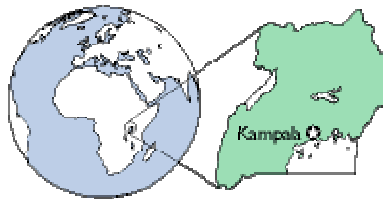


COUNTRY REVIEW

Uganda



4 October 2009

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EULER HERMES COUNTRY RISK GRADE: C

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- The political system is relatively stable and transition to a multi-party democracy is being instituted
- Good record of expansion in real GDP
- First country to reach its completion point under the Heavily Indebted Poor Countries initiative (HIPC) and therefore awarded significant debt reduction
- Reasonable relations with the IFIs and the donor community, despite periodic concerns relating to achievement of some economic targets and levels of corruption
- Potential oil exporter

Weaknesses

- Trade and communication links are vital because Uganda is landlocked. Disruption to these can have detrimental effects on business and the economy, as was seen following violence in Kenya after elections in December 2007
- President Museveni appears increasingly autocratic
- Failure to achieve a negotiated settlement with the Lord's Resistance Army in the north
- Dependence on the primary sector exposes economic development to the vagaries of climatic changes, including periodic drought, and to internationally-determined commodity prices
- Energy shortages result from reduction in hydro-electric power as water levels in Lake Victoria decline
- Fiscal and current account deficits remain large and require financing, re-affirming the need for donor support
- Aid dependent

Key Risks

- **Further social unrest in Kenya could restrict Uganda's ability to transport goods to and from world markets. This would put additional pressures on the fiscal accounts and currency and further heighten aid dependency**

Country Risk Assessment

Ratings	Uganda		Median Grade C	Peers		
	Latest	Previous		Cameroon	Mozambique	Ghana
Systemic Political Risk:	P3-	P3-	P2-	P3-	P2-	P2+
Systemic Economic Risk:	E5	E5	E5	E5	E5	E5
ME rating:	ME4	ME4	ME5	ME4	ME5	ME5
<i>Structure</i>	6.0	6.0	5.7	6.0	6.0	6.0
<i>Policy</i>	4.2	5.2	5.2	4.3	4.3	5.6
<i>Solvency</i>	2.0	2.0	2.8	2.0	5.2	3.0
<i>External Liquidity</i>	4.2	1.9	4.6	2.8	4.6	5.6
SBE rating:	SBE5	SBE5	SBE4	SBE5	SBE5	SBE4
COUNTRY GRADE:	C	C	C	C	C	C

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

Country Profile

Capital city:	Kampala
Population:	31.66 mn (2008)
GDP:	USD 16472 mn (2008)
Currency:	Shilling (UGX)
Form of state:	Republic
Head of government:	President Yoweri Museveni
Next elections:	Presidential and legislative by February 2011

Major Industries (% of GDP at market prices, 2008e)		Global Assumptions	2009f	2010f
Agriculture	23.0%	Real GDP grth (% yr/yr) *	-3.9	0.9
Industry	25.0%	Inflation (% , av) *	-0.1	1.3
Services	52.0%	Dated Brent (USD/b)	61.0	72.0
		* m major economies		

Main Exports (% of total, 2008e)		Main Imports (% of total, 2008e)	
Coffee	16.0%	Machinery & transport equipment	26.0%
Fish	5.0%	Fuels	11.0%
Tea	2.0%	Chemicals	11.0%
Cotton	1.0%		
Lead Export Markets (% of total exports, 2007)		Lead Import Markets (% of total imports, 2007)	
Netherlands	10.2%	Kenya	31.8%
Belgium	9.8%	China	7.8%
Germany	7.9%	UAE	7.7%
France	7.2%	India	5.2%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	11,011	13,549	16,473	16,190	18,269
Population (mn)	29.65	30.64	31.66	32.70	33.78
GDP per capita (USD)	371	442	520	495	541
Real GDP growth (% yr/yr)	7.0	8.2	8.3	3.5	5.0
Inflation (% , average)	7.3	6.2	12.0	12.0	8.0
Fiscal balance (% of GDP)	-2.0	-1.7	-1.8	-3.0	-3.2
Current account balance (% of GDP)	-4.0	-3.9	-6.6	-5.6	-4.4
External debt/GDP (%)	11.5	11.9	10.9	13.0	10.9
External debt/Exports of goods & services (%)	41.5	40.7	38.0	43.5	40.4
Debt-service ratio (%)	3.8	1.7	1.9	2.1	2.0
Foreign exchange reserves (USD mn)	1,811	2,560	2,300	1,900	1,950
Import cover (months)	6.2	6.8	4.7	3.9	3.7
Exchange rate assumption, UGX:USD (av)	1,832	1,724	1,720	2,045	2,080
f: CRU central forecast					

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

President Yoweri Museveni, a former rebel leader who has ruled since coming to power in a military coup in 1986, and a small elite maintain close control of the levers of power. Although political parties are not proscribed their development was not encouraged until 2005 and Museveni heads an organisation labelled '**the National Resistance Movement (NRM), a grass roots entity that has dominated politics since its inception.**' The president is elected by universal suffrage and the constitution originally limited an individual to a maximum of two five-year terms. Initially, Museveni claimed that he would stand down from office in 2006 but he **engineered a revision of the constitution** to allow him a third term. In the absence of a clear successor, Museveni is likely to stand for re-election in 2011. In any event, it is **likely that the elite within the NRM will retain close control of the power base.** This means that continuity of policy direction is relatively assured, at least until 2011. The international community (including key donors) has criticised Museveni's record in relation to extension of his period in office and corruption within the country, but was partly instrumental in the decision to hold a referendum on multi-party politics in 2005—which provided strong backing for Museveni—and is likely to remain supportive.

For elections in February 2006, the NRM registered itself as a political party under the name of the National Resistance Movement Organisation (NRMO). Traditional opposition groups—the Uganda People's Congress (UPC), the Democratic Party (DP) and the Conservative Party (CP)—also registered, as did some new organisations, including the Forum for Democratic Change (FDC). Museveni and the NRM were victorious in the elections but Kizza Besigye of the FDC did well in the presidential poll—37% to Museveni's 59%—and opposition parties gained representation in the legislature. Although a semblance of multi-party democracy has therefore been introduced, we do not envisage that the Movement system will disintegrate, especially as **opposition groups appear unlikely to unite to form a challenge to the NRMO.** Nevertheless, there are domestic uncertainties and, in September 2009, violent riots erupted that partly reflected disputes over land and power. In attempting to keep unelected traditional leaders out of politics, Museveni has heightened disputes with Buganda, one of four ancient kingdoms, which has aspirations of self-government. The Bagandan people constitute 17% of the total population and Museveni may have to make concessions to appease them in the period up to the elections in 2011. Further unrest is likely before the polls, with heightened political manoeuvring and deal-making.

A war against the Lord's Resistance Army (LRA) in the north of the country has been waged since 1988. Despite peace talks in Sudan in July 2006, and cessation of outright hostilities the month following, a final settlement has yet to be agreed, partly because the government rejects demands of the LRA that its rebel fighters should be assimilated into the official army. The rebel forces, led by the messianic Joseph Kony, are known for their brutality against civilians and abduction of children to serve as combatants. An estimated 2mn people have been displaced from their homes (700,000 still live in camps) causing a significant refugee problem. Moreover, **the conflict has directed military and financial resources away from other productive uses and prolonged the humanitarian problems in the area.** Kony and other rebel leaders were indicted for war crimes by the International Criminal Court in The Hague and are likely to face trial (perhaps in their absence) for abuses of human rights.

Regional relations are mixed, with **close economic and trading ties with Kenya and Tanzania.** The East African Community's (EAC) five partner states—Burundi and Rwanda as well as Kenya, Tanzania and Uganda—met in September 2009 to discuss creation of an East African Monetary Union, but a single currency is some way off. There remain strong disagreements with neighbouring Sudan and DR Congo (now the base for Kony). Wider international relations are likely to remain good, largely because the country is **dependent on strong donor support to promote economic stability** and the country has adopted IMF-backed reforms and is viewed as a showcase for the benefits of this approach to economic development. Despite some disagreements with donors over military expenditure and concerns that Museveni has increasingly autocratic tendencies, international support is likely to remain solid in the medium term, partly because Uganda is a (relative) African economic success story.

Economic Stability

Uganda has recovered markedly from the economic decline of the 1970s and 1980s, with Museveni's reform agenda prioritising macro-economic stability and poverty reduction, assisted by donor support. However, the country remains classified by the World Bank as 'low-income' and it ranks a lowly 156

out of 179 in terms of the UN's Human Development Index, with a life expectancy of 50 years, adult illiteracy of almost 28% and 36% of the population does not have access to an improved water supply.

The economy remains based on agriculture, which accounts for around 23% of GDP, with **coffee the principal crop and leading generator of export receipts**. Annual real per capita incomes, although increasing, remain low—we estimate current incomes are around USD500 per head. Uganda followed a three-year poverty reduction and growth facility (PRGF) under the auspices of the IMF until January 2006. Since then the Fund has assisted the country with a Policy Support Instrument (PSI). IMF backing is contingent upon adoption of agreed policies—and achievement of regular targets—including fiscal consolidation through improvements in the tax collection service, developments in the country's infrastructure (as a spur to growth) and increased access to education and health provision. Government policies actively encourage diversification of the economy, particularly into export sectors, in order to disperse risk and counteract the volatility of primary commodity markets. The Ugandan economy proved resilient to the economic impact of political turmoil in Kenya in 2008 and to high international prices of food and oil. However, **the global downturn in 2009 will result in lower than trend growth—average GDP expanded by 6.2% in 1991-2000 and 7.1% in 2001-08—of 3.5% and 5% in 2009 and 2010, respectively.**

Economic **diversification is principally through exploitation of oil reserves** in the Lake Albert area. These are now confirmed at around 700mn barrels, although the potential is much larger, and the field is **considered to be the largest discovered in Sub-Saharan Africa in the last 20 years**. Some of the oil will be used for power generation and to ameliorate Uganda's persistent energy shortfalls, and also to promote local private industry. Exports will require investment in a lengthy pipeline infrastructure, probably to the port of Mombassa in Kenya. The latest reports suggest that Asian and Middle East backers will provide sufficient finance to make the 1,300km pipeline viable. Most of the economic impact of Uganda's nascent oil sector will fall beyond our forecast period.

The donor community has periodic disagreements in relation to fiscal policy (as well as to perceptions of an increasingly autocratic stance by President Museveni), largely because government spending includes high expenditure on military activities, but is likely to remain supportive into the medium term. Donors, particularly the UK government, provide substantial budgetary support, equivalent to around 40% of state budget expenditures. The fiscal deficit/GDP ratio had declined from 11.4% in 2002 to 1% in 2005 but ongoing government investment in development projects (including energy and transport infrastructure) and higher spending/lower revenue resulting from periodic drought have pushed upwards the deficit to 2-4% and **reliance on donor financing will remain 30-35% of total revenues**.

Food products account for around 27% of the consumer price index and inflation thereby tends to reflect the volatility in agricultural output, which itself depends on unreliable weather conditions, and on exogenous factors. With high energy (fuels account for 11% of the value of imported goods) and food import costs in 2008, the inflation rate peaked at almost 16% in August last year. While some inflationary pressures have now eased—the CPI was 11.6% yr/yr in July 2009—we **do not expect the government's official inflation target of 5% to be achievable in the forecast period**, particularly given strong regional food demand and weak local rains. Nevertheless, policy focus is on GDP growth rather than inflation so monetary policy is likely to remain relatively loose in 2009-10. The **shilling will depreciate further in 2010**, partly reflecting continuing high current account deficits. Foreign exchange reserves (and therefore import cover) will remain comfortable in 2010 and thereby limit pressure on the shilling.

As a **landlocked economy**, Uganda seeks benefits from regional integration. Together with Kenya and Tanzania, it signed a protocol in 2004 to set up a customs union, which has subsequently widened to include other smaller neighbours (see also Political Stability). Uganda **currently has a narrow, coffee-oriented export base** and needs to import fuels, manufactured goods and inputs for infrastructural development. These continuing needs and uncertain climate-dependent export revenues result in swings in the current account. Regular deficits are recorded, equivalent to 3-7% of GDP in recent years. Nonetheless, **external financing needs are largely covered by strong net FDI**, which will represent 65-70% of the current account deficit in 2009 and 2010, and new loan inflows. FX reserves increased to USD2,300mn at end-2008, compared with only USD800mn in 2000, and were relatively unchanged by April 2009. **Import cover is likely to remain close to four months in 2009-10**, while short term debt plus principal repayments due are equivalent to a manageable 6% of FX reserves. External debt and its servicing, which uses up scarce financial resources, remain an impediment to economic development but, with debt/GDP and debt/exports at 10-14% and 40-45% from 72% and 322% in 2004, respectively, following debt relief, the position has

improved markedly. Uganda was the first country to reach its completion point under the enhanced Heavily Indebted Poor Countries (HIPC) initiative. Consequently, the debt service ratio is now a much improved 2% of export earnings (9% in 2005).

Structural Business Environment

The business environment is well below average for the countries we assess. The Heritage Foundation's Index of Economic Freedom (IEF) classifies the country as "moderately free", with businesses particularly hampered by regulatory problems (including perceptions of corruption and inefficient government services) and insufficient property rights (including a judicial system that is not independent). The 2009 IEF ranks Uganda 63 out of 179 countries, below Malaysia, Saudi Arabia and South Africa but above France, Romania and Thailand. The World Bank's Doing Business 2010 report ranks Uganda 112 out of 183 economies for the overall ease of doing business. The recovery rate of insolvency claims is more than twice as high as the regional average and the time involved is less, but the cost of resolving bankruptcies is 50% higher than average. Enforcing contracts takes less time and the cost is lower than the regional average. In terms of corruption, Transparency International's Corruption Perceptions Index 2008 ranks the country 126 out of 180 countries assessed, below Indonesia, Libya and Mozambique but above Nicaragua, Pakistan and Ukraine.

The banking sector is now relatively open to competition. Direct government involvement has been minimised, although the state has a significant presence in the high-volume and low-asset microfinance sector. **Most commercial banks are foreign owned**, with four accounting for approximately 75% of the total asset base. Banks are generally sound and well capitalised and the central bank has tightened supervision and regulatory requirements.

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Charts

