, Shs **13,947.7 billion** was shillings denominated credit while **Shs 5,938.9 billion** was foreign currency denominated credit during the month. This was mainly on account of subdued economic activity occasioned by the **spill-over effects of the Russia-Ukraine war** as well as the **tight monetary** stance by the central bank.

Figure 4: showing the Interest Rates Vs. Central Bank Rate for last 12 months.



Lending institutions are starting to realign their portfolios from illiquid sectors such as **building, mortgage, construction & real estate** that demand for a lot of money but have long repayment periods to sectors like **business, community, and social services; and personal and household loans** which have shorter repayment periods.

As was the case in October 2022, **personal and household loans** took the largest share of approved credit at **29.2% (Shs 333.2 billion)** in November 2022, followed by **Trade at 18.4% (Shs 209.4 billion)**. These two sectors accounted for almost half of the funds approved for disbursement during the month. Other notable sectors were manufacturing **(14.8%),** agriculture **(13.1%)** and building, mortgage, construction & real estate that accounted for **11.7%**

Uganda therefore needs to develop its **own local long-term savings** that can be used to address oligopolistic tendencies in the financial structure.

i. Amend the current Government Pensions Law to promote long term savings in the economy. Government employees need to contribute to their pension through salary deductions and monthly government contributions as opposed to the "pay as you go" scheme. This will grow savings and enable the private sector to borrow just as it is with NSSF.

i. Create a risk guarantee schemes for about 7 prioritized sectors including agriculture, manufacturing, education and health, real estate, oil and gas, ICT (Information, Communication, and Technology) and tourism. This will achieve a reduction in lending rates from an average of **18.9%** to between **10%** and **15%** depending on the sector.

ii. Develop the National competition law to address the oligopolistic tendencies within the financial sector.

iii. Consider exempting Capital Gains Tax in the Income Tax Act (ITA) on the earnings from venture capitalists to attract start-up capital for youth-oriented businesses but also support the deepening of the capital markets in Uganda.

2.1.5 External Sector Developments

Uganda's trade deficit slightly narrowed to **US$ 299.9 million** from **US$ 305.2 million** registered in October 2022. This was on account of a reduction in the import bill which more than offset the reduction in export earnings for the month. Compared to November 2021, the trade deficit reduced from **US$ 304.2 million** to **US$ 299.9 million** in November 2022 owing to an increase in export receipts which more than offset the increase in the import bill.

Exports declined by 4.7% form **US$ 348.82 million** in October to **US$ 335.77 million** in November 2022. This was explained mainly by lower export earnings from coffee, Simsim, Cocoa beans, and cement among others. Coffee export earnings during the month declined by 4.4% from **US$ 67.10 to US$ 64.14 million in** November 2022. This decline was due to a lower **export volumes** and **lower international prices** that prevailed during the month. But there was increased earning of tobacco, beans, and sugar due to food scarcity in neighboring countries.

As was the case in October 2022, the EAC remained the top destination of Uganda's exports accounting for US$ 216.52 million **(64.5%)** during the month of November 2022. This was followed by the European Union **(16.4%)** and Asia **(6.4%).**

PSFU proposes the following recommendation required to facilitate and grow exports in the economy.

i. Invest in addressing the constraints which limit supply of exported products through promotion of standards, value chain development, traceability systems and cold chain related export infrastructure.

ii. Invest on export market information studies for key identified markets such as DRC, South Sudan, Ghana, Algeria among others under the AfCFTA to inform the private sector on the existing market opportunities.

iii. Address the challenges which impact competitiveness of manufacturing and agriculture sector to support exports**.**

Members of PSFU Board are requested to note the progress made and provide any other necessary advice.

5.0 Other Policy Updates

1. Private Sector Position Paper on National Budget Framework Paper FY 2023/24.
2. PSFU also submitted the tax proposals for the FY 2023/24 to the Ministry of Finance, Planning and Economic development and continues to engage the same on the tax policy positions for the private sector.

3. PSFU with the support of Mastercard worked with the Ministry of Finance, Planning and Economic Development to develop the second National Strategy for Private Sector Development 2022/23-2026/27. MoFPED committed to supporting the implementation of the strategy. The primary objective of the strategy is envisioned in its theme "*Consolidating efforts for private sector competitiveness".*

Members of PSFU advisory council and BOD are requested to note the progress made and provide any other necessary advice.

5.2 Prevalence of climate change.

During the period, the economy has registered severe climate change related challenges which has contributed to rising food prices for maize, beans, tomatoes, among others. It has also increased the risk associated to food insecurity especially in Northern Eastern part of the country but also our key trade partners issuing permits to import maize out of EAC. This has far reached implications related to potential damping which reduces the market opportunities for Ugandan maize. In addition, H.E the President directive to support NEC, Prisons, and large farmers to produce and address food insecurity issues which distorts the market for the private sector, besides it not being sustainable.

<u>Our preliminary proposal is that in short run, Government should develop an emergency plan under the PDM to focus on food insecurity for short-term crops. In the medium term, priority of the next FY budget strategy should be promoting market driven agriculture with priority investment in infrastructure for water for production to facilitate irrigation, storage and market guarantees.</u>

PSFU Advisory council and the Board are requested to provide guidance and direction on how the issues of climate change can be holistically addressed while promoting commercial agriculture to cushion of inflation, promote exports and grow the economy. For example,

i. **advising Government on how the Parish Development Model can be leveraged and aligned to create employment and,**
ii. **advising the Ministry of Agriculture Animal Industries on the most feasible short-term interventions to undertake to address food insecurity issues.**

5.3: CNOOC launched the drilling of oil at the Kingfisher Development Area

On 24th January 2023, China National Offshore Oil Corporation (**CNOOC)** Uganda limited launched the drilling of oil at the Kingfishers development area. The area is expected to produce 40,000 barrels of oil per day at peak. The development plan for the Kingfisher filed includes the onshore drilling of 31 wells from four well pads. This shows a good trajectory to the expected 2025 oil production.

6.0 Conclusion:

The business environment currently is worrying businesses. This has led to many cutting back on re-investment due to implications of risen levels of inflation which have increased cost of production while constraining consumption. There is uncertainty with when the prices of fuel will reduce as its underpinned on external factors.

Consequently, projected GDP growth is rebased to **5%** from **6.3%.** The Government will need revise the economic growth strategy by considering structuring demand to stimulate production and improve purchasing power- amongst the population. The PSFU Advisory Council and its members are therefore called upon to take note of these matters and to offer any guidance they deem necessary.

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