Bank of Uganda

State of the Ugandan Economy

Research Function

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EXECUTIVE SUMMARY

1.1 Introduction

This paper outlines the performance of the economy over the six months to June 2005. Overall, the macroeconomic performance during this period is in line with the monetary program for 2004/05 and government's Medium Term Expenditure Framework (MTEF).

1.2 Macroeconomic objectives for 2004/05

Real GDP was initially projected to grow by 6.0 percent in 2004/05; average annual headline and underlying inflation rates were expected to turn out at 6.0 and 4.0 percent respectively. Real GDP was however revised downwards to 5.5 percent on account of reduced electricity supply and the effects of drought. The drought and energy price developments led to an upward revision of the average headline and underlying inflation rates to 8.2 and 4.5 percent per annum respectively. To attain this inflation objective, Bank of Uganda (BoU) was to limit growth in broad money (M3) to about 13.4 percent. Base money was projected to grow at 15.2 per cent. The overall fiscal deficit, excluding grants, was projected at about 10.9 percent of GDP, while the external current account deficit was projected to widen to 12.2 percent of GDP reflecting the continued strong growth in imports. International reserves are expected to cover 6.5 months of imports of goods and non-factor services. Base money remains the operational target of the Bank of Uganda.

1.3 Conduct of monetary policy and exchange rate management

For the period to end June 2005, the conduct of monetary policy remained focused on promoting price stability to support the broad macro-economic objectives outlined above. Specifically,

- A cautious monetary policy stance was adopted during the second half of FY 2004/05, notwithstanding the inflationary pressures during this period, monetary policy was generally in line with the broad objective of macroeconomic stability.

- Repurchase agreement instruments (Repos) facilitated short-term intra-auction liquidity management while the net-issuance of Treasury bills and Treasury bonds were mainly used to sterilize liquidity.

- The Bank's actions in the foreign exchange market remained consistent with the policy of having a market-determined exchange rate and intervening only to limit short-term exchange rate fluctuations. In addition the Bank resumed sterilisation of liquidity, using sales of foreign exchange during this period. In line with the fundamentals, the shilling depreciated against the US dollar over the six months to June 2005 on account of increased outflows and the general strengthening of the dollar.

1.4 Prices and market developments

- **Inflation:** Inflationary pressures built up mainly on account of considerable increases in food crop prices. The rate of annual headline inflation rose to an average of 10.5 percent, up from 5.4 percent during the first half of 2004/05. This was also higher than the annual headline inflation average of 1.9 percent registered over the same period in FY 2003/04. Similarly, the average of annual underlying inflation rate for the second half of FY 2004/05 increased to 5.4 percent, from 4.0 percent registered in the first half of the financial year.

- **Domestic money and securities markets:** Active participation was recorded in both primary and secondary markets. Interest rates on Treasury bills although higher than those recorded during the period July – November 2004, were lower than the rates in December 2004.

- **Foreign exchange market and exchange rate:** Depreciation pressures increased towards the close of the second half of 2004/05. The real effective exchange rate (REER) index depreciated as well by 2.3 percent to 116.42 (2000=100) in the second half of 2004/05 from 113.8 attained in the first half of 2004/05, compared to an appreciation of 6.3 percent recorded in the first half of 2004/05 from the level recorded for the second half of 2003/04

1.5 Monetary and financial sector aggregates

- Base money: Base money in gross terms declined by 1.3 per cent over its December 2004 level. Excluding commercial banks' holdings of BOU instruments, it grew by 0.4 per cent from Shs. 924.6 billion in December 2004 to Shs. 928.3 billion in June 2005.

- Broad money: Broad Money (M3) grew by 6.2 per cent from Shs. 2,646.7 billion December 2004 to Shs. 2,811.1 billion in June 2005. This represents a faster growth compared to the 2.2 percent growth recorded in the first half of 2004/05, but a slower growth rate compared to 7.5 percent of the corresponding period 2003/04. M3 growth in the second half of 2004/05 was on account of increased net foreign assets of the banking system and increased commercial bank credit to the private sector.

- Deposit base: Private sector deposits at commercial banks increased by 7.2 percent from the December level to Shs. 2,206.1 billion in June 2005, reflecting in part deposit mobilization by commercial banks and the continued improvement of confidence in the financial system. Time and Savings deposits increased by 3.0 percent to Shs. 690.7 billion, private demand deposits increased by 16.3 percent to Shs. 860.1 billion, while foreign currency deposits increased marginally by 1.1 percent to Shs. 653.3 billion.

- Non-bank financial institutions (NBFIs): The assets of Non-Bank Financial Institutions (NBFIs) increased from Shs. 181.7 billion in December 2004 to Shs.194.1 billion in June 2005. Total loans and advances rose by Shs. 13.7 billion, from Shs.103.7 billion to Shs.117.4 billion. Total deposits also rose from Shs. 110.1 billion to Shs. 120.5 billion during the same period.

1.6 Government fiscal operations

- **Revenue:** Government revenue excluding grants during the second half of 2004/05 is estimated at Shs 1,015.9 billion, which was well above Shs 932.4 billion realised in the first half of 2004/05. Grants are also estimated to have risen to Shs 679.2 billion from Shs 598.7 billion during the same period. Domestic revenue as a percentage of GDP increased by 0.3 percentage points from 12.6 percent in 2003/04 to 12.9 percent in 2004/05, partly on account of improvements in tax administration.

- **Expenditure:** Total government expenditure, including net lending is estimated at Shs 1833.2 billion in the second half of 2004/05 up from Shs 1437.3 billion recorded in the first half of 2004/05. Expenditure as a percentage of GDP is estimated 21.6 percent in 2004/05 down from 23.4 percent in 2003/04.

- **Fiscal balance:** The fiscal deficit (excluding grants) is estimated at 8.7 percent of GDP down from 10.7 percent in 2003/04. On a commitment basis, the deficit is estimated at 0.3 percent of GDP in 2005/04 down from 1.3 percent of GDP in 2003/04.

1.7 External sector and balance of payments developments

- **The overall balance of payments position:** The overall balance of payments position is estimated at a surplus of US$112.6 million during the second half of FY 2004/05, down from a surplus of US$121.7 million realised in the first half. For the FY 2004/05, the overall balance is estimated at a surplus of US$234.3 million, an improvement from a surplus of US$192.2 million recorded in 2003/04.

- **The current account:** The current account deficit is estimated to have increased to US$67.0 million during the second half of 2004/05 compared to US$66.7 million and US$57.9 million in the first half of 2004/05 and the corresponding period of 2003/04 respectively. The marginal widening of the deficit in the second half compared to the corresponding half of 2003/04 is largely due to increased imports of goods and services.

- **Exports of goods:** Export proceeds during the second half of 2004/05 are valued at US$439.36 million. Coffee exports receipts were recorded at US$88.0 million, higher than US$66.6 million recorded in the corresponding period of 2003/04, largely resulting from increased coffee prices. Receipts from non-coffee exports were recorded at US$351.4 million, 19.0 percent higher than the corresponding period in 2003/04. For the entire fiscal year, export proceeds are estimated at US$786.3 million compared to US$647.2 million in 2003/04.

- **Imports:** Imports of goods during the second half of 2004/05 were recorded at US$812.3 million, 2.1 percent and 22.7 percent more than the import bill in the first half of 2004/05 and the corresponding period of 2003/04 respectively. This increase is largely accounted for by growth of private sector imports, partly on account of high oil prices. Government imports declined to US$70.4 million in the second half of 2004/05, compared to US$87.4 million in the first half of 2004/05.

- **Services and income account:** Compared to the first half of 2004/05, inflows on account of services increased by 12 percent to US$257.7 million. Income inflows also rose to US$25.8 million compared to US$ 16.24 million in the first half of 2004/05. However, the increased outflows in both accounts resulted in a deficit of US$267.8 million, compared to the deficits of US$231.4 million and US$211.5 million realised in the first half of 2004/05 and corresponding period of 2003/04, respectively.

- **Current transfers:** The current transfers surplus reduced to US$573.8 million in the second half of 2004/05, compared to US$613.2 million realised in the first half. This was largely on account of the decline in private transfers, which on account of seasonality factors, fell to US$261.9 million, compared to US$340.2 million in the first half of 2004/05.

- **The capital and financial account:** Net foreign direct investment during the second half of 2004/05 is estimated to have increased by 6.3 percent to US$126.4 million in comparison to the US$119.0 million recorded in the first half of 2004/05. This is on account of increased liabilities on the part of foreign investors and increased re-invested earnings.

- **External debt:** Total maturities for medium and long-term public and publicly guaranteed external debt amounted to US$72.3 million in the second half of 2004/05. Of the total maturities, cash debt service amounted to US$49.5 million, while HIPC resources amounted to US$23.1 million during the same period.

1.8 Real economy developments

- **Index of Industrial Production:** A quarterly analysis of the index of production covering major manufacturing industries shows that the all item index increased during the first three quarters of 2004/05 before falling to 165.6 during the fourth quarter. The drop in the index during the fourth quarter is attributed to huge cutbacks in the production of sugar (37%), edible oil (28%), and soft drinks (10%).

- **Fuel Consumption.** During the financial year ended June 2005, imports of the major fuel products i.e. premium, diesel and kerosene exceeded that of the previous two years. The increases in imports reflect increases in demand for these major petroleum products particularly in the case of diesel, which is a major input into the industrial sector and to some extent this is supported by the developments in the index of industrial production, which has generally improved over the last 3 years.

- **Electricity consumption:** The average number of customers during the financial 2004/5 was 265,774, 90 percent of which are domestic consumers. Electricity consumption has however decreased as a result of lower production levels, which is largely driven by low water levels that have affected electricity generation.

- **Investment:** In the year to June 2005, the value of projects licensed increased by 30 percent from $520.03 million recorded in the previous year to $675.66 million. This increase is mainly attributed to high planned investments in the water and energy; manufacturing; and agriculture, forestry and fishing sub sectors.

- **Uganda Securities Exchange:** Trading at the Uganda securities exchange during the financial year 2004/5 was higher than that in the previous two years both in terms of turnover and shares traded.

1. INTRODUCTION

This paper provides an analysis of the performance of the economy in the period January to June 2005 against the performance benchmarks of the 2004/05 macroeconomic framework. Overall, the developments in aggregates were in line with the performance benchmarks contained in the program for 2004/05. To discuss this performance this paper in Section 1 provides an overview of the macroeconomic objectives for 2004/05; while Section 2 discusses the management strategies and actions undertaken during the period. Sections 3 - 4 provide an analytical assessment of the performance in light of the management strategies undertaken during the period under review.

2. MACROECONOMIC OBJECTIVES FOR 2004/05

Real GDP was initially projected to grow by 6.0 percent while average annual headline and underlying inflation rates were expected to turn out at 6.0 and 4.0 percent respectively. However, on account of reduced supply of electricity and effects of drought, the real GDP growth rate was revised downwards to 5.5 percent. The effect of drought also led to an upward revision of the annual average headline inflation rate to 8.2 percent from the initial 6.0 percent while energy price developments led to revisions in the average underlying inflation to 4.5 from 4.0 per cent. Consistent with the attainment of the inflation objective and a stable environment for financial intermediation, BoU was to limit growth in broad money (M3) to about 13.4 percent. Base money was projected to grow at 15.2 per cent. The fiscal deficit, excluding official grants, was projected to narrow by 1.3 percentage points to 10.9 percent of GDP, while it was envisaged that the external current account deficit would be 12.2 percent of GDP. International reserves were expected to remain at a comfortable level of nearly 6.5 months of imports of goods and non-factor services by end of June 2005.

The above objectives are in line with the GOU/IMF second annual program supported by the three-year Poverty Reduction and Growth facility (PRGF) arrangement, which was approved in September in 2002 and guided by the revised Poverty Eradication Action Plan (PEAP).

3. MONETARY AND EXCHANGE RATE POLICY

Bank of Uganda (BOU)'s monetary policy focused on maintaining macroeconomic stability and containing inflation to low rates, to create a conducive environment for achievement of a real GDP growth rate of 5.5 percent. This was to be done in a cautious manner, which would not exacerbate instability in the markets. Sterilization of excess liquidity was effected through a combination of sales of Treasury bonds, net issues of Treasury bills and daily sales of foreign exchange. This notwithstanding, BOU continued to use the Repurchase Agreements (REPOs) as a fine-tuning instrument in order to manage the intra-auction liquidity movements. The liquidity management effort was supplemented by adjustments in the pricing of the liquidity providing windows, the Rediscount Rate and Bank rate, to ensure a consistent monetary policy stance. Consistent with the broad macro-economic objectives for the year, Bank of Uganda maintained a tight but cautious monetary policy stance to contain inflation within targeted levels. Annual headline inflation averaged 8.0 percent during financial year 2004/05 lower than the program target of 8.2 percent, while annual underlying inflation averaged 4.7 percent marginally higher than the program target of 4.5 per cent projected for the FY 2004/05, although slightly below the government's target of 5.0 percent.

During FY 2004/05, interest rates on treasury bills were relatively stable and lower than what prevailed in the last two financial years. This was largely attributed to the fiscal restraint and the continued use of long-term government bonds. Liquidity injections associated with fiscal operations turned out to be lower than in the previous financial year on account of higher revenue collections relative to the previous year. Long-term securities eased the pressure on treasury bills particularly when the appreciation pressures in the foreign exchange market in the first half of the financial year hindered the BOU's ability to effect daily foreign exchange sales for liquidity sterilization. The strong appreciation of the shilling against the US dollar during the first half of 2004/05, prompted the authorities to temporarily suspend daily sales of foreign exchange for liquidity sterilization. However, BOU occasionally intervened in the IFEM on the buy side to smoothen the short-term erratic movements in the exchange rate. The purchases of foreign exchange by BOU injected liquidity, which combined with liquidity injections associated with fiscal operations, posed a challenge to monetary policy management. In order to avoid the rapid expansion of base money, the burden of liquidity management was borne by increased issuance of government securities, contributing to the slight upward movement in the interest rates during the financial year 2004/05. Despite the above challenges, the Bank achieved the daily average base money targets during the period to June 2005.

Bank of Uganda continued to pursue the flexible exchange rate policy, with occasional intervention in the inter-bank foreign exchange markets (IFEM) to minimise market instability. Over the first six months of 2005, the shilling depreciated against the US Dollar, with a few incidences of excessive depreciation pressures in the months of March and April 2005, requiring Bank of Uganda's intervention in the market to restore tranquillity. BOU resumed daily sterilization using foreign exchange sales in the month of May to control excess liquidity in the system.

In the outlook, BOU is committed to a cautious monetary policy stance in order to ensure that inflation remains low and stable. It is also committed to liquidity management in a manner that does not compromise the stability of domestic financial markets. Overall, BOU remains committed to the cardinal objective of maintaining macroeconomic stability in order to ensure sustained growth of the economy.

4. DOMESTIC PRICE AND MARKET DEVELOPMENTS

4.1 Domestic prices

During the second half of FY 2004/05, inflationary pressures increased mainly on account of substantial increases in food crop prices. The rate of annual headline inflation surged to an average of 10.5 percent, up from 5.4 percent during the first half of 2004/05. This was also higher than the annual headline inflation average of 1.9 percent registered over the same period in FY 2003/04. The annual food crops inflation averaged 31.3 percent in the last six months of 2004/05, compared to 10.5 percent exhibited in the first six months of the financial year.

Similarly, the average annual underlying inflation rate for the second half of FY 2004/05 increased to 5.4 percent, up from 4.0 percent registered in the first half of the financial year. The increase in the underlying inflation during this period was largely due to a higher increase in the average prices of goods[1], which rose by 5.7 percent compared to 4.1 percent in the previous period. The services sub-group index also rose by 4.9 percent compared to 3.8 percent in the first half of the financial year.

The inflationary pressures during the second half of FY 2004/05 may be attributed to a combination of factors, including:

- The low supply of food crops witnessed during the first four months of 2005 following relatively poor harvests caused by prolonged drought in the food producing areas compared to the corresponding period of the previous financial year.

- Increases in the average prices of alcoholic beverages especially the locally brewed brands. The increase in the prices of alcoholic beverages is also attributed to drought, which caused the scarcity of the raw materials used in the production process.

- The rise in charcoal prices and electricity tariffs. The price of charcoal recorded a general upward trend during the second half of FY 2004/05 largely on account of tighter controls on deforestation; and the effect of higher transportation and distribution costs. Electricity tariffs were also raised by an average of 26 percent in April 2005.

- The continuous surges in the domestic prices of petroleum products at the back of higher world prices and its second round effects on the prices of other goods and services. The pump price for premium, diesel and kerosene, rose from monthly average of Shs 1,738, Shs 1,470 and Shs 1,400 respectively per litre in December 2004 to Shs 1,975, Shs 1,673 and Shs 1,526 respectively, per litre during the month of June 2005.

Details of inflation developments during each half of the FY 2004/05 and a comparison with a corresponding period of the previous financial year are shown in table 1, while figure 1 depicts bi-annual inflation developments for the period 1999 – 2005.

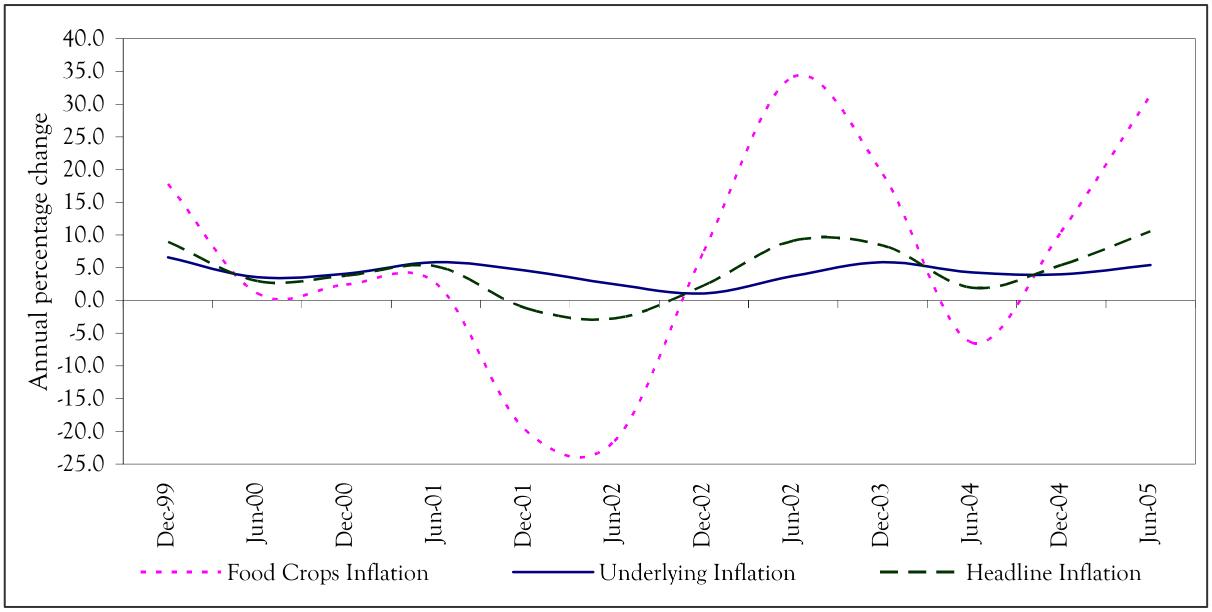
Table 1: The biannual average inflation out-turns (December 2003-June 2005)

Six months ending...	Headline inflation	Underlying inflation	Food crops inflation
December 2003	8.4%	5.9%	19.3%
June 2004	1.9%	4.3%	-6.5%
December 2004	5.4%	4.0%	10.5%
June 2005	10.5%	5.4%	31.3%

Source: Uganda Bureau of Statistics

[1] Underlying inflation has two sub-group indices, the goods sub-group index and the services sub-group index.

Figure 1: Biannual average inflation rates developments (December 1999- June 2005)



Source: Uganda Bureau of Statistics

4.2 Domestic money and securities markets

4.2.1 Primary Market

(a) Treasury bills

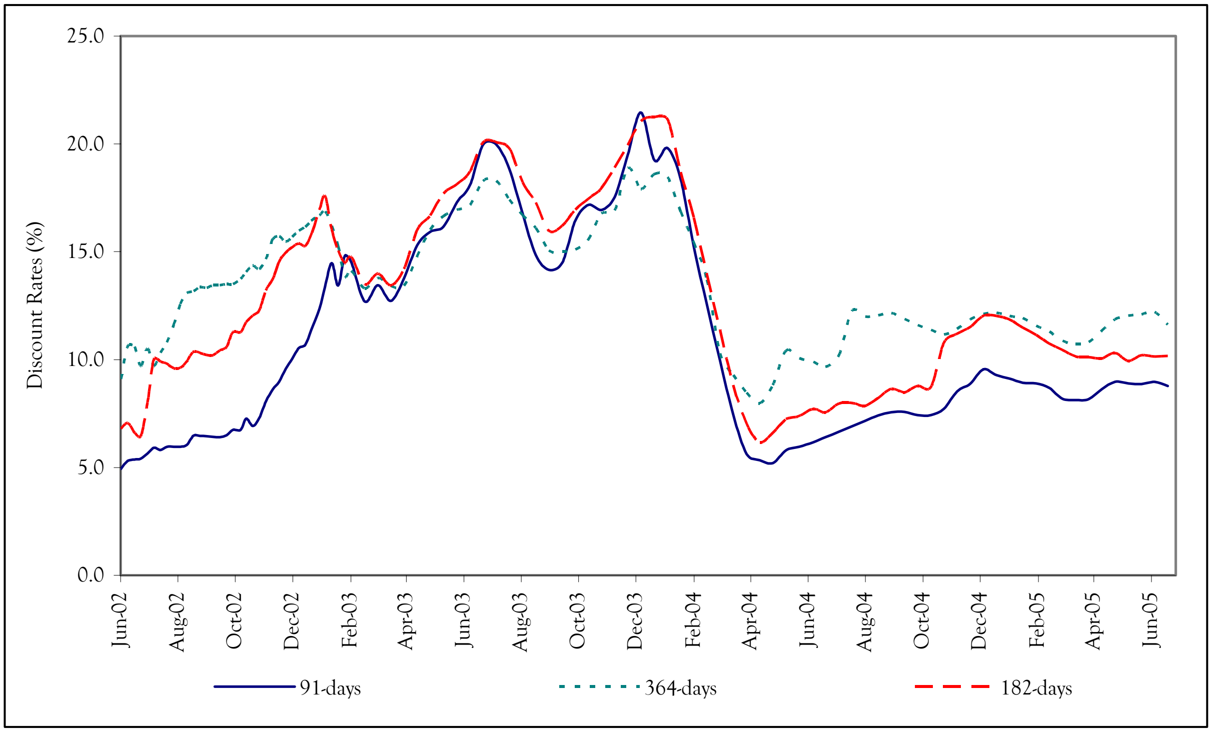
The primary issuance of Treasury bills continued to be an important tool for monetary policy management. As the main sterilization instrument, the primary issuance of treasury bills was actively used in liquidity management during the six months to June 2005. In March 2005, Bank of Uganda discontinued the issue of the 273-day paper in order to enhance the capacity of the Treasury bill to handle more and larger trades.

The stock of Treasury bills dropped by 3.0 percent, from Shs. 1,176.0 billion recorded at the end of December 2004 to Shs. 1,140.5 billion as at end-June 2005. This was mainly due to the continued monthly issuance of the bond instrument that locked up liquidity for longer periods. Of the outstanding stock of Treasury bills, commercial banks held Shs. 708.0 billion or 62.1 percent by end-June 2005, compared to Shs. 752.6 billion or 64.0 percent by end-December 2004. The participation of offshore investors in the Treasury bill market marginally rose from Shs. 13.2 billion or 1.1 percent in December 2004 to Shs14.7 billion or 1.3 percent as at end June 2005.

Interest rates on Treasury bills were marginally higher in the six months to June 2005 compared to the rates that prevailed in the five months to November 2004, but were lower than the rates observed within the month of December 2004.

On an end-period basis, the respective weighted annual discount rates for the 91-day, 182-day, and 364-day bills were 8.78, 10.17, and 11.62 percent, respectively, in the last auction of June 2005. These were lower than the respective levels of 9.28, 12.02, and 12.18 percent in the last auction of December 2004. The trend of discount rates on treasury bills during the period June 2002 – June 2005 is depicted in Figure 2.

Figure 2: Trend of discount rates on Treasury bills (June 2002 to June 2005)



Source: Bank of Uganda

(b) Treasury bonds[1]

In the second half of financial year 2004/05, Bank of Uganda issued and reopened treasury Bonds in the tenors of 2 and 3 years. The treasury bonds continued to support monetary policy implementation by improving liquidity management and promoting market development. In addition, these securities have assisted to extend both the maturity of the instruments traded and the yield curve. They also deepened the capital market by increasing the variety of instruments available for savings and investment.

During the second half of 2004/05, several issues were reopened with the aim of creating more liquid and tradable securities. Total Treasury bond issues in the six months to June 2005 amounted to Shs. 165.0 billion at face value. This is a decline of 17.5 percent from Shs. 200.00 billion issued in the previous period to December 2004.

Of the outstanding stock of Treasury bonds by end-June 2005 that stood at Shs 530 billion, Commercial Banks, Pension Funds, other Financial Institutions, and Bank of Uganda held 69.0 percent, 20.5 percent, 3.3 percent and 2.3 percent respectively compared to 69.1 percent, 27.8 percent, and 3.1 percent for the corresponding period ending December 2004. All the bonds issued were oversubscribed and were listed on the Uganda Securities Exchange. Details are shown in Table 2 below.

[1] A bond is a market instrument with a maturity term longer than one year.

Table 2: Treasury bond volume, cost price and interest rates

Tenor/Issue date	Total Q1 & Q2 FY04/5	2 -Years New issue Jan 27-05	2 -Years Reopened Feb 23-05	2-Years Reopened Mar 23-05	3-Years New issue Apr 20-05	3-Years reopened May 18-05	2- Years New issue Jun 15-05	Total Q3 & Q4 FY04/5
Offers (Shs bn)	200.000	30.000	35.000	35.000	25.000	20.000	20.000	165.000
Total bids (Shs bn)	267.894	38.527	45.417	45.846	39.225	25.566	39.452	234.033
O/w Competitive	239.447	38.458	45.398	45.834	39.214	25.562	39.431	233.897
Over (under) subscription	67.894	8.527	10.417	10.846	14.225	5.566	19.452	69.033
Amount sold (face value)	200.000	30.000	35.000	35.000	25.000	20.000	20.000	165.000
Amount sold (cost price)	178.637	27.598	32.797	33.059	21.656	16.862	18.430	150.402
Cover ratio %		128.4	129.8	131.0	156.9	127.8	197.3	
WAP per Shs.100		91.993	93.707	94.454	86.625	84.308	92.152	
Yield to maturity %		14.8	14.3	14.5	16.04	17.7	14.7	

Source: Bank of Uganda

As depicted in Table 2 above, the yields to maturity on the 2-year bond remained relatively stable in the range of 14.30 to 14.67 percent in the second half of 2004/05, lower than 15 percent in the previous half. The yields-to-maturity on the 3-year bond rose to 17.70 percent in May 2005, from 16.04 percent in April 2005, but was comparable to rates in the previous period. A total of Shs. 18.23 billion was paid to cover coupon payments on bonds between January and June 2005.

4.2.2 Secondary Market

(a) Treasury bills

The secondary market for Treasury bills provided the background for active monetary operations in short-term instruments for fine-tuning liquidity. A marked increase of activity in the secondary market for treasury bills was observed in the six months to June 2005 (See Table 3). This was largely on account of the active use of the Horizontal REPO Agreement (HRA) to facilitate inter-bank lending, and the ease with which securities can be transferred on the Central Depository System (CDS). In addition, Bank of Uganda introduced a Guide on Market Performance for the primary dealers, as a fair and transparent ranking system. This tool is aimed at motivating primary dealers in the key areas of primary and secondary markets, and market intelligence.

The average indicative rates derived from daily 'bid' and 'offer' yield-to-maturity rate quotations by the primary dealers for secondary trading of Treasury bills realized over the period January to June 2005 were 8.91/8.65, 11.04/10.77, and 12.59/12.29 percent for the 91-days, 182-days, 273-days and 364-days securities. This is compared to the average rates of 8.81/8.56, 10.52/10.25, and 12.31/12.09 percent for the respective papers in the six months to December 2004.

Total trades over this period amounted to Shs. 162.9 billion, with 67.9 percent of the trades in bills with a tenor of 91-days or less to maturity. This volume was higher than the Shs. 97.1 billion executed in the period July 2004 to December 2004. A total of Shs. 61.5 billion in horizontal REPO transactions took place during the period. The rest of the trades were outright sales. Indicators of the secondary market activity in treasury bills are summarized in Table 3.

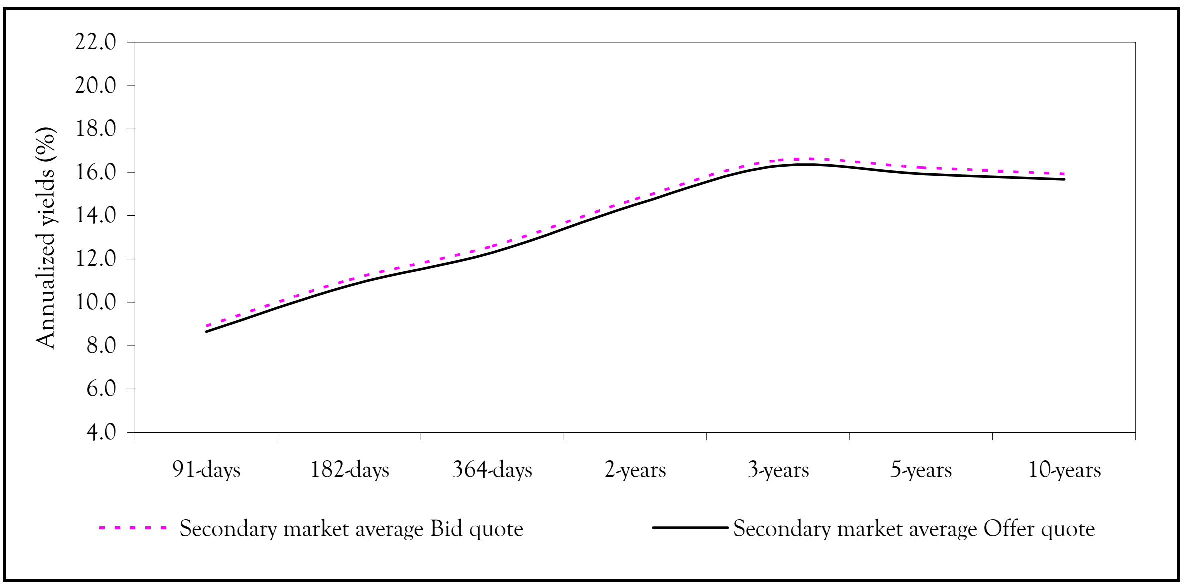
Table 3: Summary indicators from the Secondary Market for Treasury bills (Jan-June 2005)

	91 days		182 days		364 days	
Yield to maturity rates – quotation (%)						
	bid	offer	Bid	offer	bid	offer
Minimum	7.95	7.68	10.15	9.87	11.35	11.06
Maximum	9.55	9.29	13.39	13.39	15.30	14.99
Average	8.91	8.65	11.04	10.77	12.59	12.29
Trading activity						
Transactions (Shs bn)		110.637		37.915		14.358
O/w horizontal repos		61.50		-		
Av. horizontal repo rate		7.58 %				
O/w outright sales		49.137		37.915		14.358
Total across maturities (Shs bn)			162.910			
Av. discount rate		11.36%		11.33%		11.08%
Av. yield to maturity rate		11.95%		11.99%		12.03%

Source: Bank Of Uganda

The yield curve derived from average yield-to-maturity quotations in the secondary market was upward sloping up to the 3-year bond, followed by an inversion up to the 10-year bond (see Figure 3).

Figure 3: Securities yield curve for the period Jan 2005 – June 2005



Source: Bank of Uganda

(b) The Treasury bond

During the period January to June 2005, the average indicative bid/offer yield-to-maturity rates in the secondary market were 14.75/14.50, 16.55/16.30, 16.21/15.92, and 15.92/15.67 percent for the 2-year, 3-year, 5-year and 10-year bonds, respectively. This compares with the respective average rates of 14.41/14.17, 15.40/15.17, 15.40/15.14, and 17.69/17.10 percent for the six months to December 2004.

In the same period, a total of Shs 7.8 billion of the 2-year bond, Shs 1.6 billion of the 3-year bond, Shs 0.2 billion of the 5-year bond, and Shs0.50 billion of the 10-year bond were traded on the secondary market at the Uganda

Securities Exchange. A summary of indicators of secondary market activity in the Treasury bond market is provided in Table 4 below.

Table 4: Treasury bonds secondary market summary indicators (Jan-Jun 2005)

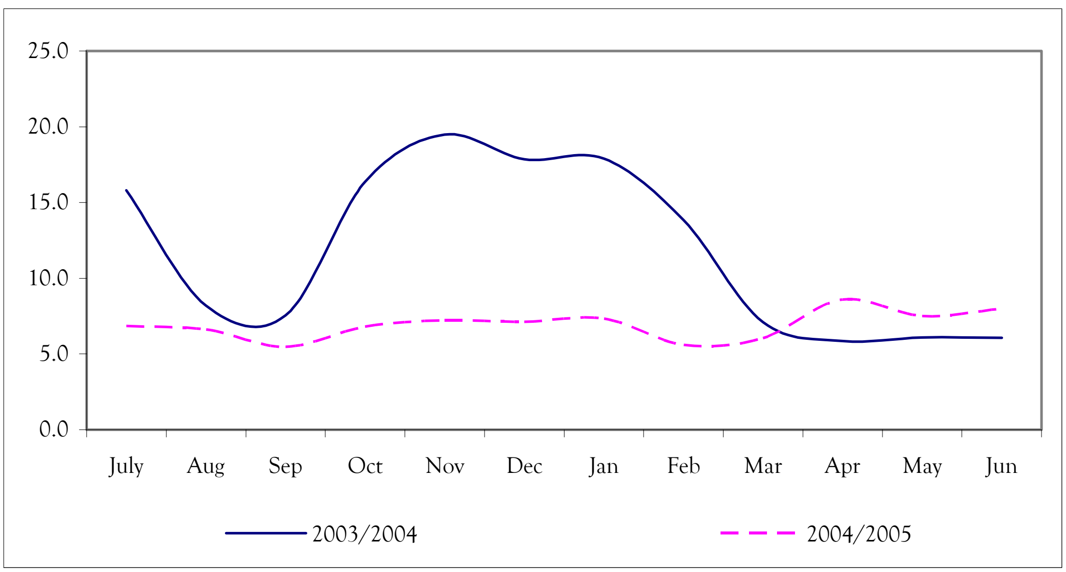
Tenor→	2 years		3 years		5 years		10 years	
YTM (%)→	bid	offer	bid	offer	bid	offer	bid	offer
Minimum	13.0	12.8	14.8	14.5	14.5	14.3	13.5	13.3
Maximum	15.5	15.1	18.3	18.0	19.1	18.9	21.5	21.3
Average	14.8	14.5	16.6	16.3	16.2	15.9	15.9	15.7

Source: Bank of Uganda

4.2.3 The Inter-bank market

During the second half of 2004/05, the domestic inter-bank money market continued to be active registering even broader participation, higher transaction volumes and increasingly comparable though lower rates among participants. The inter-bank transactions were mainly concentrated in the call money market (i.e. less than 30 days tenor), of which the largest portion was of tenors between overnight and one week. This increased activity is indicative of improved liquidity management by commercial banks and overall development of the domestic money market. The minimum and maximum lending rates recorded in the inter-bank money market were 5.5 percent and 8.6 percent in February and April 2005 respectively. Total volumes traded in the second half amounted to Shs 1,961.4 billion relative to Shs 1,345.2 billion in the previous period. The inter-bank money market lending rates were stable (with the lowest being 5.5 percent in September 2004 and the highest 8.6 percent in April 2005) and trended below the previous year's levels for the most part of 2004/05. Developments in the inter-bank money market lending rates during 2003/04 and 2004/05 are shown in figure 4

Figure 4: Movements in the inter-bank weighted average rates during 2003/04 and 2004/05.



Source: Bank of Uganda

4.2.4 Commercial Banks' interest rates

Effective lending rates on shilling denominated loans initially increased for most of the period before declining in June 2005. As shown in Table 5, effective lending rates for shilling denominated loans stood at 18.1 percent in June 2005 compared to 20.6 percent in March 2005 and 20.89 percent in June 2004. Similar movements in the interest rates were observed in the lending rates for foreign currency denominated loans, which stood at 7.6 percent in June 2005, compared to a level of 8.1 percent in June 2004.

Deposit rates on the other hand registered an upward trend. The rates on shilling time deposit registered a consistent increase from 8.5 percent in December 2004 to 10.2 percent in June 2005. The foreign currency denominated time deposit rate on the other hand rose to 3.9 percent in September 2004 but declined to 2.1 percent by end-June 2005. The rates on both shilling and foreign currency denominated savings and demand deposits on the other hand maintained a stable trend for the second half of FY 2004/05 after registering consistent decreases in the first half of the year. Developments in commercial bank lending rate are shown in Table 5 below.

Table 5: Commercial bank's lending and deposits rates

Weighted average rates (%)	2003/04				2004/05			
	Sep-03	Dec-03	Mar-04	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05
Shilling Credit								
Lending	18.42	21.43	22.12	20.89	19.55	18.8	20.63	18.07
Demand deposits	1.33	1.32	1.32	1.14	1.11	1.23	1.12	1.08
Savings deposits	2.65	2.49	2.12	2.14	1.76	1.76	1.94	1.77
Time deposits	9.23	12.11	6.94	5.29	8.64	8.49	8.21	10.19
Foreign currency credit								
Lending	8.29	10.16	9.11	8.08	9.25	9.07	9.17	7.59
Demand Deposits	0.96	0.89	0.96	1	0.98	0.97	0.98	0.98
Savings Deposits	1.55	1.71	1.66	1.45	1.45	1.45	1.45	1.45
Time Deposits	1.85	1.75	1.51	2.73	3.88	3.98	2.69	2.1

Source: Bank of Uganda

4.3 The foreign exchange market and the exchange rate

4.3.1 Exchange rate developments

On annual basis, the Uganda shilling appreciated against the US dollar during the FY 2004/05. The weighted average mid rate in the inter-bank foreign exchange market appreciated by 10.2 percent from Shs 1,936.2 per US dollar in 2003/04 to Shs 1,737.9 per US dollar in 2004/05. This is in contrast to the depreciation of 2.9 per cent posted in the preceding financial year when the average mid rate moved from Shs 1,881.1 per US dollar in 2002/03 to Shs 1,936.2 per US dollar. On a monthly basis, the Shilling appreciated by about 4.4 per cent, from Shs 1,818.7 per US dollar in June 2004 to Shs 1,738.3 per US dollar in June 2005.

The Uganda shilling depreciated by 0.40 percent in the second half of 2004/05 when it moved from a period average rate of Shs 1,734.2 per US dollar in the first half to Shs 1,741.0 per US dollar in the second half. The spread between the buying and selling rates narrowed from Shs 13.5 in the first half to Shs 12.3 in the second half of FY 2004/05. Movements in the exchange rate during this period were partly driven by current account developments, including increased imports of goods and services by the private sector and reduced private transfers.

The nominal effective exchange rate (NEER) index depreciated by 3.2 percent during the second half of 2004/05, compared to an appreciation of 8.0 percent posted in the first half of the same year. The movements in the NEER index mainly reflect the relative movements of the Uganda shilling against the currencies of Uganda's major trading partners. Indeed, movements in the NEER during this period are consistent with movements in the shilling vis-à-vis the currencies of our major trading partners. During the second half of the financial year 2004/05, the shilling depreciated against the currencies of our major trading partners. The shilling depreciated by 2.2 per cent against the UK pound, 5.8 per cent against the Kenyan shilling, 2.2 percent against the Euro and 0.6 per cent against the South African Rand.

The real effective exchange rate (REER) index depreciated as well by 2.3 percent in the second half of 2004/05 to 116.42 (2000=100) from 113.8 attained in the first half of 2004/05, compared to an appreciation of 6.3 percent recorded in the first half of 2004/05 from the level recorded for the second half of 2003/04. Figure 5 presents the trend of the inter-bank monthly average mid exchange rate from Jan 2001 to June 2005, while Figure 6 shows the trend in real and nominal effective exchange rate indices.

Figure 5: Developments in the foreign exchange market, January 2001 - June 2005

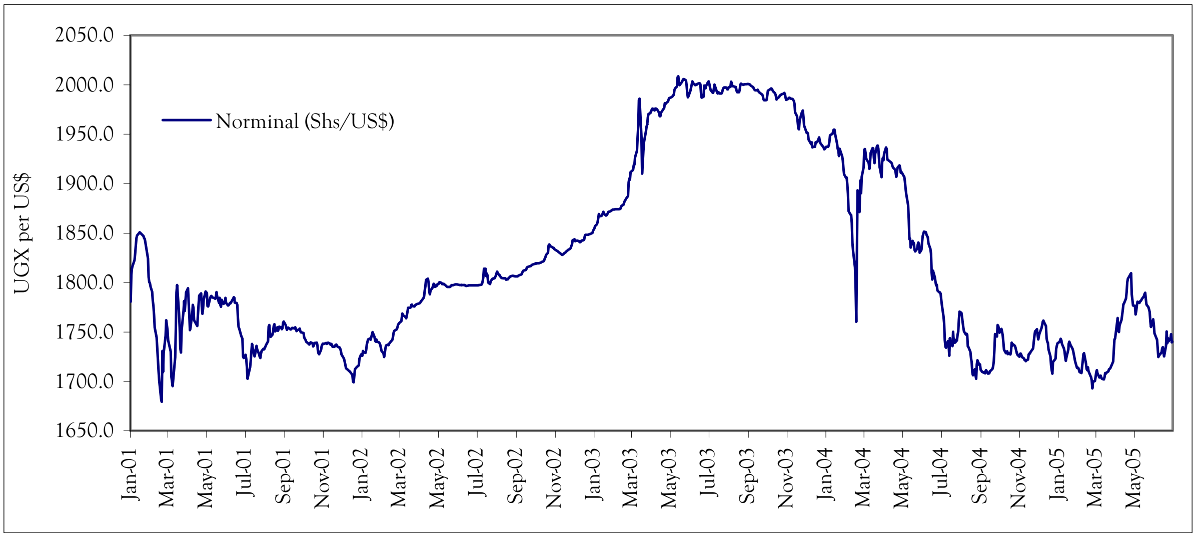
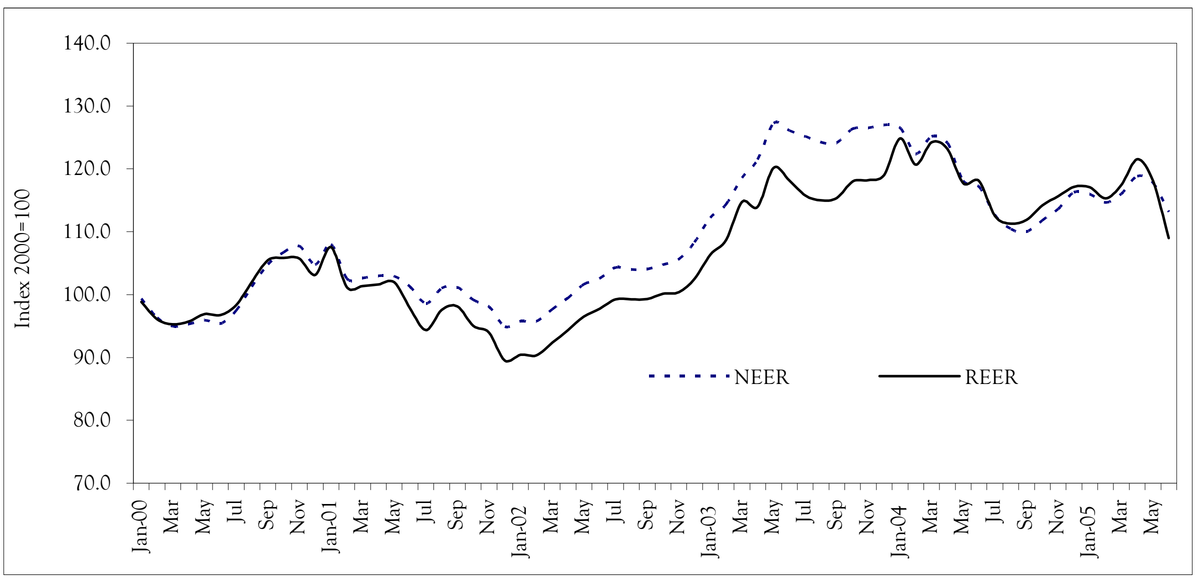


Figure 6: Real and nominal exchange rates, January 2000 - June 2005



Source: Bank of Uganda

4.3.2 Activity in foreign exchange market

Bank of Uganda's presence in the Inter-bank Foreign Exchange Market (IFEM) under the sterilization strategy to mop up excess liquidity generated by poverty reduction government expenditure resumed during the second half of 2004/05 so as to maintain stability of the exchange rate. Net sales of foreign exchange by Bank of Uganda on account of sterilization and intervention in the second half amounted to US$ 62.2 million, up from US$7.1 million of the previous half, but was lower than US$137.4 million and US$108.4 million of the corresponding periods in 2002/03 and 2003/04 respectively.

Gross purchases in the inter-bank foreign exchange market increased by 4.3 percent from US$ 972.2 million during first half to US$ 1,014.2 million in the second half of 2004/05. On the other hand, gross sales increased by 10.5 per cent from US$ 985.1 million in the first half to US$ 1,088.1 million in the second half of FY 2004/05.

5. MONETARY AND FINANCIAL SECTOR AGGREGATES

This section presents developments in base money and broader money aggregates, which incorporate the activities of commercial banks and non-bank financial sector. Base money is the operational target under the monetary targeting framework of the Bank of Uganda, and since FY 2002/2003, it has been one of the performance benchmarks outlined in the Government of Uganda monetary program mentioned above.

5.1 Base money

Base money in gross terms, defined as commercial banks' deposits at Bank of Uganda, plus currency issued and commercial banks' holdings of BOU securities, declined by 1.3 per cent over its December 2004 level. Excluding commercial banks' holdings of BOU instruments, it grew by 0.4 per cent from Shs. 924.6 billion in December 2004 to Shs. 928.3 billion in June 2005. These developments represent a slower expansion in base money over the last six months compared to growth of 6.6 percent in the preceding half. With regard to the components of base money, reserves of commercial banks held at BOU increased by 8.2 percent to Shs. 229.7 billion by the end of June 2005 compared to Shs. 212.1 billion by the end of December 2004. Currency issues grew only marginally by 0.3 percent to Shs. 698.6 billion over the same period as the demand for currency declined compared to the first half to December 2004. Currency issues grew by 15.1 percent in the six months to December 2004. Commercial banks' holdings of BOU instruments fell from Shs. 16.0 billion to zero between December 2004 and June 2005. As in the first half of 2004/05, increased net foreign assets on account of lower sales of forex to the IFEM continued to contribute to base money growth in the second half.

Table 6: Monetary Authority Balance Sheet (billion Shs)

Aggregate	Dec 2003	June 2004	Dec. 2004	June 2005
Total Liabilities	843.5	924.3	940.6	928.3
Base Money	805.3	867.1	924.6	928.3
Commercial Banks' Holdings of BoU Instruments	38.2	57.2	16.0	00.0
Total Assets	805.1	867.1	924.6	928.3
Net Foreign Assets	1,679.8	1,680.5	1,960.6	2,050.8
Net Claims on Government	-217.7	-489.6	-622.0	-833.4
Claims on Commercial Banks	106.4	85.8	84.0	86.7
Claims on Private Sector	0.0	23.9*	23.9	20.1
Claims on Parastatals	4.2	1.9	1.5	1.3
Other Items, Net	-767.6	-435.5	-523.4	-397.3

* From June 2004, staff loans at BOU were reclassified from Other Items, Net to Claims on Private Sector.

Source: Bank of Uganda.

5.2 Broad money

Between December 2004 and June 2005, Broad Money (M3) (comprising of currency in circulation and all private sector deposits) grew by 6.2 per cent from Shs. 2646.7 billion to Shs. 2811.1 billion. This represents faster growth compared to the 2.2 percent growth recorded in the previous six months to December 2004, but a slow down compared to 7.5 percent of the corresponding period to June 2004. Private sector deposits at commercial banks increased by 7.2 percent to Shs. 2,206.1 billion in June 2005, reflecting in part aggressive deposit mobilization by commercial banks and the continued improvement of confidence in the financial sector. Time and Savings deposits grew by 3.0 percent to Shs. 690.7 billion, private demand deposits rose by 16.3 percent to Shs. 860.1 billion, while foreign currency deposits increased minimally by 1.1 percent to Shs. 653.3 billion. The increase in residents' foreign deposits was partly due to the exchange rate depreciation. Between December 2004 and June 2005, foreign currency deposits grew by 1.1 percent, up from a decline of 2.5 percent in the previous half. In dollar terms, they grew by 1.1 percent from US$371.65 million in December 2004 to US$375.38 million in June 2005, up from 0.4 percent in the six months to December 2004. Currency in circulation grew by 2.8 percent, demand deposits by 16.3 per cent and time and savings deposits by 3.0 percent. Most of the growth in M3 was therefore attributed to a rise in the banking system's net foreign assets (NFA) and growth in private sector credit.

Additionally, financial depth as measured by the ratio of financial savings to Broad Money (M2) declined to 32.1 percent in June 2005, from 33.7 per cent in December 2004, mainly on account of faster growth in M2 over this period (see Table 7). In numerical terms, financial savings rose s by 3 percent or Shs20.2 billion to Shs692.7 billion while M2 increased by 7.9 per cent or shs157.2 billion to shs2157.9 billion.

5.2.1 Net Foreign Assets (NFA)

The net foreign assets of the banking system increased by 3.5 percent between December 2004 and June 2005 from Shs. 2,559.0 billion to Shs. 2,647.7 billion. This growth is lower than 8.0 percent observed for the previous corresponding half. The net foreign assets of BOU rose by 4.6 percent to Shs. 2,050.8 billion, of which foreign reserves rose by 1.5 percent. A major part of the increase in foreign assets constituted net inflows of donor budget support. At the level of commercial banks, net foreign assets declined marginally by 0.3 percent to Shs. 596.8 billion over the same period. Table 7 summarizes these developments.

5.2.2 Net Domestic Assets (NDA)

During the period December 2004 to June 2005, the net domestic assets of the banking system (excluding revaluation) increased by 17.4 percent to Shs 689.2 billion as at the end of June 2005 from Shs. 587.0 billion. The government's net position with the banking system at the end of June 2005 was a saving amounting to Shs 176.3 billion, representing an improvement of Shs 164.0 billion over the December 2004 position. This was mainly due to the build up of Government deposits at Bank of Uganda associated with disbursements of donor support.

Claims on the private sector by the banking system grew strongly by Shs 117.3 billion between December 2004 and June 2005. In terms of currency denomination, foreign currency loans increased by 13.7 percent (Shs 36.2 bn) while Shilling denominated loans rose by 9.6 percent (Shs 81 bn). In comparison, during the previous half-year period ending December 2004, foreign currency loans grew at about 23 percent (Shs 49.4 bn), while Shilling denominated loans increased by 5.8 percent (Shs 45.8 bn). The sectoral distribution of credit indicates that it is heavily weighted in favour of the trade and other services sector, which accounted for about 62 percent of the stock of loans in June 2005, up from 59 percent in December 2004 and 57 percent in June 2004. These developments are summarized in Table 8.

Table 7: The Monetary Survey (Shillings, billions)

Aggregate	June 2003	Dec. 2003	June 2004	Dec. 2004	June 2005
Net Foreign Assets	**2,101.3**	**2,255.3**	**2,370.5**	**2,559.0**	**2,647.7**
Monetary Authority (net)	1,500.5	1,679.8	1,680.5	1,960.6	2,050.8
Foreign Reserves	1,931.1	2,081.4	2,029.4	2,273.1	2,306.8
Commercial Bank (net)	600.8	575.5	6,90.1	598.4	596.8
B. Domestic Credit					
Central Government (net)	390.4	320.5	68.2	-12.3	-176.3
Parastatals	6.6	8.3	13.6	10.6	8.1
Private Sector	848.6	955.9	1,010.0	1,105.2	1,222.5
C. Other Items (net)	**-974.1**	**1133.9**	**-875.4**	**-1016.3**	**-890.3**
D. Broad Money – M3	**2,373.4**	**2,407.0**	**2,587.3**	**2,646.7**	**2,811.1**
o/w Foreign Exchange Accounts	624.2	587.3	662.4	646.1	653.3
E. Broad Money – M2A	**1,749.2**	**1,815.9**	**1,924.9**	**2,000.5**	**2,157.9**
Certificates of Deposit	4.0	3.8	2.0	2.0	2.0
Currency in Circulation	461.4	546.2	529.3	588.6	605.1
Demand Deposits	725.1	692.2	804.0	739.4	860.1
Time and Savings Deposits	558.7	577.4	589.6	670.5	690.7
Memorandum Items:					
1. Growth Rates Relative to Previous June (%)					
M3	23.3	1.4	9.0	2.3	8.7
M2A	17.3	4.0	10.0	3.9	12.1
2. Components of M3 (in percent of the total)					
Foreign Exchange Accounts	26.3	24.4	25.6	23.0	23.2
Certificates of Deposit	0.2	0.2	0.1	0.1	0.1
Currency in Circulation	19.4	22.7	20.5	20.9	21.5
Demand Deposits	30.6	28.8	31.1	26.3	30.6
Time and Savings Deposits	23.5	24.0	22.8	23.9	24.6
3. Financial Depth					
Financial Savings (billion Shs) 1/	562.7	581.2	591.6	672.5	692.7
Financial Savings/M2 (%)	32.2	31.0	30.8	33.7	32.1

1/ Financial savings are defined as time and savings deposits plus Certificates of Deposits (CDs).

Source: Research Department, Bank of Uganda.

Table 8: Sectoral Analysis of Commercial Bank Credit to the Private Sector (%)

Recipient Sector	Jun. 2003	Dec. 2003	Jun. 2004	Dec. 2004	Jun. 2005
Agriculture	10	9	11	11	10
Manufacturing	24	23	21	20	19
Trade & Other Services	57	57	57	59	62
Transport, Electricity & Water	6	7	8	6	6
Building and Construction	3	3	3	4	4
Mining and Quarrying	0	0	0	0	0
Total	100.0	100	100.0	100	100

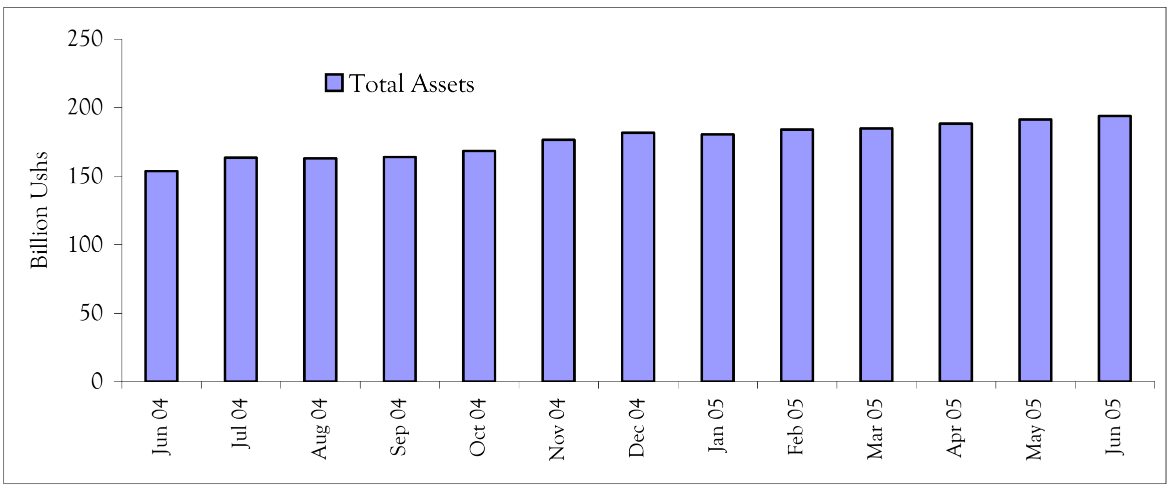
Source: Research department, Bank of Uganda

5.3 Non-Bank Financial Institutions[2]

The assets of Non-Bank Financial Institutions (NBFIs) increased over the period end-June 2004 to end-June 2005. The assets grew by Shs 40.3 billion (26.2 percent) to Shs. 194.1 billion over the period under review compared to an increase of Shs 21.6 billion (16.3 percent) realized in the corresponding period of 2003/04. The total loans and advances rose by Shs 26.4 billion, from Shs. 91.0 billion at end-June 2004 to Shs. 117.4 billion at end-June 2005. Lending to the building and construction sector continues to take the largest share of credit from NBFIs, averaging 69.3 percent of the total volume of loans over the period. The balances of NBFIs held with commercial banks, both in Uganda and outside Uganda rose by Shs 11.9 billion to Shs. 34.6 billion over the same period while their investments in government securities, stocks, shares and other investments declined by Shs. 0.1 billion to Shs. 20.1 billion as at end-June 2005 from Shs. 20.2 billion at end-June 2004. Figure 6 plots the growth in Assets.

On a fiscal year basis, total assets grew by 26.2 percent during 2004/05 from Shs 153.8 billion to Shs 194.1 billion. This growth was mainly on account of increases in advances to the private sector and balances with commercial banks, and was higher than the 16.3 percent growth observed in the financial year 2003/04.

Figure 7: The trend of NBFIs total assets (June 2004- June 2005)



Source: Bank of Uganda

The total deposits in the NBFIs grew by 27.5 percent to Shs 120.5 billion at end-June 2005, from Shs 94.5 billion at end-June 2004. This increase was largely attributed to growth in the time deposits, which more than doubled from Shs 10.8 billion at end-June 2004 to Shs. 24.9 billion at end-June 2005.

On a fiscal basis year, total deposits of the credit institutions increased by 27.6 percent to Shs 119.0 billion in 2004/05. The growth over this period was mainly on account of the rise in time deposits, which increased by more than twice the deposits of Shs 10.8 billion recorded in the financial year 2003/04.

[2] Covers only the credit institutions

Table 9: Developments in the activities of Non-Bank Financial Institutions (Shs billions)

Assets and deposit types	Jun. 2004	Sep. 2004	Dec. 2004	Mar.2005	Jun. 2005
Total Assets	153.76	164.05	181.74	185.04	194.09
o/w Loans and advances	91.03	96.37	103.71	110.18	117.44
Secured & unsecured	12.73	14.90	15.01	18.65	27.66
Mortgage	54.06	57.53	63.72	66.98	65.01
Administered	24.23	23.94	24.98	24.55	24.47
Total Deposits	94.46	94.16	110.13	113.74	120.45
Savings	56.34	53.67	61.99	61.48	63.18
Time	10.78	12.73	19.30	21.73	24.91
Agency Funds	26.15	27.04	28.30	29.50	30.90

Source: Bank of Uganda

6. GOVERNMENT FISCAL OPERATIONS

6.1 Revenue and grants

Table 10 shows preliminary developments in fiscal operations for first and second half of FY 2004/05 and the outturn for FY 2003/04. According to provisional information from the Ministry of Finance, Planning and Economic Development (MFPED), domestic revenue during the second half of 2004/05 is estimated to have surpassed that of the first half by Shs 83.5 billion to record Shs 1,015.9 billion. This is largely attributed to the improvement in tax administration. Total grants for both budget and project support also increased by 13.5 percent to Shs. 679.2 billion in the second half largely on account of increased disbursements by donors, particularly the World Bank. Overall, total revenue and grants grew by 10.7 percent to Shs 1,695.1 billion in the second half of FY 2004/05 from Shs 1,531.1 billion realised in the previous half. On a fiscal year basis, domestic revenue as a percentage of GDP increased by 0.3 percentage points from 12.6 percent in 2003/04 to 12.9 percent in 2004/05.

6.2 Expenditure

Total government expenditure and net lending for the second half of 2004/2005 is estimated at Shs 1,833.2 billion, up from Shs 1,437.3 billion recorded in the previous half. The expenditure on wages and salaries is estimated at Shs 416.0 billion, an increase of Shs 57.8 billion from that registered in the first half of FY 2004/05. The expenditure on other non-wage recurrent activities amounted to Shs 531.6 billion against Shs 379.9 billion the previous period, while interest payments remained relatively stable at about Shs 116.5 billion. In addition, development expenditure increased from Shs 539.0 billion in the first half to Shs 688.4 in the second half mainly driven by an increase in Non-PAF expenditures.[3] However, the estimate of total expenditure as a percentage of GDP declined to 21.6 percent in 2004/05 from 23.4 percent of GDP realised in 2003/04.

6.3 Overall budget balance

The overall budget balance including grants during the second half of FY 2004/05 is estimated to have deteriorated to a deficit of Shs 138.1 billion from a surplus of Shs 93.8 billion in the first half. Excluding grants, the deficit is estimated to have worsened to Shs 817.3 billion from a deficit of Shs 504.9 billion in the previous period. Over the FY 2004/05, the deficit excluding grants as a percentage of GDP is estimated at 8.7 percent, down from 10.7 percent in 2003/04. This compares with the program deficit for 2004/05 of 10.9 percent of GDP. On a commitment basis, the deficit is estimated at 1.4 percent of GDP in 2004/05, up from 0.3 percent of GDP in 2003/04. The budgetary deficit was mainly financed through net external borrowing of Shs 126.3 billion and net domestic financing amounted to Shs –67.9 billion.

[3] Non- PAF constitutes Defence, Other ministries, Missions abroad and Deferred payments

Table 10: Fiscal operations: 2003/04 – 2004/05 (Shs bn)

Categories	FY 2003/04	*Prel.* FY 2004/05	**H1** 2004/05	H2 2004/05
Revenue and grants	2,911.8	3,226.2	1,531.1	1,695.1
Revenue	1,669.1	1,948.3	932.4	1,015.9
Grants	1,242.6	1,277.9	598.7	679.2
Total expenditure and net lending	3,085.9	3,270.5	1,437.3	1,833.2
Recurrent expenditure	1,892.2	1,978.8	880.0	1,098.7
Wages and salaries	683.0	774.2	358.2	416.0
Interest	263.0	229.7	113.2	116.5
Other recurrent	887.1	911.5	379.9	531.6
Development expenditure	1,142.9	1,227.4	539.0	688.4
Domestic	441.4	487.1	192.2	294.9
Deferred expenditures	-	7.1	7.1	0.0
External	701.5	74.04	346.8	393.5
Net lending and investment	4.1	-7.6	-4.0	-3.6
Domestic Arrears Repayment	46.7	71.9	22.2	49.7
Overall deficit(-)/surplus (+)	-174.1	-44.3	93.8	-138.1
Excl. grants	-1,416.8	-1,322.2	-504.9	-817.3
Financing	174.1	44.3	-93.8	138.1
Foreign (net)	300.6	126.3	102.0	24.3
Domestic (net)	-126.5	-67.9	-192.2	124.3
Banking system	-206.2	-259.8	-95.8	-164.0
Non bank	79.7	191.8	-96.4	288.2
GDP at factor cost (current prices)	13,200.3	15,134.3		
Memorandum items (% of GDP)				
Total revenue & grants	22.1	21.3	-	-
Domestic revenue	12.6	12.9	-	-
Grants	9.4	8.4	-	-
Expenditure and net lending	23.4	21.6	-	-
Recurrent	14.3	13.1	-	-
Development	8.7	8.1	-	-
Overall deficit	-1.3	-0.3	-	-
Overall deficit (excluding grants)	-10.7	-8.7	-	-

Source: Ministry of Finance, Planning and Economic Development.

7. EXTERNAL SECTOR AND BALANCE OF PAYMENTS DEVELOPMENTS

7.1 Overall balance of payments

During the second half of fiscal year 2004/05, the overall balance of payments recorded a surplus position of US$112.6 million, compared to a surplus of US$89.8 million recorded in the corresponding period in FY 2003/04. This is explained by improvements in the capital and financial account. The current account deficit widened to US$67.0 million, from a deficit of US$57.9 million recorded in the second half of 2003/04. The deterioration of the current account was to a large extent due to the increase in imports of goods and services, relative to the corresponding period in 2003/04. The capital and financial account recorded a surplus of US$179.6 million in the period under review, compared to the US$147.7 million recorded in the corresponding period last fiscal year. The improvement in the capital and financial account more than offset the deterioration in the current account, leading to an overall positive balance of payments position of US$112.6 million. On a fiscal year basis, the capital and financial account balance was at a surplus of US$368.0 million in 2004/05, which was 34.6 percent higher than the surplus of US$273.4 million recorded in 2003/04. Details of the developments in the balance of payments are shown in Table 11 below.

7.2 The current account

7.2.1 Trade balance

The trade balance deteriorated from a deficit of US$300.0 million in the second half of 2003/04 to a deficit of US$372.9 million in period under review. This deficit is largely accounted for by increase in imports, which more than offset the increase in exports[4]. This deficit was however lower than the deficit of US$448.5 million realised in the first half.

[4] Imports rose by 22.7 percent while exports rose by 21.4 percent

Table 11: Balance of payments summary table (US $ mn)

	FY 2003/04	H1 2003/04	H2 2003/4	FY 2004/05	H1 2004/5	H2 2004/5
CURRENT ACCOUNT BALANCE	-81.20	-23.26	-57.94	-133.68	-66.69	-66.99
Goods Account (Trade Balance)	-663.16	-363.14	-300.01	-821.47	-448.53	-372.94
Total Exports (fob)	647.18	285.20	361.98	786.32	346.95	439.36
Total Imports (fob)	-1,310.34	-648.34	-661.99	-1,607.79	-795.49	-812.31
Services Account (Services net)	-239.71	-111.35	-128.36	-331.86	-144.64	-187.22
Inflows (credit)	366.78	159.09	207.69	487.83	230.12	257.72
Outflows (debit)	-606.49	-270.45	-336.05	-819.70	-374.76	-444.93
Income Account (Income net)	-150.27	-67.18	-83.09	-167.35	-86.72	-80.62
Inflows (credit)	40.04	20.61	19.43	42.01	16.24	25.77
Outflows (debit)	-190.31	-87.79	-102.52	-209.36	-102.96	-106.40
Current Transfers (net)	971.94	518.41	453.52	1,187.00	613.21	573.79
Inflows (credit)	1,141.85	613.02	528.82	1,392.65	708.87	683.78
Outflows (debit)	-169.91	-94.61	-75.30	-205.65	-95.66	-109.99
CAPITAL AND FINANCIAL ACCOUNT BALANCE	273.37	125.68	147.70	368.01	188.39	179.62
Capital Account	0.00	0.00	0.00	0.00	0.00	0.00
Capital Transfers inflows (credit)	0.00	0.00	0.00	0.00	0.00	0.00
Capital Transfers, outflows (debit)	0.00	0.00	0.00	0.00	0.00	0.00
Nonproduced nonfinancial assets (credit)	0.00	0.00	0.00	0.00	0.00	0.00
Nonproduced nonfianncial assets (debit)	0.00	0.00	0.00	0.00	0.00	0.00
Financial Account; excluding financing items	273.37	125.68	147.70	368.01	188.39	179.62
Direct Investment	204.10	101.10	103.00	245.44	118.99	126.44
Direct investment abroad	0.00	0.00	0.00	0.00	0.00	0.00
Direct investment in Uganda	204.10	101.10	103.00	245.44	118.99	126.44
Portfolio Investment	8.27	17.66	-9.39	-10.87	-7.79	-3.07
Assets	-2.15	-2.15	0.00	0.00	0.00	0.00
Liabilities	10.42	19.81	-9.39	-10.87	-7.79	-3.07
Other Investment	61.00	6.92	54.08	133.44	77.19	56.25
Assets	-111.27	-103.79	-7.48	23.32	7.63	15.69
Liabilities				110.12	69.56	40.56
C. OVERALL BALANCE (A+B)	192.17	102.41	89.76	234.33	121.70	112.63
D. RESERVES AND RELATED ITEMS	-192.17	-102.41	-89.76	-234.33	-121.70	-112.63
Reserve assets	-143.37	-74.72	-68.65	-182.18	-97.60	-84.58
Use of Fund credit and loans	-48.85	-20.13	-28.73	-51.68	-23.92	-27.76
Exceptional Financing	9.24	1.88	7.35	4.44	2.98	1.46
Errors and Omissions	-9.19	-9.45	0.26	-4.92	-3.17	-1.75

Source: Bank of Uganda

7.2.2 Exports

Table 12 shows the composition of Uganda's merchandise exports for 2003/04 and 2004/05. Total export earnings from goods were recorded at US$786.3 million in 2004/05 compared to US$647.2 million realized in 2003/04. Exports in the second half of 2004/05 were recorded at US$439.4 million compared to the US$362.0 million recorded in the corresponding period of 2003/04. There was an improvement in the performance of both coffee and non-coffee exports. Coffee export earnings during the second half of 2004/05 amounted to US$88.0 million up from US$66.6 million realized in the corresponding period of 2003/04. Although export volumes fell from 1.39 million (60 kg) bags during the second half of 2003/4 to 1.28 million bags in the corresponding half of 2004/05, the 43.3 percent increase in the realized average unit price more than offset the decline in export volumes[5].

Similarly, there was an in increase in receipts from non-coffee exports. Non-coffee export earnings amounted to US$351.4 million, about 19.0 percent higher than the US$295.4 million realised during the corresponding period of 2003/04. The increase in non-coffee export earnings is largely accounted for by improved performance in cotton, fish and its products, hides & skins, simsim, flowers, oil re-exports and cobalt[6].

The value of simsim exports, in particular rose to US$2.8 million in the second half of 2004/05, compared to US$0.3 million in the first half[7]. In the same vein, receipts from cotton exports were recorded at US$34.8 million, up from US$6.5 million in the preceding half of 2004/05. Receipts from oil re-exports also rose to US$17.5 million in the second half compared to US$15.6 million in the first half of 2004/05 and US$12.5 million in the second half of 2003/04.

7.2.3 Imports

Total imports are recorded at US$812.3 million during the second half of 2004/05, an increase of 2.1 percent and 22.7 percent over the level recorded in preceding half of 2004/05 and the corresponding period 2003/04 respectively. Increase in imports was largely on account of the continued growth in private sector imports of merchandise. Government imports declined to US$70.4 million in the second half of 2004/05, compared to US$87.4 million in the first half.

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[5] The realized average unit price during the second half of 2004/05 was US$ 1.14 per kg, compared to US$ 0.80 per kg realized during the same period last year.

[6] Exports receipts from maize, tea, and electricity declined,

[7] Export volumes in particular rose to 4.040 metric tonnes from 0.410 metric tonnes in the previous period.

Table 12: Exports of merchandise (US$ mn)

	FY 2003/04	H1 2003/04	H2 2003/4	FY 2004/05	H1 2004/5	H2 2004/5
Total Exports	647.18	285.20	361.98	786.32	346.95	439.36
Coffee	114.13	47.55	66.58	144.53	56.56	87.97
Gross coffee shpmt (vol) ('000 60-Kg bags)	2.55	1.16	1.39	2.52	1.24	1.28
Av. unit value	0.75	0.68	0.80	0.96	0.76	1.14
Non-Coffee exports	533.05	237.65	295.40	641.79	290.40	351.39
Electricity	12.64	6.54	6.10	8.25	5.97	2.28
Volume (Gigawatts)	198.60	103.21	95.38	131.05	96.91	34.14
Unit value	0.06	0.06	0.06	0.06	0.06	0.07
Gold	58.49	24.51	33.98	71.33	39.84	31.49
Cotton	42.84	4.55	38.29	41.34	6.54	34.81
Volume ('000 mtons)	29.56	3.82	25.74	42.13	5.14	36.99
Unit value (US$/kg)	1.45	1.19	1.49	0.98	1.27	0.94
Tea	39.25	20.39	18.86	33.13	16.60	16.53
Volume ('000 mtons)	36.18	17.53	18.65	34.01	16.79	17.22
Unit value (US$/kg)	1.08	1.16	1.01	0.97	0.99	0.96
Tobacco	36.16	13.48	22.68	36.20	17.65	18.55
Volume ('000 mtons)	24.91	10.76	14.16	28.63	15.57	13.07
Unit value (US$/kg)	1.45	1.25	1.60	1.26	1.13	1.42
Fish & its prod. (excl. regional)	88.82	40.59	48.23	121.22	52.82	68.40
Volume ('000 mtons)	29.14	13.85	15.29	37.84	18.69	19.14
Unit value (US$/kg)	3.05	2.93	3.15	3.20	2.83	3.57
Fish & its prod. (regional exports)	29.31	13.39	15.91	48.39	21.09	27.31
Volume ('000 mtons)	32.05	15.24	16.82	40.39	19.95	20.43
Unit value (US$/kg)	0.91	0.88	0.95	1.20	1.06	1.34
Hides & skins	5.86	3.09	2.77	6.38	2.59	3.79
Volume ('000 mtons)	22.65	12.25	10.40	23.78	8.98	14.80
Unit value (US$/kg)	0.26	0.25	0.27	0.27	0.29	0.26
Simsim	3.38	0.85	2.54	3.07	0.25	2.82
Volume ('000 mtons)	5.38	1.51	3.87	4.45	0.41	4.04
Unit value (US$/kg)	0.63	0.56	0.65	0.69	0.60	0.70
Maize	18.76	8.87	9.89	13.29	6.10	7.20
Volume ('000 mtons)	97.64	39.76	57.88	52.49	25.54	26.95
Unit value (US$/kg)	0.19	0.22	0.17	0.25	0.24	0.27
Beans	4.87	1.94	2.93	4.33	1.69	2.64
Volume ('000 mtons)	17.26	7.68	9.58	14.17	5.31	8.86
Unit value (US$/kg)	0.28	0.25	0.31	0.31	0.32	0.30
Flowers	27.16	11.59	15.57	31.71	14.23	17.47
Volume ('000 mtons)	6.05	2.82	3.23	6.68	3.25	3.43
Unit value (US$/kg)	4.49	4.10	4.82	4.75	4.38	5.10
Oil re-exports	34.32	21.83	12.48	33.05	15.60	17.45
Cobalt	2.69	0.00	2.69	13.70	7.31	6.40
Volume ('000 mtons)	101.54	0.00	101.54	518.77	276.71	242.06
Unit value (US$/kg)	26.45	16.49	26.45	26.41	26.40	26.43
Others	128.53	66.04	62.49	176.40	82.14	94.26

Source: Bank of Uganda

7.2.4 Services account

There was a continued increase in the receipts from exports of services. These were recorded at US$257.7 million in review period, up from US$230.1 million in the previous half and US$207.7 million in the corresponding period in 2003/04. This was mainly on account of the inflows through computer & information services, financial services and other business services. Imports of services similarly increased – these were recorded at US$444.9 million, 18.7 percent higher than the US$374.8 million in the first half of FY 2004/05. This was mainly on account of the increase in outflows associated with freight on imports of goods, insurance and other business services.

7.2.5 Income account

The income account recorded a deficit of US$80.6 million in the second half of 2004/05 – an improvement of 7.0 percent over the deficit of US$86.7 million during the preceding half. This was on account of increased income earnings on other investments i.e. interest earned on both BOU deposits and commercial banks' deposits abroad.

7.2.6 Current transfers

Net current transfers were recorded at a surplus of US$573.8 million in the second half of 2004/05, compared to the surplus of US$613.2 million in the first half. This development is largely accounted for by both reduced inflows and increased outflows of the private sector.

7.3 The capital and financial account

Net inflows of foreign direct investment continued to increase – recorded at US$126.4 million, up from the US$118.9 million in the preceding half of 2004/05 and US$103.0 million recorded during the same period of 2003/04. There was a US$3.26 million build-up in holdings of currency and deposits assets of banks during the review period, vis-à-vis the run-down of US$43.0 million recorded in the first half of 2004/05. Similarly, there was a decrease of US$11.0 million in the currency and deposit liabilities of banks, compared to the increase of US$12.1 million in the previous period. The capital and financial account generally deteriorated to a surplus of US$179.6 million in the review period, from US$188.4 million in the previous half mainly due to lower disbursements of official aid in form of loans.

7.4 Foreign reserves

Gross foreign exchange reserves were recorded at US$ 1,325.6 million as at end-June 2005, an increase of US$16.9 million from the level recorded in December 2004. These are estimated to cover 5.9 future months of imports of goods and services. The build up of reserves during this period is largely due to increased budget support, increase in export earnings and a relatively stable exchange rate.

7.5 External debt

During the second half of 2004/05, maturities falling due on medium and long-term public and publicly guaranteed debt (excluding IMF credit) were estimated at US$72.3 million. Debt owed and paid to the International Monetary Fund (IMF) was US$28.7 million – with principal maturities of US$27.7 million, and the balance consisting of interest payments and other charges. Of the total maturities, cash debt service amounted to US$49.5 million, while HIPC resources amounted to US$23.1 million during the same period.

Total cash payments of medium and long-term public and publicly guaranteed debt (excluding IMF) during 2004/05 amounted to US$82.9 million compared to US$66.4 million in 2003/04. Of the total debt service payments, US$45.1 million is from the HIPC debt relief initiative. External debt indicators up to end June 2004/05, indicate that the total debt stock will was approximately US$4,416.3 million, which is about 50.0 percent of GDP. The evolution of key external debt indicators is shown in Table 13 below.

Table 13: Key debt indicators

Memorandum items:	FY 2003/04	H1 2003/04	H2 2003/04	FY 2004/05	H1 2004/05	H2 2004/05
Exports of Goods and Services	1,013.96	444.29	569.67	1,274.15	577.07	697.08
Debt Stock (US$ million)	4,464.92	4,485.59	4,464.92	4,416.30	4,753.79	4,416.30
GDP at Market prices (US$ million)	6,822.38	6,316.77	7,054.79	8,701.82	13,301.85	8,754.46
Debt Stock/GDP	65.45%	71.01%	63.29%	50.75%	35.74%	50.45%
Debt Stock/Exports of Goods and Services	440.34%	1,009.60%	783.78%	346.61%	823.78%	633.54%
Debt Service/Exports of Goods and Services	15.97%	19.81%	17.56%	14.45%	16.82%	16.15%

Source: Bank of Uganda

8. REAL ECONOMY DEVELOPMENTS

8.1 Economic Growth

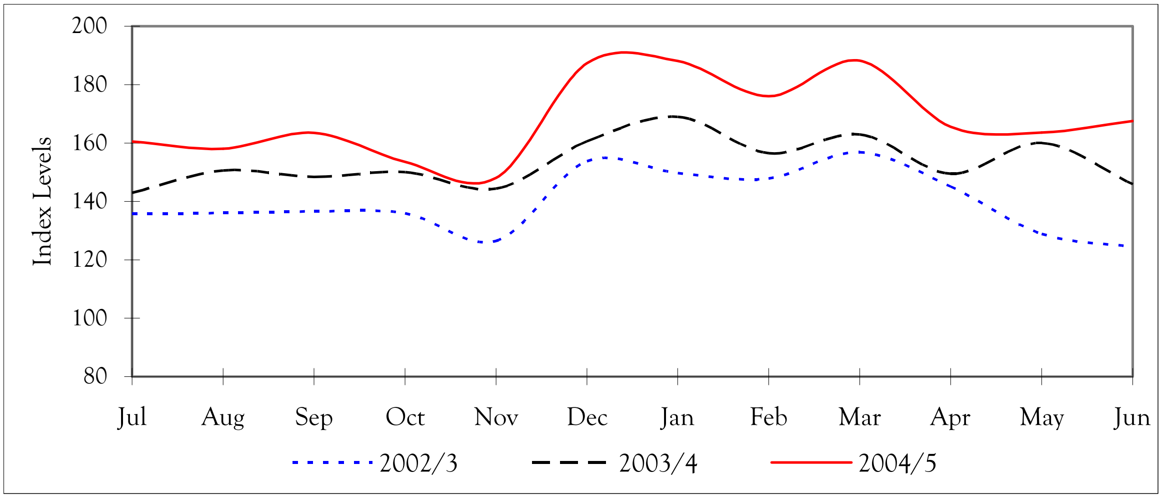
The economy grew by 5.7 percent in 2004/05, slightly below the growth rate of 5.9 percent realized in 2003/04. Monetary GDP grew by 6.6 percent while non-monetary GDP increased by only 1.8 percent on account of a decline in non-monetary food crop production. Non-monetary food crop registered a negative growth rate of 0.3 percent and this is attributed to the drought experienced during the financial year 2004/05. The fastest growing sector was transport and communications, which grew by 17.9 percent. Construction; and mining and quarrying sub-sectors also registered growth rates of more than 10 percent. Formal manufacturing output is projected to have grown by 7.5 percent compared to 4.7 percent in the previous fiscal year.

8.2 Index of Industrial Production

The performance of the manufacturing sector as measured by the Index of Industrial Production[8] has generally improved during the last three financial years. As shown in Figure 8, the index followed the same seasonal pattern over the three years, reflecting a response in production to seasonal variations in demand.

[8] The index covers major establishments producing sugar, beer, soft drinks, cigarettes, cement, textiles, laundry soap, edible oil and metal products.

Figure 8: Trends of the major index of industrial production



Source: Uganda Bureau of Statistics

A quarterly analysis of the movement of the index during 2004/05 shows that the all item index increased during the first three quarters but declined in the last quarter. The drop in the index during the fourth quarter is attributed to huge cutbacks in the production of sugar (37%), edible oil (28%), and soft drinks (10%).

The decline in the production of sugar was due to the temporal closure for annual repair and maintenance of two factories, one in April 2005 and another in June 2005. The production of soft drinks on the other hand declined largely on account of cutback in production by one major manufacturing establishments in April and May due to a fall in demand for its brands, while the production of edible oil suffered a setback due to constraints in the supply of production inputs throughout the quarter. Developments in the index are shown in Table 14 below.

Table 14: Index of Industrial Production for FY 2002/3 – 2004/5

Fiscal year	Sugar	Beer	Soft Drinks	Cigarettes	Textiles	Cement	Laundry Soap	Edible Oil	Metal Products	All Items
2002/3	180.7	111.7	135.8	62.9	66.1	165.8	160.1	142.5	176.3	139.8
2003/4	190.5	115.1	157.1	74.3	91.4	194.4	158.4	163.9	197.1	153.4
2004/5	187.1	118.8	200.9	62.1	110.0	225.7	188.6	174.6	224.9	168.3
HI 2004/05	190.4	115.3	176.0	59.5	99.3	223.8	172.0	189.8	203.0	161.9
H2 2004/05	184.0	122.3	225.9	64.9	120.8	226.1	205.1	159.4	245.3	174.9
Q1 2004/05	198.3	111.2	162.8	50.9	95.1	235.7	173.5	174.8	210.7	160.7
Q2 2004/05	182.4	119.4	189.2	68.1	103.5	211.9	170.5	204.8	195.3	163.0
Q3 2004/05	225.2	119.6	237.7	58.7	122.8	221.5	209.6	185.5	242.9	184.2
Q4 2004/05	142.8	124.9	214.0	71.2	118.8	230.8	200.5	133.3	247.8	165.6

Source: Uganda Bureau of Statistics

8.3 Fuel Consumption

The volume of major fuel[9] imports during the year ended June 2005 exceeded that of the previous two years as shown in Table 15. During 2004/05, premium, diesel and kerosene imports rose by 4.1 percent, 18.6 percent, and 3 percent respectively, from the levels registered in 2003/04. The increase in fuel imports is largely attributed to the need to satisfy the increase in demand for these major petroleum products.

[9] Major fuel products include premium, diesel and kerosene

With respect to sales, preliminary estimates indicate that diesel and kerosene sales increased by 11.9 percent to 282.5 million litres from 252.5 million litres in the previous year. Sales of kerosene also recorded an increase of 6.2 percent. Premium sales, on the other hand, declined by 3.7 percent during the same period. On a half-year basis, imports of premium, diesel and kerosene recorded during the second half of 2004/05 exceeded those of the first half. However, with the exception of diesel, whose sales rose from 130.5 million litres to 152 million litres, the sales of premium and kerosene declined (see Table 15). The increase in diesel sales is partly attributed to increase in demand by the industrial sector and the running of thermal electricity generators at the Lugogo power station.

Table 15: Imports and sales volumes of major fuel products (million of litres)

		FY 2002/3	FY 2003/4	FY 2004/5	H1 2004/05	H2 2004/05
Premium (PMS)	Imports	224.9	222.5	231.6	112.30	119.40
Diesel (AGO)		250.1	281.5	333.7	149.70	183.90
Kerosene (BIK)		51.1	54.9	56.6	28.00	28.60
Premium (PMS)	Sales	205.7	191.5	184.4	92.60	91.80
Diesel (AGO)		243.7	252.5	282.5	130.50	152.00
Kerosene (BIK)		51.3	43.3	45.9	27.60	18.40

Source: Ministry of Energy and Mineral Resources

8.4 Electricity consumption

The average number of customers during the 2004/5 was 265,774, 90 percent of which are domestic consumers. Commercial consumers comprised only 9 percent of the total customer base. The customer base rose by 4.6 percent between the first and second halves of 2004/05 (see table 16). The increase in the customer base over this period is attributed to the continued restructuring of the electricity sub sector that has resulted in improved service delivery.

Table 16: Electricity consumption by category of consumer, FY 2002/3 – 2004/5

	FY 2002/3	FY 2003/4	FY 2004/5	H1 2004/5	H2 2004/5
Domestic	203,086	221,110	240,736	235,551	245,921
Commercial	21,368	22,383	23,941	23,274	24,608
Large scale Industrial	81	94	103	98	108
Medium scale industrial	667	697	666	651	681
Street Lighting	311	335	328	183	323
Total	**225,513**	**244,619**	**265,774**	**259,756**	**271,640**
Domestic	382.80	439.97	340.13	147.38	192.75
Commercial	148.32	147.78	142.82	67.38	75.44
Large scale Industrial	255.64	290.69	344.51	165.52	178.99
Medium scale Industrial	199.47	262.51	231.76	117.81	113.95
Street Lighting	3.20	2.36	1.04	0.59	0.45
Total	**989.43**	**1,143.32**	**1,060.26**	**498.68**	**561.58**

Source: UEDCL and UMEME (UMEME statistics start March 2005)

Note: No data exists for number of customers in January and February 2005 because of the transition that was made from UEDCL to UMEME so March numbers were used to represent the quarter. Figures for consumption for the same period are only estimates.

Electricity consumption however decreased as a result of lower production levels. Low water levels affected the amount of electricity that could be generated. To be able to cope with the ever-increasing demand for electricity, exports of electricity were reduced in December 2004 and Uganda started importing electricity from Kenya. In addition, in May 2005, thermal generation of electricity commenced.

8.5 Investment

In the year to June 2005, the value of projects licensed[10] increased by 30 percent from $520.0 million recorded in the previous year to $675.7 million. The increase was mainly attributed to big investments planned in the water and energy; manufacturing; and agriculture, forestry and fishing sub sectors. The Ministry of Energy and Mineral Development is undertaking exploration activities and high value projects planned for this sector may be in response to these development efforts. The total number of planned projects recorded for the year ended June 2005 is 210, up from 173 projects recorded in the previous year. The planned employment of 18,477 jobs during the financial year 2004/5 is however lower than that of 21,411 for the previous year. Details of investment activity during the period July 2003 to June 2005 are shown in Table 17 below.

Table 17: Uganda Investment Authority (UIA) performance indicators and targets (July 2003 – June 2004; July 2004 – June 2005)

	Jul '03 – Jun '04				Jul '04 - Jun '05			
Sector	Projects Licensed	Planned Investment (US$ mn)	Planned Employment	Share of Investment (%)	Projects licensed	Planned Investment (US$ mn)	Planned Employment	Share of Investment (%)
Agriculture, forestry & fishing	33	207.86	7,679	40.0%	54	95.77	5,084	14.2
Manufacturing	52	49.20	3,711	9.5%	70	116.71	4,552	17.3
Construction	12	29.63	1,318	5.7%	16	16.38	774	2.4
Mining & quarrying	8	21.03	589	4.0%	5	20.52	1,149	3.0
Finance services	0	0	0	0.0%	1	0.75	27	0.1
Tourism	18	44.91	2,225	8.6%	16	13.48	609	2.0
Professional Services	8	18.32	916	3.5	11	10.54	547	1.6
Social Services	6	9.25	504	1.8	-	-	-	-
Water & Energy	8	116.78	3,432	22.5	6	298.70	2,584	44.2
Transport, Comm. & Storage	11	9.35	330	1.8	10	58.63	1,460	8.7
Real Estate	2	1.00	47	0.2	7	25.67	616	3.8
Other business services	15	12.71	390	2.4	14	675.66	1,075	2.8
Total	173	520.03	21,141	100.0	210	675.66	18,477	100.0

Source: Uganda Investment Authority
Data is available on half-year basis.

8.6 Activity at the Uganda Securities Exchange

Trading at the Uganda Securities Exchange during the financial year 2004/5 was higher than that in the previous two years both in terms of turnover and shares traded. Activity was vibrant during the second half of 2004/05 compared to the first half of the same financial year as can be seen from Table 18 below. This was as a result of the listing of DFCU in October 2004. During each of the nine months to June 2005, trading at the DFCU counter constituted between 60 and 90 percent of total trading activity. Most of the investments in DFCU shares are by

[10] Information on actual investment activity is not available thus analysis is limited to intentions and is based on licenses issued by the Uganda Investment Authority.

institutional investors and trading has been quite vibrant because some of these investors failed to buy shares during the initial public offer. The increased activity during the second half of 2004/05 was also partly attributed to enhanced confidence in stocks listed on the USE. During 2004/05, trading activity, both in terms of turnover and number of shares traded increased in each successive quarter as shown in Table 18.

Table 18: Trading at Uganda Securities Exchange for FY 2002/3 – 2004/5

	FY 2002/3	FY 2003/4	FY 2004/5	H1 2004/5	H2 2004/5
Shares traded (number)	584,484	245,451	7,716,864	314,115	7,402,749
Turnover (Shs mn)	1,108.0	310.65	3,355.07	177.12	3,177.95
Trading days	95	99	98	50	48

Source: USE

9. MACROECONOMIC OUTLOOK FOR 2005/06

The macroeconomic programme for 2005/06 initially aimed at achieving a GDP (factor cost) growth rate of 6.4 percent and inflation of less than 5.0 per cent. However, on account of exogenous factors, the GDP growth number has now been revised to 6.1 per cent. Factors including a slower rebound in agricultural output, the delayed commissioning of the two power units at Kiira dam, a slower growth in monetary construction due to reduced public construction expenditure and higher energy prices are largely responsible for this development. Fiscal policy in 2005/6 initially aimed at reducing the budget deficit (excluding grants) to 9.2 percent of GDP but this is now projected at 8.7 per cent. This target will be achieved through a reduction in recurrent expenditure and increase in domestic resource mobilization. Tax revenue in particular is projected to increase by 0.5 percentage points of GDP to 13.4 percent of GDP. Underlying inflation is projected at 4.9 percent, while the current account deficit is projected at about 13.0 percent of GDP, which is consistent with a viable medium-term debt position. International reserves are expected to remain at comfortable levels of around 5.8 months of import cover of goods and non-factor services. The monetary programme will continue to target base money, which is programmed to expand by 12.2 percent in 2005/06.

10. ADDENDUM

Developments during the first five months of 2005/06

1 Monetary policy and exchange rate management

- During the first five months of 2005/06, the conduct of monetary policy remained focused on promoting price stability.

- A cautious monetary policy stance was maintained. In general, monetary policy was in line with the broad macroeconomic objective for 2005/06

- REPOs and the net-issuance of Treasury bills and Treasury bonds were used for short-term intra-auction liquidity management and liquidity sterilization, respectively.

- BOU's presence in the IFEM remained consistent with the objective of a market-determined exchange rate.

2. Prices and market developments

Inflation:

- The upward trend in headline inflation observed since the last quarter of FY 2003/04 reversed during the first four months of 2005/06. The average annual headline inflation rate for the first four months of FY 2005/06 eased to 7.7 percent, down from 11.4 percent in the four months to June 2005. In October 2005, headline inflation was recorded at 5.0 percent down from 11.5 percent in June 2005.

- Underlying inflation remained relatively stable, recording an average of 5.6 percent during the same period.

- Average food crop inflation declined to 15.3 percent during the same period compared to 34.6 percent registered in the last four months of 2004/05.

Domestic money and securities markets

- Consistent with the achievements registered so far, active participation was recorded in both primary and secondary markets during the period July – November 2005.

- During this period REPOs of longer dated tenors were issued. Although this had a net effect of marginally scaling up the REPO rate, it did succeed in moping-up liquidity for longer periods.

- The 91-day Treasury bill rate averaged 8.3 percent in the first five months of FY 2005/06, down from 8.9 percent in the last five months of FY2004/05.

Foreign exchange market and exchange rate:

- On a monthly average basis, the exchange rate depreciated from Shs 1738 per US dollar in June 2005 to Shs. 1834 per US dollar in November 2005.

- The spread between buying and selling rates in the IFEM remained relatively stable, within the range of Shs 8.0 – Shs. 15.

- BOU continued with the daily sterilization policy through to 30 November, 2005. This policy was however temporarily discontinued in December due to the expected huge inflows that are likely to cause appreciation pressures in the foreign exchange market, and the expected tightness in liquidity conditions relative to the desired levels.

3. Monetary and financial sector aggregates

Base money:

- In gross terms, base money increased to Shs 955.4 billion at the end of November 2005 from the June, 2005 level of Shs 927.8 billion. Excluding commercial banks' holdings of BOU instruments, base money grew by Shs 21.13 billion during the same period. This was consistent with the BOU monetary policy stance of ensuring price stability.

Broad money:

- Data available on broad monetary aggregates indicates that in the period to September 2005, M3 grew by 3.1 percent relative to the outturn as at 30th June 2005. This is in contrast to the decline of 0.18 percent that was observed between September 2004 and June 2004.

- Within the components of M3, private sector deposits grew by Shs 54.6 billion, while currency in circulation expanded by Shs 13.56 billion. The growth in private sector deposits, in part reflects increased deposit mobilization by the commercial banks.

- Private sector credit increased by 8.1 percent to Shs 1243 billion while NFA declined by 1.7 percent to Shs 2602.9 billion during the same period.

Non-Banking financial institutions:

- The assets of credit institutions increased from Shs 205.99 billion in June 2005 to Shs 208.15 billion in September 2005. Total loans and advances rose by Shs 5.24 billion over the same period.

- Total deposits remained the same at Shs 94.9 billion in June and September 2005.

- The three Micro Deposit-taking Institutions (MDIs) licensed and supervised by BOU were reported to be holding Shs 8.039 billion in assets. Of this amount, Shs 48.92 billion was in net loans outstanding. Total deposits held at the MDIs were Shs 10.20 billion.

4. Government fiscal operations

Revenue:

- During the period July to September 2005, government revenue and budget support grant disbursements amounted to Shs. 554.7 billion. This was 20.1 below the programmed level of Shs. 694.4 billion.

- This performance also represented a decrease of Shs. 491.0 billion or 47.0 percent over the estimates for the quarter ended June 2005.

Expenditure:

- Total government expenditure and net lending amounted to Shs. 545.7 billion, 35.6 percent lower than the programmed level. It is also lower than the Shs. 950.8 billion expenditure of the preceding quarter.

This was largely attributed to the expenditure controls and accounting procedures followed at the beginning of every financial year.

5. External sector and balance of payments developments

Overall balance:

The preliminary outturn of the external sector indicates that the overall balance was a deficit of US$60.81 million in the first quarter of 2005/06 in contrast to a surplus of US92.08 million in the last quarter of 2004/05.

Current account balance:

- Between the last quarter of 2004/05 and the first quarter of 2005/06, the current account declined from a surplus of US$17.58m to a deficit of US$ 162.23 million. This was mainly explained by declines in exports and the high increase in imports.

- Preliminary information indicates that total exports declined from US$ 234.13 million to US$ 207.59 million, while imports grew from US$426.09 million to US$482.05 million during the same period.

The capital and financial account balance:

- Net foreign direct investment during the first quarter of 2005/06 was US$ 66.64 million, a slight increase from US$ 63.22 million that was recorded in the last quarter of 2004/05. This is mainly on account of increased liabilities to direct investors.

External debt:

- Total debt maturities for medium and long-term public and publicly guaranteed external debt amounted to US$44.568 million in the first quarter of 2005/06. Of this amount, US$ 43.48 million was for cash debt service while US$ 1.1 million was HIPC resources.

- As a result, BOU reserves declined from US$1325.5 million in June 2005 to US$ 1250 million in September 2005.

6. Real economy developments

Index of Industrial Production:

- The manufacturing sector as measured by the Index of Industrial Production[11] grew by 4.3 percent, 4.2 percent and 1.0 percent in July, August and September 2005 respectively. The growth in July 2005 was attributed to growth in Sugar and beer production while in August, Cigarettes, textiles, metal products and laundry soap boosted the rise in the index.

Electricity consumption:

- The number of customers grew by 0.9 percent and by 1.7 percent in July and August 2005 respectively to 256,472, of which 90 percent were domestic consumers. Commercial consumers accounted for only 10 percent of the total customer base.

[11] The index covers major establishments producing sugar, beer, soft drinks, cigarettes, cement, textiles, laundry soap, edible oil and metal products.

- Electricity consumption decreased by 2.7 percent and by 2.4 percent in August and September 2005. This was as a result of lower production levels largely on account of low water levels.

Uganda Securities Exchange:

- Trading activity at the Uganda Securities Exchange (USE) gained during October 2005 compared to September 2005. The total turnover grew by Shs 17 million (14.7%) during the period.

- The improved performance at the USE is attributed to market response to corporate action. As companies announced and paid dividends and awarded bonus shares, more investors were attracted.

- The DFCU and UCL counters dominated activity with 73.6 percent and 25.8 percent of total turnover in the October 2005.

- USE's market capitalisation rose to Shs 3,549.3 billion October 2005.