

## AFRICA RISK CONSULTING

## Country briefing – Uganda

14 August 2013

## 1 Summary

*The Central Bank's tight monetary policies limit the impact of inflation with the International Monetary Fund estimating that it will remain constant until 2018. Increases in government spending before 2016 elections will increase inflationary pressures. A dry spell that has increased food prices is likely to last until September. Parliament passes the Public Order Management Bill reducing risk of large scale political protests. The Central Bank holds lending rate at 11% and under Emmanuel Tumusiime-Mutebile is likely to maintain its policy in face of inflationary pressures.*

*Inflation moderate, but elections beckon*

Inflation may lead to increased political tensions as campaigning for the 2016 elections begins. The **Central Bank's** tight monetary policy has seen inflation reined in from its 2011 peak in an effort to mop up excess liquidity while the **International Monetary Fund (IMF)** forecasts that it will remain at a moderate level.<sup>1</sup>

	2011	2012	2013	2014	2015	2016	2017	2018
<b>Inflation</b>	27.0%	5.9%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%

However, in August the **Bureau of Statistics** revealed that annual headline inflation rose from 3.6% in June to 5.1% in July 2013.<sup>2</sup> The cause of the increase is not political but rather the dry spell which has had a detrimental impact on the crop harvest in the centre and west of the country and has pushed up the price of food. The dry spell is predicted to continue into September, with a continued increase in the price of food, especially fruit and vegetables.<sup>3</sup> In the immediate term, the

<sup>1</sup> IMF World Economic Outlook April 2013 figures

<sup>2</sup> East African Business Week, 5 August 2013

<sup>3</sup> Ibid

concern will be the humanitarian impact of the dry spell, with disaster preparedness minister, **Engineer Hillary Onek**, warning in early August that by October, an estimated 530,000 Ugandans will be vulnerable to food shortages before the rains return.<sup>4</sup> In the long term, the rise in inflation highlights Uganda's continued vulnerability, especially if the government increases spending as it begins campaigning in earnest.

Inflation and a weak currency have left the economy more vulnerable to external shocks and internal unrest (see below). The situation is comparable to that before the 2011 presidential election when Uganda's fiscal discipline collapsed. By December 2010, half way through the financial year, the government had spent 85% of the national budget with most diverted to campaigning and shoring up support amongst **National Resistance Movement** members of parliament. In January 2011 the government, struggling to meet recurrent spending requirements on salaries, passed a supplementary budget to cover election spending. By March, it had resorted to printing money and raiding reserves. The government's overspending combined with a slowdown in donor funding caused by corruption concerns and the global recession, triggered a sharp decline in Uganda's external position and a sliding currency. Central Bank governor **Emmanuel Tumusiime-Mutebile** declared inflation at 30% as "out of control". In response he raised the central bank lending rate and issued extra treasury bills.<sup>5</sup> However, there was no uptake, forcing the government to offload them on the **National Social Security Fund**.

Inflation typically makes foreign investors skittish. Uganda has benefited from the flow of capital to emerging markets in recent years. According to the World Investment Report 2013, Uganda's foreign direct investment inflow increased by 92% from \$894m in 2011 to \$1.721 in 2012.<sup>6</sup> The decision by the **United States (US) Federal Reserve** to scale back its policy of quantitative easing and bond buying stimulus package later in 2013 and end it entirely in mid-2014 has triggered global risk aversion as investors anticipate higher returns in the US.<sup>7</sup> Uganda is vulnerable to a sudden reversal of capital flow due to its large current account deficit (see below), but the profits to be found in Uganda's nascent oil industry make this improbable regardless of inflation.

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<sup>4</sup> Ibid

<sup>5</sup> [www.bis.org](http://www.bis.org)

<sup>6</sup> United Nations Conference on Trade and Development, World Investment Report 2013

<sup>7</sup> Business Day, 19 June 2013



	2011	2012	2013	2014	2015	2016	2017	2018
<b>Current Account Balance</b>	-11.5%	-10.9%	-12.9%	-14.8%	-14.7%	-14.0%	-13.3%	-12.1%

*Inflation may trigger unrest but...*

Economic concerns are a latent source of political tension in Uganda, especially amongst the youth who don't remember the days before Museveni and who are more concerned about employment and economic opportunities.<sup>8</sup> However, parliament passed the Public Order Management Bill in an acrimonious hearing on 7 August, curtailing freedom of assembly and stifling political dissent.<sup>9</sup> This will reduce the potential for inflation to trigger public protests as rising food and fuel prices have done in the past, most notably the "walk to work" protests in 2011- 2012. The law requires groups to register with the inspector general of police three days before any gathering of three or more people that may encourage discussions of a political nature. The police may prevent groups from registering their gatherings for any "reasonable cause", while groups meeting without prior approval will face arrest. Opposition political parties and trade unions are exempt from the legislation. The law was originally written in the wake of opposition demonstrations in 2011. **Amnesty International** and **Freedom House** have both criticised the provisions of the bill, with **Sarah Jackson**, deputy Africa director at Amnesty describing the bill as "*representing a serious blow to open political debate in a country where publicly criticizing the government is already fraught with risk*".<sup>10</sup> The bill marks a break from Museveni's previous policy of engaging with opposition,

*"Museveni has always been, what I would describe as quasi-authoritarian, he's never been a full convert to democracy. At the same time, he's never been afraid to engage with people who disagree with him. He used to call radio stations to debate with presenters or people calling in who were criticizing him. He doesn't do that anymore, now it's very much his word is final."*<sup>11</sup>

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<sup>8</sup> Source, business consultant

<sup>9</sup> New Vision, 7 August 2013

<sup>10</sup> Deutsche Welle, 9 August 2013

<sup>11</sup> Source, business consultant

### *Central Bank will maintain policies*

The Central Bank is likely to maintain its tightening policy but remains flexible. Despite being in the middle of an easing cycle, it responded to upwards inflationary pressures in August by holding its benchmark lending rate at 11% for the second consecutive month.<sup>12</sup> The Central Bank's decision to cut its rate to 11% in June has had a positive impact, with commercial banks lowering their lending rates as forecast. According to the Central Bank, commercial lending rates have decreased from 27% in June 2012 to 22.6% in June 2013.<sup>13</sup> Any rise in government spending may increase tension between president Museveni and Central Bank governor Tumusiime-Mutebile who has been insistent that the government tighten its spending policies. Tumusiime-Mutebile is credited with persuading Museveni to abandon Marxism and lift price and currency controls, leading the government's sounder economic policies. Should tension between the government and the Central Bank over spending force Tumusiime-Mutebile to resign, his likely successor is deputy governor **Louis Kasekende**. Kasekende is a former chief executive at the **African Development Bank** and executive director of the **World Bank for Africa Group**. He would likely follow Tumusiime-Mutebile's tough line to encourage fiscal discipline.

### *Implications*

Inflation is likely to remain an ongoing concern in Uganda and rising food prices will increase political tensions especially in Kampala. Inflationary pressures will continue as the government increases spending in the run up to the 2016 election and oil production comes online. However the opposition lacks the organisation to scale up protests to trigger widespread instability. The Public Order Management Bill will contribute to rising political tensions in Uganda. It has also attracted a large degree of international attention and condemnation. Its encroachment on political freedoms will be unwelcome in donor eyes and may well be a risk to aid disbursements. The Central Bank will maintain its policy of maintaining a low benchmark lending rate at least until the impact of the dry spell on the country's food supply ends. However, it will come under political pressure to loosen its policies and increase government spending before the 2016 election. Should the Central Bank accede to government demands, Uganda can expect a rise in inflation similar to, if not as severe as, that seen in 2011.

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<sup>12</sup> The Independent, 5 August 2013

<sup>13</sup> Ibid