Country Report

Uganda

Uganda at a glance: 2003-04

OVERVIEW

The president, Yoweri Museveni, and the Movement-led government are expected to remain in office throughout the forecast period. Nevertheless, the political environment in Uganda is expected to undergo significant change as the Movement's National Executive Committee and Mr Museveni have announced their support for a return to multiparty politics. It is becoming increasingly clear that Mr Museveni intends to stand and win the presidential election in 2006. Given a fragmented opposition, it is likely that he will indeed win and that the Movement will also triumph in the legislative election. Real GDP growth is forecast to slow to 5.2% in 2003, as low coffee prices and poor rains will have a negative effect on agriculture. Improved weather conditions and increased exports should lift GDP growth to 6.5% in 2004. The current-account deficit will remain high in 2003, at 8.9% of GDP, and will rise to 10.3% of GDP in 2004 owing to increased imports.

Key changes from last month

Political outlook

- The death of Uganda's former president and dictator, Idi Amin, on
- August 16th will not affect Uganda's political outlook. Nevertheless, it does herald the end of a brutal chapter in Uganda's history.

Economic policy outlook

- The US energy company, AES Corporation, has withdrawn from the US$550m Bujagali power project after failing to agree with the World Bank on the project's financing terms. The government of Uganda is now trying to persuade the South African firm, Eskom, to enter into negotiations. AES's withdrawal is a major setback for Uganda's attempts to attract foreign investment in the infrastructure sector.

Economic forecast

- Owing to a poor harvest and rising food prices, the Economist Intelligence Unit has revised upwards its inflation forecast. Inflation is now forecast to average 7.4% in 2003, and fall to 6.5% in 2004 as food prices recover.

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The Economist Intelligence Unit

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Outlook for 2003-04

Political outlook

Domestic politics

The president, Yoweri Museveni, and the Movement-led government are expected to remain in office throughout the forecast period. Nevertheless, the political environment in Uganda is on the verge of change: the Movement's decision-making body, the National Executive Committee (NEC), and the president have clearly stated their support for a return to multiparty politics. The plan is for the question of a shift to multiparty politics to be put to a national referendum in 2004. What is becoming increasingly clear is that the return to multiparty democracy will provide an effective smokescreen for Mr Museveni to scrap the current two-term limit on the presidency and ensure that he retains power. Under the current system, Mr Museveni cannot serve a third term in office; reforming the system will permit him to stand for president and lead a "reformed" Movement to power.

The Economist Intelligence Unit believes that it is highly likely that Mr Museveni will contest the next presidential election under a multiparty system as the "elected" candidate of a new Movement "party". In contrast to the situation in countries such as Zambia and Malawi, the constitutional changes necessary to allow Mr Museveni to stand for a third term would be made during a total reworking of the political system, and therefore a third term could be presented as a "first term" under the new system. The coming months will see much manoeuvring as the government tries to secure a political advantage for the Movement once it becomes a party—as evidenced in May by the cabinet reshuffle of key ministerial positions and the appointment of a new vice-president, Gilbert Bukenya, to replace the more controversial Speciosa Kazibwe. Those dismissed from the cabinet are largely seen as being unsupportive of another term for Mr Museveni. Given the fragmented opposition, it is likely that, if elections are held, the president and his Movement will win. The prestige of Mr Museveni and the Movement has been boosted by the visit to Uganda of the US president, George W Bush, in early July (see International relations). The results of an opinion poll found that 41% of Ugandans would support a third term of office for the president.

Fighting in the north is expected to continue throughout 2003, with only a slightly better chance of a successful ceasefire in 2004. The latest ceasefire has been broken and Mr Museveni has again resorted to force. The Lord's Resistance Army (LRA) has unrealistic (and often bizarre) goals, and its leader, Joseph Kony, has continued to prove an unreliable and unreasonable negotiator. Mr Museveni will remain desperate to bring this rebellion to an end, for both political reasons (to enter into the new political environment with a peace dividend in the north) and economic reasons (the costs of the war are substantial). Nonetheless, Mr Kony remains the biggest stumbling block to peace and as long as his leadership of the LRA continues peace will remain elusive. Uganda will continue to benefit from the Sudanese authorities having granted Ugandan troops permission to cross the border. In addition, international donors will continue to push for a diplomatic solution to the

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fighting, although this appears increasingly unrealistic, given the eccentric goals of the LRA.

Election watch

Members of opposition parties have already voiced their mistrust of a referendum, claiming that the government cannot be relied on to ensure that the vote is free and fair. The change in policy by the president and the NEC is unlikely to lessen political tension in the short term, as the degree to which multipartyists will be allowed to campaign in the run-up to the referendum and the freedom of parties to act in the interim is unclear. The greatest potential source of tension on the part of the opposition is that the current "non-party" system will remain in place until the referendum, some time in 2004, which will severely restrict the opposition parties' attempts to campaign prior to that. A committee is currently being established by the Movement to examine the constitutional reforms needed to change to a new political system. Nonetheless, the evidence so far suggests that the authorities will try to limit the activities of the opposition parties, although donor pressure may force a change of policy. Some discussions on the political transition have taken place between the Movement and opposition members, but it is likely that the opposition will not be allowed to participate as actively as it would like. There is little doubt that even after a transition to multiparty politics, the Movement will still be the dominant party, as it will take time for the opposition parties to rebuild themselves into viable challengers after years of repression. There is also the possibility that, beneath the surface, the government will be quite content for Ugandans living in rural areas to remain uninformed about political pluralism.

International relations

Uganda's foreign policy in 2003-04 will be dominated by its relations with donors and its regional neighbours. Whereas Uganda's relations with donors, and particularly the US, are cordial, regional tensions still exist. Mr Bush's visit to Uganda and Mr Museveni's recent trip to Washington have reinforced the friendship between the two countries. Mr Bush commended Mr Museveni on his effective battle against HIV/AIDS and relations are expected to remain cordial throughout the forecast period. Relations with the EU countries are expected to remain good, although concerns regarding Uganda's defence spending may pose a minor hindrance.

Closer to home, diplomatic tensions with Sudan are expected to lessen over the forecast period. Recent reports indicate that Ugandan forces have been less active in southern Sudan recently, as most LRA rebels have moved back into northern Uganda. As long as Uganda is not found to be supporting the Sudan People's Liberation Army (SPLA) and Sudan continues to allow Ugandan troops onto its soil, relations between the two countries will remain stable. Nevertheless, reports that some elements of the Sudanese military have resumed support for the LRA will remain a cause for concern for the Ugandan government, although the Sudanese government has made it clear that this is not official Sudanese policy.

Under the aegis of a UN-backed peace plan, Uganda began withdrawing its forces from Ituri district in the north-east of the Democratic Republic of Congo (DRC) on April 25th. The DRC has acknowledged Uganda's continuing security concerns and permitted Uganda to maintain a small presence of approximately

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2,500 troops in the Rwenzori Mountains area within DRC territory. There is little doubt that Ugandan forces would return to the border areas of the DRC in large numbers if Uganda's own security were thought to be under threat from dissident groups believed to be operating in the region. Furthermore, the lucrative business of illicit resource exploitation in the region will ensure that both Rwanda and Uganda remain active in the DRC, albeit more discreetly. Following Uganda's departure from Ituri district, battles between ethnic Hema and Lendu militias broke out in Bunia, causing many refugees to flee across the border into Uganda—horrific reports of ethnic cleansing and atrocities carried out in Bunia have been plentiful. Uganda has made it clear that responsibility for security in the area now resides with the UN, as it was the UN's misguided insistence that Uganda pull out before sufficient UN troops had been put in place that led to the rapid decline in Ituri's already fragile security. It is a cause for concern that the latest steps taken towards achieving political unity in the DRC have largely excluded Ituri groups.

The situation in the DRC continues to be the most volatile factor in Uganda's relations with Rwanda; the two countries have been fighting a proxy war over mineral resources within DRC territory for years. However, Uganda's withdrawal of its forces from Ituri district will help to smooth relations with Rwanda. Relations between the two countries already seem to be improving following a meeting in London in May between Mr Museveni and the Rwandan president, Paul Kagame, and the withdrawal of Rwandan forces from the boundary with Uganda.

Economic policy outlook

Policy trends

The three-year, US$17.8m, poverty reduction and growth facility (PRGF) agreed with the IMF in September 2002 will remain the framework for medium-term economic policy. The main aim of the programme is to help the government to meet the targets set in its poverty eradication action plan (PEAP) by stimulating economic growth through increasing export diversity, encouraging private-sector activity and controlling non-essential expenditure. In recent years this IMF-guided macroeconomic policy has been pursued in a fairly stringent manner, yielding commendable real GDP growth rates. It is expected that this trend will continue throughout the forecast period. At the latest donor meeting, held in Kampala in May, donors backed the government's economic policies with promises of US$1.5bn for the period 2003-05. Donor funding will remain in place provided that Uganda makes satisfactory progress on the policy reforms recommended by the IMF.

Shortly after the budget for fiscal year 2003/04 (July-June) was announced on June 25th, the IMF released the first review of Uganda's performance under the PRGF and disbursed US$2.8m. The World Bank also allocated US$100m for rehabilitation in the north and east of Uganda, thereby endorsing the budget. Although the Fund broadly commended Uganda's macroeconomic stability, high economic growth rates, improved fiscal revenue performance and improving health and financial sectors, it urged the government to control the overall fiscal deficit by meeting agreed revenue targets and curbing non-essential expenditure. The IMF acknowledged the need for higher defence

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spending to tackle the rebels in the north and stressed that this would make it even more critical to curb non-priority expenditure. The government has been known to offset spending overruns with reductions in some areas of priority social spending—a practice that the IMF has not been happy with. The IMF will continue to give technical assistance to the Uganda Revenue Authority (URA) in its efforts to improve revenue collection and reduce corruption.

The budget for fiscal year 2003/04 was introduced by the finance minister, Gerald Ssendaula, on June 12th 2003 and continues a broadly reformist path while highlighting the need to control the fiscal deficit. The theme of the budget was "increased production for exports and the eradication of absolute poverty", and it re-emphasised the government's commitment to stimulating the private sector and export growth. The 2003/04 budget aims to expand and improve the competitiveness of exports; strengthen the business environment by improving regulation, infrastructure and labour; control the fiscal deficit in order to improve the private sector's access to financial credit; and improve public financial management, governance and security. A host of tangible reforms were also unveiled, including enforcement of EU regulations in the fisheries sector, a marketing and agro-processing strategy for exports, a development plan for roads, and a micro-finance regulatory framework. The extent to which these reforms are implemented will be vital to reform efforts.

Fiscal policy

Mr Ssendaula highlighted the need for maintaining control over the fiscal deficit—he emphasised this at both the beginning and the end of his budget speech. He announced that the revenue authority had met its collection target in 2002/03, thereby preventing a further increase in the fiscal deficit. Mr Ssendaula stated that, excluding grants, the deficit fell to 11.1% of GDP in 2002/03; nevertheless, public expenditure overruns continued to be a problem. In 2003/04 expenditure is forecast to rise to 24.3% of GDP, whereas revenue excluding grants is projected to rise to 13% of GDP; donor funds are expected to finance 48% of budget expenditure. The minister projected that the overall budget deficit in 2003/04 excluding grants would be NUSh1,463bn (US$706m), equivalent to 11.2% of GDP. Taxes are to be increased on cellular airtime, fuel, vehicle licences and hotel accommodation. Tax breaks will include the establishment of export-processing zones and tax exemptions granted on computer software and carbonated waters. The Economist Intelligence Unit considers the fiscal deficit target to be overoptimistic; although reforms are expected to maintain economic growth of around 5.5% per year, thereby contributing to revenue growth alongside improvements in revenue collection, non-essential expenditure has not been curbed substantially enough. Although measures have been announced to make the public sector more efficient, none will be sufficiently effective to compensate for the 16% increase in spending. We expect the 2002/03 budget deficit, including grants, to be around 5% of GDP, and for the deficit to widen to 7.2% of GDP in 2003/04. The deficit will be financed through grants and external borrowing as well as domestic sources.

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Monetary policy

Monetary policy is expected to remain tight and money supply growth will slow in an attempt to curb rising inflation. Real interest rates remained high in 2002, at 19%; although partly policy induced, this was primarily the result of government demand for credit. Despite the tight monetary policy, real interest rates are expected to fall to around 18.6% in 2003 as commercial lending rates fall slightly in response to increased competition between banks for private-sector business. Lower inflation should see real interest rates fall further to 18.5% in 2004.

Economic forecast

International assumptions

International assumptions summary

(% unless otherwise indicated)

	2001	2002	2003	2004
Real GDP growth				
World	2.2	2.9	3.2	3.9
OECD	0.9	1.8	1.7	2.4
EU	1.5	1.0	0.7	1.9
Exchange rates				
¥:US$	121.5	125.3	118.1	116.8
US$:€	0.896	0.945	1.123	1.183
SDR:US$	0.785	0.772	0.718	0.702
Financial indicators				
¥ 2-month private bill rate	0.17	0.10	0.07	0.10
US$ 3-month commercial paper rate	3.61	1.70	1.01	1.33
Commodity prices				
Oil (Brent; US$/b)	24.5	25.0	26.8	18.9
Coffee (robusta; US cents/lb)	27.6	30.0	36.8	32.9
Food, feedstuffs & beverages (% change in US$ terms)	-1.9	12.7	2.1	1.8
Industrial raw materials (% change in US$ terms)	-9.7	2.2	9.1	3.9

Note. Regional GDP growth rates weighted using purchasing power parity exchange rates.

Our near-term outlook for the global economy has brightened, as there is evidence of a modest recovery in the second half of 2003. We forecast world GDP growth of just 3.2% in 2003, rising to 3.9% in 2004 (at purchasing power parity exchange rates), from 2.9% in 2002. The pace of recovery in the EU—which is vital for Uganda's trade—is very weak and its GDP is now forecast to grow by a modest 0.7% in 2003 and 1.9% in 2004. However, Uganda will benefit from higher average prices for coffee—its main commodity export—this year. Coffee prices (robusta) have risen in the last two quarters—pushing the average forecast price up to 36.8 US cents/lb in 2003—but they will fall throughout the second half of the year as the effects of global oversupply push average prices back down to 32.9 US cents/lb in 2004. The second half of 2003 will see the price of Brent crude remain fairly high, amid low US stocks and delays in the resumption of Iraqi oil production, resulting in an average full-year price of US$26.8/barrel. Global oversupply should bring oil prices down to an average of US$18.9/b in 2004. International interest rates are expected to edge up in 2004, which will moderately increase the cost of servicing external debt.

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Economic growth

Economic growth will continue to be determined mainly by the performance of the agricultural sector. Real GDP growth is expected to slow to 5.2% in 2003 (January-December), owing to poor rains in the first half of the year, but it will be supported by healthy exports and growth in local manufacturing and services, and in transport and communications. Growth in industry and services will be strong, but electricity generation in 2003 will probably suffer from the postponement of the Bujagali dam project (which was scheduled to begin in early 2003), owing to the US multinational, AES Corporation, pulling out of the deal and doubts about the sustainability of the planned pricing system of the plant. Tourism is also unlikely to grow much, as Uganda has yet to establish an extensive tourist infrastructure or marketing strategy, although recent data indicate some increase in visitor numbers. Information technology services are expected to grow moderately as increasing numbers of Ugandans come online and companies seek to modernise their operations. Assuming normal weather conditions and higher coffee production in 2004, real GDP is forecast to grow by 6.5%.

Inflation

The negative effect of dry weather on harvests in the first half of 2003 led to headline year-on-year inflation of 10.5% in April and 10.3% in May but this fell to 9.5% in June, as food prices dropped. Food prices constitute around 45% of Uganda's consumer price index, which makes the index highly sensitive to food-price movements. The prices of petrol products have also increased in the budget, leading to higher transport charges and costs across all sectors of the economy. In light of these factors, and on the assumption of average harvests later in the year, we have revised our inflation forecast for 2003; average inflation is expected to reach 7.4% in 2003 (up from our previous forecast of 6.1%). Higher food prices in the first half of 2003 should make year-on-year comparisons less striking in 2004 and, assuming a favourable harvest and no external inflationary shocks, average inflation is forecast to fall to 6.5% in 2004.

Exchange rates

Rising imports in the first half of 2003 exerted downward pressure on the Ugandan shilling. Accordingly, we expect the Ugandan shilling to depreciate by around 10% in 2003 (slightly higher than our previous forecast of 7%) to an average of NUSh2,005.9:US$1. An improved performance by non-coffee exports should increase foreign-exchange earnings in 2004, reducing some of the pressures on the currency, and the shilling will depreciate more slowly (by 7%) to an average of NUSh2,168:US$1. The Bank of Uganda (the central bank) will continue to intervene in the market to reduce fluctuations; however, foreign-exchange reserves will fall in line with reduced donor inflows to an annual average of US$887m in 2003-04 and this lack of reserves will limit the central bank's power to intervene effectively in the market.

External sector

Stronger international coffee prices in the first half of 2003 have lifted coffee export receipts to US$138m in the 2002/03 coffee year (October-September), but international prices will weaken and bring total coffee receipts down to US$125m in 2003/04. Higher investment in fish-processing facilities will lift receipts from fish exports to US$109m in 2003 and US$100m in 2004. Re-exports (gold) will also improve over the forecast period. As a result, total exports are forecast to rise to US$528m in 2003. In 2004 falling international

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commodity prices will be offset by increased production and exports will slow to US$521m. Imports will increase over the forecast period, as increased foreign investment in industry (manufacturing and textiles) and a more robust economy will result in greater import demand; we expect imports to rise from US$1.16bn in 2003 to US$1.25bn in 2004. The lack of a significant services industry in Uganda will keep the services account firmly in deficit, despite modest improvements in banking, tourism and information-technology receipts, as higher imports will result in increased trade-related costs. Net transfers will remain strongly positive in 2003-04, owing to large inflows of donor funds. The current-account deficit is estimated at 9.1% of GDP in 2002 and is forecast to improve to 8.9% of GDP in 2003 before worsening to 10.3% of GDP in 2004 as the trade gap widens.

Forecast summary

(% unless otherwise indicated)

	2001[a]	**2002**[b]	**2003**[c]	**2004**[c]
Real GDP growth	5.2[b]	5.5	5.2	6.5
Industrial production growth	6.2[b]	6.3	6.0	7.5
Gross agricultural production growth	5.0[b]	5.5	4.3	6.0
Consumer price inflation (av)	2.0	-0.3[a]	7.4	6.5
Consumer price inflation (year-end)	-3.3	3.9[a]	5.0	5.0
Short-term interbank rate	22.7	19.1[a]	18.6	18.5
Government balance (% of GDP)[d]	-13.6	-11.4	-13.0	-14.7
Exports of goods fob (US$ m)	451.6	457.7	527.6	521.3
Imports of goods fob (US$ m)	1,026.6	1,118.4	1,159.8	1,246.6
Current-account balance (US$ m)	-434.5[b]	-511.9	-505.5	-613.6
Current-account balance (% of GDP)	-8.0[b]	-9.1	-8.9	-10.3
External debt (year-end; US$ bn)	3.7	3.4	3.1	2.9
Exchange rate NUSh:US$ (av)	1,755.7	1,797.6[a]	2,005.9	2,167.8
Exchange rate NUSh:¥100 (av)	1,444.6	1,434.0[a]	1,713.0	1,876.9
Exchange rate NUSh:€ (year-end)	1,522.4	1,942.8[a]	2,470.4	2,591.3
Exchange rate NUSh:SDR (year-end)	2,170.9	2,518.6[a]	2,993.3	3,160.6

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts. [d] Fiscal year (July-June). Ratio calculated using an adjusted GDP value equal to GDP for the fiscal year of July-June.

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