BANK OF UGANDA

STATE OF THE
ECONOMY AS AT END JUNE 2006

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EXECUTIVE SUMMARY

1.1 Introduction

This paper outlines the macroeconomic framework for 2005/06 and the performance of the economy over the six months to June 2006. Overall, the macroeconomic performance during this period is in line with the programme benchmarks.

1.2 Macroeconomic objectives for 2005/06

Real GDP growth was initially projected at 6.0 percent. However, on account of adverse exogenous factors, from both domestic and external sources, real GDP growth rate was revised downwards to 5.3 per cent. These factors have also resulted into an upward revision of the annual average headline inflation rate to 8.5 percent from the initial projection of 4.5 percent while the average underlying inflation was also revised to 5.2 from the initial projection of 4.2 per cent. On a fiscal year basis, annual headline inflation declined to 6.6 percent in 2005/06 compared to 8.0 percent in 2004/05, while annual underlying inflation rose slightly to 5.3 percent compared to 4.7 percent registered in 2004/05.

Consistent with the attainment of the inflation objective and a stable environment for financial intermediation, Bank of Uganda was to limit growth in broad money (M3) to about 13.5 percent while base money was projected to grow at 12.6 per cent. The fiscal deficit, excluding official grants, was projected to increase to 9.2 percent of GDP in 2005/6 from the 8.6 percent of GDP recorded in 2004/5, while it was envisaged that the external current account deficit would be 13.9 percent of GDP. International reserves were expected to decline marginally to a level of about 6.2 months of imports of goods and non-factor services by end of June 2006

1.3 Conduct of monetary policy and exchange rate management

For the period to end June 2006, 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 2005/06. 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 line with the fundamentals, the shilling depreciated against the US dollar over the six months to June 2006 driven by an increase in outflows relative to inflows.

1.4 Prices and market developments

- **Inflation:** Inflationary pressures continued to prevail mainly on account of increases in food crop prices due to drought. The rate of annual headline inflation rose to an average of 6.7 percent during the period under review, up from 6.5 percent during the first half of 2005/06. However, this was much lower than the annual headline inflation average of 10.5 percent registered over the same period in 2004/05. The average of annual underlying inflation rate for the second half of 2005/06 declined to 5.3 percent, from 5.5 percent registered in the first half of the financial year.

- **Domestic money market and securities markets:** Active participation was recorded in both primary and secondary markets during the second half of 2005/06. Interest rates on Treasury bills were generally lower over the period January to June 2006 compared to the rates recorded between July and December 2005. The 2-year and 3-year bond rates also declined gradually and were lower than the rate recorded in the first half.

- **Foreign exchange market and exchange rate:** Depreciation pressures on the exchange rate were evident for most of the six months period to June 2006. The real effective exchange rate (REER) index depreciated by 6.0 percent to an average index of 121.9 in the second half of 2005/06 from an index of 115.0 in the first half of 2005/06. This compares with a depreciation of 2.3 percent during the corresponding period of 2004/05.

1.5 Monetary and financial sector aggregates

- **Base money:** Base money in gross terms declined by 1.9 percent in June 2006 over its December 2005 level. Excluding commercial banks' holdings of BOU instruments, it declined by 0.5 per cent from Shs. 1,051.21 billion in December 2005 to Shs. 1,046.11 billion in June 2006. These developments represent a slower expansion in base money over the last six months compared to growth in the preceding half.

- **Broad money:** Broad money (M3) grew by 5.5 per cent from Shs. 3,101.5 billion in December 2005 to Shs. 3,271.6 billion in June 2006. This represents a slight deceleration compared to the 10.3 percent growth recorded in the previous period.

1.6 Government fiscal operations

- **Revenue:** Government revenue excluding grants during the second half of 2005/06 are estimated at Shs. 1,168.8 billion, which was above Shs. 1,090.9 billion realised in the first half of 2005/06. However, the corresponding Grants slightly declined to Shs. 460.2 billion from Shs. 462.6 billion. Domestic revenue as a percentage of GDP is projected to remain at 13.3 percent of GDP in 2005/06.

- **Expenditure**: Total government expenditure, including net lending is estimated at Shs. 2,153.0 billion in the second half of 2005/06 up from Shs. 1,623.6 billion recorded in the first half of 2005/06. Expenditure as a percentage of GDP is estimated at 22.2 percent in 2005/06 down from 22.4 percent in 2004/05.

- **Fiscal balance:** The fiscal deficit (excluding grants) is estimated at 8.9 percent of GDP up from 8.6 percent in 2004/05. On a commitment basis, the deficit is estimated at 3.5 percent of GDP in 2005/06 up from 0.9 percent of GDP in 2004/05.

1.7 External sector and balance of payments developments

- The **overall balance of payments position:** The overall balance of payments position was estimated at a surplus of US$119.7 million during the second half of 2005/06, compared to a surplus of US$110.8 million realised in the corresponding period in 2004/05, and US$66.4 million in the first half of 2005/06.

- **The current account:** The current account deficit was estimated at US$118.4 million during the second half of 2005/06 compared to US$124.0 and US$70.8 in the first half of 2005/06 and the corresponding period of 2004/05 respectively. The narrowing of the deficit relative to the first half of 2005/06 was largely due to the increase in exports and income receipts relative to the previous periods.

- **Exports of goods:** Export proceeds during the second half of 2005/06 were valued at US$465.0 million. For the entire fiscal year, US$890.0 million was earned from exports compared to US$786.3 million in 2004/05 representing a 13.2 percent growth rate. In the second half of 2005/06, coffee exports receipts were recorded at US$89.7 million, compared to the US$88.0 million recorded in the corresponding period of 2004/05. Receipts from non-coffee exports were recorded at US$375.3 million, 6.8 percent higher than the corresponding period in 2004/05 and 1.0 percent higher than US$341.2 million recorded isthe first half of 2005/06.

- **Imports:** Imports of goods during the second half of 2005/06 were recorded at US$1,031.2 million, 25.1 percent and 7.4 percent higher than the import bill in the corresponding period of 2004/05 and the first half of 2005/06 respectively. This was largely on account of continued growth in private sector merchandiseimports. For the fiscal year 2005/06, merchandise imports were estimated at US$1,991.8 million.

- **Services and income account:** Compared to the first half of 2005/06, inflows on account of services increased by 16.1 percent to US$271.2 million during the second half. Income inflows were also recorded at US$29.4 million in the second half of 2005/06. However, the increased outflows on both accounts resulted in a deficit of US$250.5.million, compared to the deficit of US$ 222.8 million recorded in the corresponding period of 2004/05.

- **Current transfers:** Net current transfers surplus increased to US$698.3 million in the second half of 2005/06, compared to US$666.5 million and US$537.0 million realised in the first half of 2005/06 and the corresponding half of 2004/05, respectively.

- **The capital and financial account:** Net foreign direct investment during the second half of 2005/06 was estimated to have increased by 2.9 percent to US$130.4 million in comparison to the US$126.7 million recorded in the second half of 2004/05.

- **Foreign reserves:** Gross foreign exchange reserves were recorded at US$ 1,408.1 million as at end-June 2006, an increase of US$82.6 million from the level recorded in June 2005. These are estimated to cover 6.5 months of future imports of goods and services compared to the 6.1 months of import cover in June 2005. The build up of reserves during this period was largely due to increased budget support, the lower than expected sales of foreign exchange to the IFEM on account of the observed foreign exchange market stability and debt forgiveness from IMF, amounting to US$126.8 million.

- **External debt:** During the second half of 2005/06, maturities falling due on medium and long-term public and publicly guaranteed debt (excluding IMF credit) were estimated at US$61.2 million. Payments to the International Monetary Fund (IMF) amounted to US$0.029 million, consisting entirely of interest payments and other charges. External debt indicators up to end June 2005/06, indicate that the total debt stock was approximately US$4,464.4 million.

1.8 Real economy developments

- **Economic growth:** The economy is projected to have slowed down in 2005/06. Real Gross Domestic Product at market prices is estimated to have grown by 5.3 percent in 2005/06 down from a rate of 6.6 percent recorded in 2004/05 largely on account of the prolonged drought and the energy problems the country continued to face.

- **Manufacturing Sector:** In spite of reduced supply of energy and its attendant higher prices, the performance of the manufacturing sector as measured by the Index of Industrial Production showed substantial improvement in the second half of 2005/06. However, production of soft drinks, cigarettes, textiles, laundry soap and metal products declined in the period under review. Significant reduction was mostly notable in the production of cigarettes, which eventually ceased in April 2006.

- **Energy Sector:** Imports of Diesel, Premium and Kerosene increased in the second half of 2005/06 compared to the second half of 2004/05 mainly on account of rising international oil prices. However, when compared to the first half of 2005/06, these imports recorded lower values. Consumption of the 3 products, as depicted by sales volumes, increased during the second half of 2005/06, compared to the corresponding half of 2004/05. However, between the first and second halves of 2005/06, while consumption of diesel and premium increased, consumption of kerosene declined. Given that kerosene is mainly consumed by the poor folk, increase in its pump price may have led to a decline in its consumption.

- **Electricity Consumption:** The prolonged drought experienced in the last half of 2005 reduced the country's effective hydropower generation capacity thus reducing UMEME Limited purchases of electricity, during the period under review. The decline in electricity generation was further exacerbated by the rise in demand, as indicated by the increase in the number of customers. The rise in tariff rates, over the period under review, coupled with the power-rationing schedule, resulted in a decline in consumption of electricity.

- **Investment:** In the second half of 2005/06, while the number of projects licensed increased, planned investment declined compared to the second half of 2004/05 but rose compared to the first half of 2005/06. Investor confidence dips and boosts are thought to explain these changes.

- **Capital Markets:** The Uganda Securities Exchange (USE) recorded substantial gains in activity in the second half of 2005/06 as represented by a rise in the turnover and market capitalization. The USE recorded a cross listing of a Kenya-based Insurance firm and also increased the number of trading days from 2 to 3 per week in the period under review.

- **Credit –Leasing:** In the second half of 2005/06, the value of assets disbursed declined. The fluctuating values of leasing disbursements may be partly attributed to the terms of secured finances.

1.9 Medium-term outlook and challenges

- **Medium term outlook:** The medium-term outlook is promising. GDP is projected to grow at an average rate of about 6.0 percent over the next three years and both annual underlying and annual headline inflation rates are expected to stabilize at or below the percent level. Gross national savings and domestic investment is expected to rise to more than 22 percent of GDP. Revenue performance is also projected to rise to about 14 percent of GDP.Export receipts are projected to increase by about 10 percent per annum, while the terms of trade are expected to improve as the drive to diversification gains momentum. In order to address the current energy crisis, plans are underway to construct 2 hydropower projects at Bujagali and Karuma and to procure additional thermal power.

- **Challenges:** Notwithstanding the promising medium-term outlook however, significant challenges still lie ahead in the near term. First, sustaining high economic growth rates and macroeconomic stability should remain the key objectives of economic policy in the medium-term, as any policy slippage will be detrimental to the national development aspirations. Secondly, sustaining high growth and low inflation in an environment of ever increasing international oil prices amidst persistent power shortages on the domestic scene calls for concerted efforts by government to address the energy crisis.

- **Bank of Uganda's commitment:** Bank of Uganda recognises the need to further deepen the financial sector in order to make it more robust and resilient to shocks that could emanate from domestic and/or external sources. In addition, it is mindful of the challenges it has in supporting governments poverty reduction efforts through achieving and sustaining a growth rate of 7.0 percent per annum, and increasing access of the poor to financial services.

1. INTRODUCTION

This paper provides an analysis of the performance of the economy in the period January to June 2006 against the performance benchmarks of the 2005/06 macroeconomic framework and the performance during the preceding period and the corresponding period of 2004/05. Overall, the developments in aggregates were in line with the performance benchmarks. The rest of the paper is structured as follows: Section 2 provides an overview of the macroeconomic objectives for 2005/06; while Section 3 discusses the management strategies and policy actions undertaken during the period. Sections 4 - 8 provide an analytical assessment of the performance in light of the management strategies undertaken during the period under review.

2. MACROECONOMIC OBJECTIVES FOR 2005/06

Real GDP growth was initially projected at 6.0 percent. However, on account of adverse exogenous factors (both domestic and external)[1], real GDP growth rate was revised downwards to 5.0 per cent. These factors have also resulted into an upward revision of the annual average headline inflation rate to 8.5 percent from the initial projection of 4.5 percent while the average underlying inflation was also revised to 5.2 percent from the initial projection of 4.2 per cent. Consistent with the attainment of the inflation objective and a stable environment for financial intermediation, Bank of Uganda was to limit growth in broad money (M3) to about 13.5 percent while base money was projected to grow at 12.6 per cent.

The fiscal deficit, excluding official grants, was projected at 8.9 percent of GDP in 2005/6 from the 9.5 of GDP recorded in 2004/5, while it was envisaged that the external current account deficit would be 13.9 percent of GDP. International reserves were expected to decline marginally to a level of about 6.2 months of imports of goods and non-factor services by end of June 2006. These objectives were 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

The conduct of monetary policy remained focused on promoting price stability so as to create conditions conducive to sustained growth. This was however, done in a

[1] The domestic factors include drought, which affected agricultural output; energy shortages resulting into electricity load shedding in the second half of the financial year. The external factors include the continued rise in the international oil prices.

cautious manner in order not to exacerbate instability in the financial 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 developments. 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 macroeconomic objectives for 2005/06, Bank of Uganda maintained a cautious monetary policy stance to contain inflation within targeted levels.

During 2005/06, interest rates on treasury bills were relatively stable and comparable to those that prevailed in the last financial year. This is largely attributed to the fiscal restraint and the continued use of long-term government bonds. Long-term securities have helped ease the pressure on treasury bills particularly when the appreciation pressures in the foreign exchange market constrain BOU's ability to sale the foreign exchange amounts programmed in the period.

Bank of Uganda continued with 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 2006, the shilling depreciated against the US Dollar, with a few incidences of excessive depreciation pressures in the months of March to June 2006, which required Bank of Uganda's intervention in the market to restore stability. Daily sterilization using foreign exchange sales was done in the entire period under review.

4. DOMESTIC PRICE AND MARKET DEVELOPMENTS

4.1 Domestic prices

During the second half of 2005/06, inflationary pressures continued to prevail mainly on account of increased food crop prices due to the drought. The rate of annual headline inflation surged to an average of 6.7 percent, up from 6.5 percent during the first half of 2005/06. However, this was lower than the annual headline inflation average of 10.5 percent registered over the same period in 2004/05. The annual food crops inflation averaged 12.4 percent during this period compared to 10.7 percent recorded in the first half of 2005/06.

The average annual underlying inflation rate declined to 5.0 percent for the second half of 2005/06, from 5.5 percent registered in the first half of the financial year. The decline accrued to a slow down in the average prices of services, which rose by 4.8 percent compared to a rise of 6.5 percent in the previous period. On a fiscal year basis, annual headline inflation declined to 6.6 percent in 2005/06 compared to 8.0 percent in 2004/05 while annual underlying inflation rose slightly to 5.3 percent compared to 4.7 percent registered in 2004/05.

Overall, the inflationary outturn during the second half of 2005/06 was attributed to a combination of factors, including:

(i) The rise in prices of food crops caused by the prolonged drought experienced during the beginning of the second half of 2005/06;

(ii) The increase in the average prices of soft and alcoholic beverages especially the locally brewed brands, cigarettes and tobacco leaves. The increase in the prices of alcoholic beverages and tobacco was mainly attributed to drought, which caused the scarcity of the corresponding raw materials used in the production processes;

(iii) The continuous surges in prices of most consumer goods driven the adverse effect of the persistent power outages on costs of production. With the decline in the electricity generation witnessed since the beginning of 2005/06, most businesses have resorted to other costly power options, which have substantially raised their cost of production.

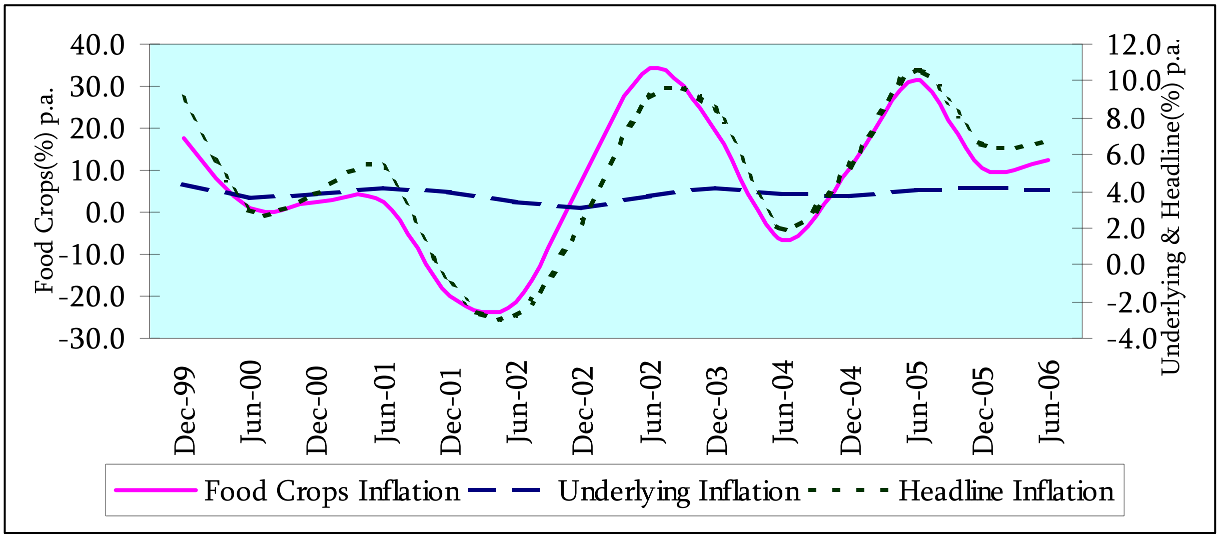
Details of inflation developments during the period December 2003 to June 2006 and the bi-annual Inflation developments for the period 1999 – 2006 are shown in Table 1 and Figure 1, respectively.

Table 1: The biannual average inflation out-turns (December 2003-June 2006)

Six months ending…	Headline inflation	Underlying inflation	Food crops inflation
Dec 2003	8.4%	5.9%	19.3%
Jun 2004	1.9%	4.3%	-6.5%
Dec 2004	5.4%	4.0%	10.5%
Jun 2005	10.5%	5.4%	31.3%
Dec 2005	6.5%	5.5%	10.7%
Jun 2006	6.7%	5.0%	12.4%

Source: Uganda Bureau of Statistics

Figure 1: Annual inflation rates developments (December 1999- June 2006)



Source: Uganda Bureau of Statistics

4.2 Domestic money and securities markets

4.2.1 The primary market for Government securities

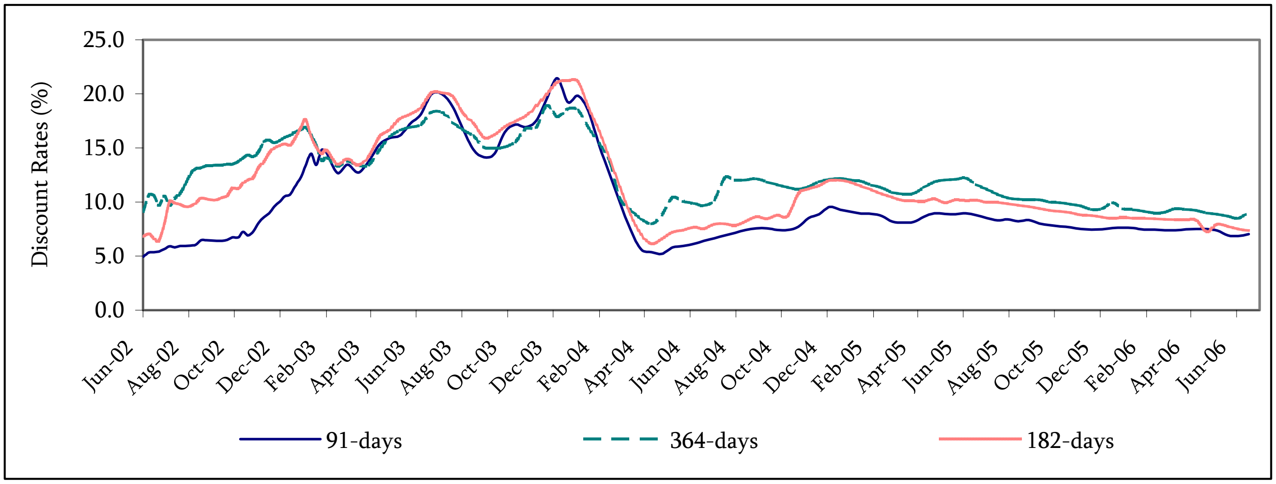
(a) Treasury bills Market

The primary issuance of Treasury bills continued to be an important tool for monetary policy management in the six months to June 2006.

The stock of Treasury bills rose by 8.7 percent, from Shs. 1,068.4 billion recorded at the end of December 2005 to Shs. 1,161.1 billion as at end-June 2006. Commercial banks held 53.7 percent of the total stock of Treasury bills compared to 59.4 percent reported in December 2005. The share of BOU holdings for monetary policy purposes increased to 28.8 percent, up from 23.0 percent over the same period.

Interest rates on Treasury bills were generally lower over the period January to June 2006 compared to the rates recorded between July and December 2005. The respective weighted annual discount rates for the 91-day, 182-day, and 364-day bills were 7.04, 7.37, and 9.06 percent, respectively, in the last auction of June 2006. These were lower than the respective levels of 7.61, 8.50, and 9.94 percent in the last auction of December 2005. developments in Treasury bills rates during the period June 2002 to June 2006 are shown in Figure 2.

Figure 2: Trend of discount rates on Treasury bills (June 2002 - June 2006)



Source: Bank of Uganda

(b) The Treasury bonds[1] Market

In the second half of 2005/06, Bank of Uganda issued and reopened treasury Bonds in the tenors of 2, 3 and 5 years to support monetary policy implementation and promotion of market development. In addition, these securities have assisted in extending both the maturity of the instruments traded and the yield curve. They have also provided an additional saving instrument, and deepened the capital market.

Total Treasury bond issues in the six months to June 2006 amounted to Shs. 192.9 billion at face value. This represented an increase of 54.3 percent from the Shs. 125.00 billion issued in the previous period to December 2005. As part of the agreed strategies to manage rollover risk, BOU partially bought back and converted 2-year and 3-year bonds in order to minimise this risk. One Treasury bond issue was reopened with the aim of creating more liquid and tradable securities. These issues, together with the 2-year bond maturities totalling to Shs.99.8 billion brought the total outstanding stock of bonds to Shs. 734.9 billion by the close of the period under review. All bond auctions during this period were oversubscribed and have been listed on the Uganda Securities Exchange. Details of the Treasury bond market activity are shown in Table 2.

[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 H1 FY05/6	2 year New issue Jan 11-06	3 Year New issue Feb 08-06	2 year Reopened On conversion Feb 17-06	3 year Reopened On conversion Feb 17-06	3 Year New Issue Mar 09-06	2 Year New Issue Apr 05-06	3 Year Reopened May 04-05	5 Year New Issue 31 May 06	Total H2 FY05/6
Offers (Shs bn)	125.000	25.000	25.000	35.000	7.900	30.000	30.000	20.000	20.000	150.000
Total bids (Shs bn)	226.372	47.389	58.580	45.829	7.900	44.898	69.783	44.152	43.504	308.306
O/w Competitive	226.235	47.368	58.570	-	-	44.881	69.753	44.145	43.489	308.206
Over (under) subscription	101.372	22.389	33.580	10.829	-	14.898	39.783	24.153	23.504	158.307
Amount sold (face value)	125.000	25.000	25.000	35.129	8.281	30.000	30.000	20.000	20.000	150.000
Amount sold (cost price)	112.274	23.782	22.778	33.618	7.215	27.667	28.760	19.086	17.542	139.615
Cover ratio %		189.556	234.320	130.940	100.000	149.660	232.610	220.763	217.159	
WAP per Shs.100		95.130	91.113	100.373	104.952	92.222	95.865	95.429	87.711	
Yield to maturity %		12.838	13.978	13.000	14.000	13.488	12.397	12.884	14.271	

Source: Bank of Uganda

The increasing demand for these longer dated government securities, as evidenced by the consistent over-subscriptions at each bond auction, the 2-year and 3-year bond rates declined gradually in the second half of 2005/06, and were lower than the rates recorded in the previous half. As depicted in Table 2, the yield-to-maturity on the 2-year bond that was at 13.27 percent in December 2005, fell to12.40 percent in April 2006. Similarly, the yield-to-maturity on the 3-year bond fell from 14.65 percent in November 2005 to 12.88 percent in May 2006. A total of Shs. 33.56 billion was paid to cover coupon payments on bonds between January and June 2006.

4.2.2 The 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. Secondary market trading in Treasury bills was mainly on account of the continued active use of the signed Horizontal Repo Agreement (HRA) to secure interbank lending transactions (see table 3). Other supportive measures that increased secondary market trading included the ease with which securities can be transferred on the Central Depository System (CDS), and Bank of Uganda's Guide on Market Performance Ranking System 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 2006 were 7.63/7.37, 8.68/8.42, and 9.91/9.62 percent for the 91-days, 182-days and 364-days securities. These were lower than the average rates of 8.26/8.00, 9.81/9.54, and 10.92/10.63 percent for the respective papers in the six months to December 2005.

Total trades over this period amounted to Shs. 198.2 billion, slightly lower than the Shs. 210.9 billion executed in the period July 2005 to December 2005. Indicators of the secondary market activity in treasury bills are summarized in Table 3.

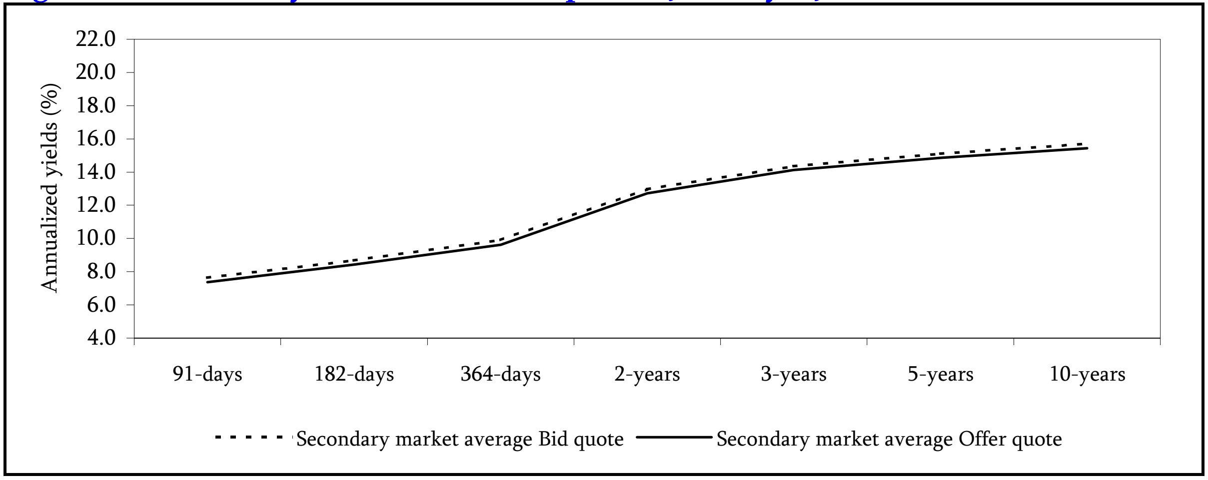
Table 3: Summary indicators from the Secondary Market for Treasury bills (January-June 2006)

	91 days		182 days		364 days	
Yield to maturity rates – quotation (%)						
	Bid	Offer	Bid	Offer	Bid	Offer
Minimum	7.05	6.79	7.66	7.39	9.04	8.76
Maximum	8.22	7.96	9.45	9.18	12.56	12.26
Average	7.63	7.37	8.68	8.42	9.91	9.62
Trading activity						
Transactions (Shs bn)		84.192		58.999		55.028
O/w horizontal repos		27.500		2.000		-
O/w outright sales		56.692		56.999		55.028
Av. discount rate (%)		8.235		8.265		8.750
Av. Yield to maturity rate (%)		8.465		8.560		9.255

Source: Bank Of Uganda

The yield curve derived from average yield-to-maturity quotes in the secondary market remained gently upward sloping throughout the maturity profile, as shown in Figure 3.

Figure 3: Securities yield curve for the period January – June 2006



Source: Bank of Uganda

(b) The Treasury bond

During the period January to June 2006, the average indicative bid/offer yields-to-maturity rates in the secondary market were 12.98/12.73, 14.36/14.12, 15.11/14.86, and 15.70/15.44 percent for the 2-year, 3-year, 5-year and 10-year bonds, respectively. This compares with the respective average rates of 13.85/13.60, 15.39/15.11, 15.94/15.69, and 16.32/16.07 percent for the six months to December 2005. These rates fell in tandem with the developments in the primary market for Treasury bonds.

A total of Shs. 29.5 billion of the 2-year bond, Shs. 3.0 billion of the 3-year bond, Shs. 1.2 billion of the 5-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.

Table 4: Treasury bonds secondary market summary indicators (January-June 2006)

Tenor→	2 years		3 years		5 years		10 years	
YTM (%)→	Bid	Offer	Bid	Offer	Bid	Offer	Bid	**Offer**
Minimum	11.75	11.50	12.35	12.10	12.40	12.15	14.90	**14.65**
Maximum	13.90	13.65	15.30	15.05	16.00	15.75	16.50	**16.25**
Average	12.98	12.73	14.36	14.12	15.11	14.86	15.70	**15.44**

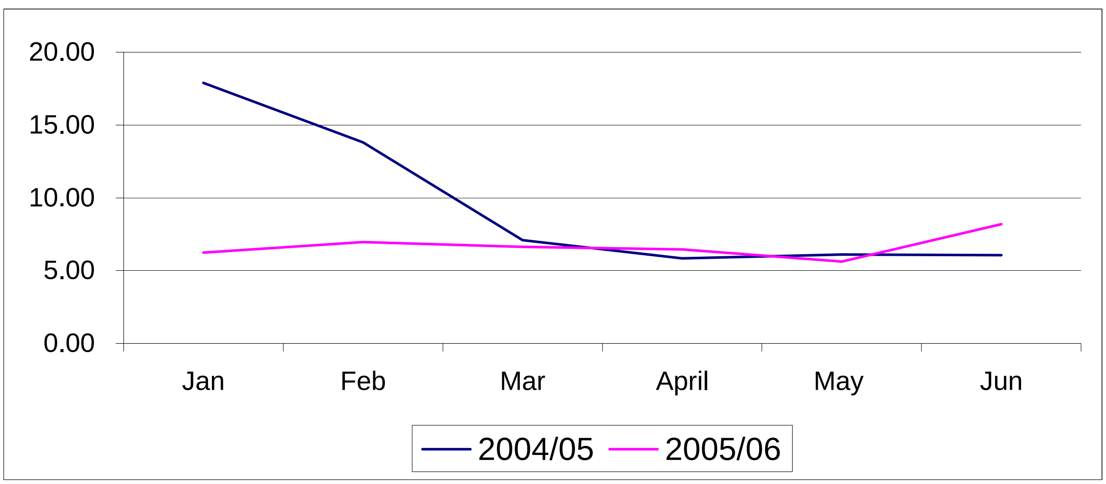
Source: Bank of Uganda

4.2.3 The Inter-bank money market

During the second half of 2005/06, the domestic inter-bank money market continued to be active, registering even wider participation and higher transaction volumes. 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 heightened activity is indicative of improved liquidity management by commercial banks and overall development of the domestic money market.

The market was broadly stable with the minimum and maximum lending rates recorded in the inter-bank money market being 5.6 percent and 8.2 percent, respectively in June 2006. These rates trended below the previous year's levels for the most part of 2005/06. Total volumes traded during this period amounted to Shs 1.5 trillion compared to Shs. 1.1 trillion of the corresponding period of 2004/05. Developments in the inter-bank money market lending rates during 2004/05 and 2005/06 are shown in Figure 4

Figure 4: Movements in the inter-bank weighted average rates during 2004/05 and 2005/06.



4.2.4 Commercial Banks' interest rates

The stability in both the effective lending rates on shilling and dollar denominated loans that were reported in the first half of 2005/06 continued throughout the second half in line with the trends in the inter bank market, securities markets and the policy rates. As shown in Table 5, effective lending rates for shilling denominated loans stood at 18.6 percent in June 2006 compared to 19.4 percent and 18.1 percent in December 2005 and June of 2005, respectively. The lending rates in the foreign currency denominated loans also increased marginally compared to those obtaining in the second half of 2004/05. In June 2006, lending rates on foreign currency denominated loans stood at 9.9 percent compared to 7.2 percent and 7.4 percent in December 2005 and June 2005, respectively.

Deposit rates on the other hand registered a downward trend. The rates on shilling time deposit declined from 9.2 percent in June 2005 to 7.6 percent in June 2006. The foreign currency denominated time deposit rate also declined consistently from 5.4 percent in June 2005 2.9 percent in June 2006. The rates on shilling denominated savings deposits rose from 1.9 percent in December 2005 to 2.0 percent in June 2006, while the foreign currency denominated savings deposit rate was relatively constant during the period under review. Developments in commercial bank lending rate are shown in Table 5.

Table 5: Commercial bank lending and deposits rates

	June 2005	December 2005	June 2006	June 2005	December 2005	Jun 2006
Weighted average rates	Shilling denominated (%)			Foreign currency denominated (%)		
Lending	18.07	19.37	18.60	7.40	7.15	9.92
Demand deposits	1.06	1.18	1.11	1.00	1.03	1.17
Savings deposits	1.79	1.92	2.02	1.45	1.45	1.45
Time deposits	9.19	7.85	7.57	5.36	3.51	2.86

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 depreciated against the US Dollar during 2005/06. The weighted average mid rate in the inter-bank foreign exchange market (IFEM) depreciated by 4.8 percent from Shs. 1,737.8 per US Dollar in 2004/05 to Shs. 1,820.6 per US Dollar in 2005/06. This is in contrast to the appreciation of 10.2 per cent posted in the preceding financial year when the average mid rate moved from Shs. 1,935.3 per US Dollar in 2003/04 to Shs. 1,737.8 per US Dollar 2004/05. On a monthly basis, the Shilling depreciated by about 7.0 per cent, from Shs. 1,738.3 per US Dollar in June 2005 to Shs. 1,860.0 per US Dollar in June 2006.

On a half yearly basis, the Uganda Shilling depreciated by 0.5 percent in the second half of 2005/06, losing ground against the US Dollar from a period average rate of Shs.1,821.04 per US Dollar in the first half of 2005/06 to Shs. 1,829.9 per US Dollar in the second half. However, during the corresponding period of 2004/05, the shilling had appreciated by 12.2 percent, gaining against the US Dollar from a period average rate of Shs. 1,981.9 per US Dollar in the first half of 2004/05 to Shs. 1,741.1 per US Dollar in the second half. The spread between the buying and selling rates narrowed from Shs. 10.7 in the first half of 2005/06 to Shs. 9.3 in the second half of 2005/06. Movements in the exchange rate during this period were partly driven by speculation by some dealers on how big players were to externalise their dividends and market sentiments.

The nominal effective exchange rate (NEER) index depreciated by 2.4 percent during the second half of 2005/06 to an index of 121.8 from 118.9 that was observed during the first half of 2004/05. This compares to a depreciation of 3.2 percent during the corresponding period of 2004/05. The evolution of the NEER index mainly reflected the relative movements of the Uganda Shilling against the currencies of Uganda's major trading partners. Indeed, the trend of the REER during this period was consistent with movements in the Shilling vis-à-vis the currencies of our major trading partners. During the second half of the 2005/06, the Shilling depreciated against the currencies of our major trading partners. The Shilling depreciated by 1.7 per cent against the UK pound, 3.9 per cent against the Kenyan shilling, 2.7 percent against the Euro 4.2 percent against the South African Rand and by 0.1 per cent against the Pakistan Rupee. It, however, registered gains of 0.8 percent against the Japanese Yen and 0.4 percent against the Indian Rupee, but this was more than offset by the depreciation against the currencies of other major trading partners.

Similarly, the real effective exchange rate (REER) index depreciated by 6.0 percent to an index of 121.9 in the second half of 2005/06 from an index of 115.0 in the first half of 2005/06 compared to a depreciation of 2.3 percent during the corresponding period of 2004/05. Figure 5 presents the trend of the inter-bank monthly average mid exchange rate from Jan 2001 to June 2006, 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 2006

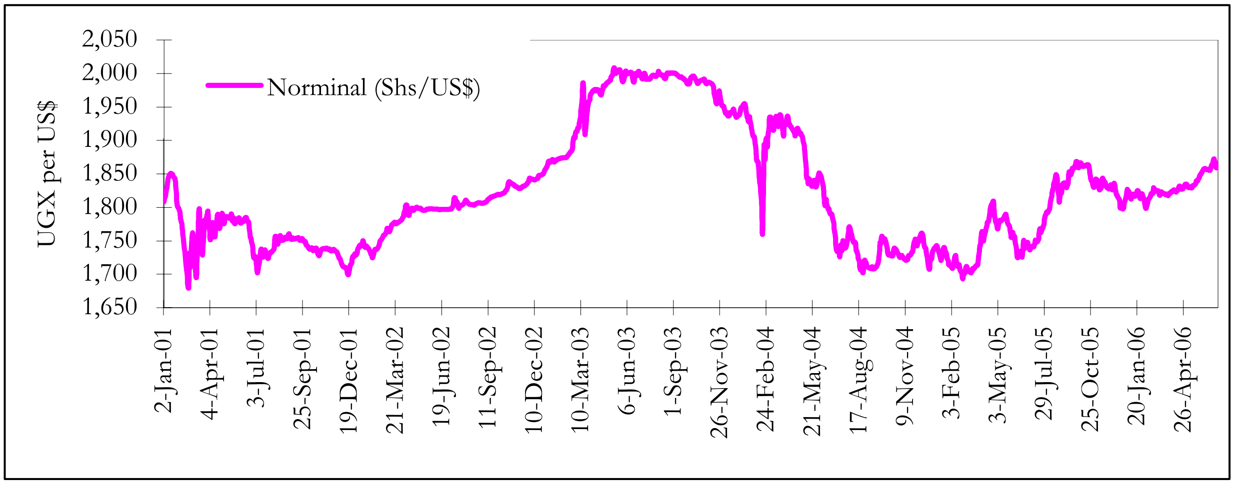
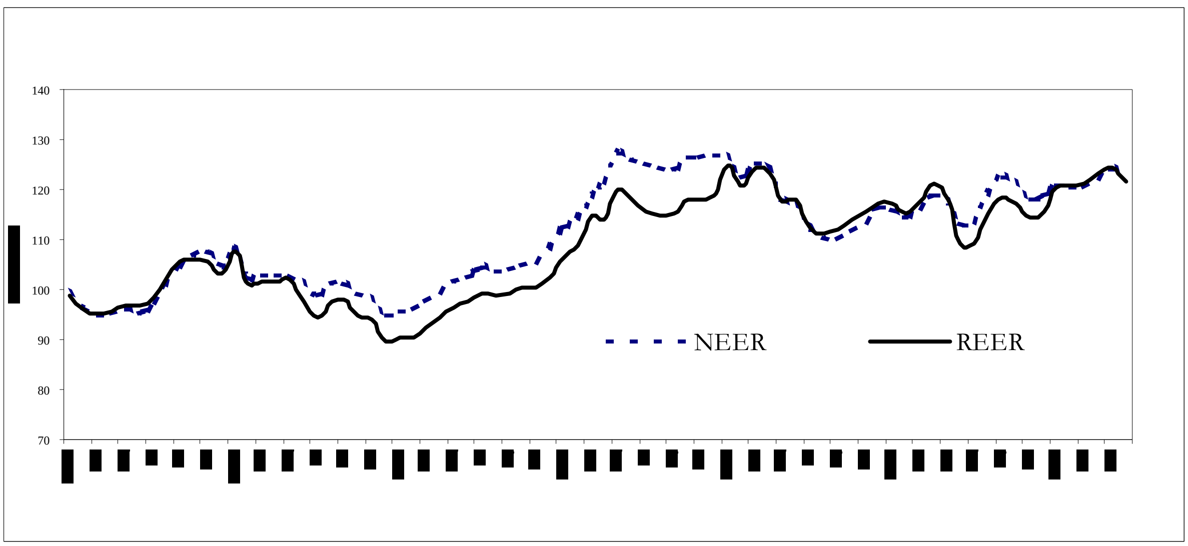


Figure 6: Real and nominal exchange rates, January 2000 - June 2006



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 continued during the second half of 2005/06. Net sales of foreign exchange by Bank of Uganda on account of sterilization and intervention in the second half of 2005/06 amounted to US$ 84.1 million, up from US$62.5 million of the previous half, but 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 7.8 percent from US$ 1,087.0 million during the first half of 2005/06 to US$ 1171.6 million in the second half of 2005/06. Compared to the corresponding half of 2004/05, this represents an increase of 15.8 percent. Similarly, gross sales increased by 14.8 percent from US$ 1,091.8 million recorded during the second half of 2004/05 and by 9.3 percent from US$ 1,146.8 million during the first half of 2005/06 to US$ 1,253.0 million in the period under review.

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 of the monetary targeting framework of the Bank of Uganda, and since 2002/2003, it is one of the performance benchmarks outlined in the IMF 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 1.86 percent in June 2006 over its December 2005 level. Excluding commercial banks' holdings of BOU instruments, it declined by 0.5 per cent from Shs. 1,051.2 billion in December 2005 to Shs. 1,046.1 billion in June 2006. These developments represent a slower expansion in base money over the last six months compared to growth in the preceding half. Like in the first half of 2005/06, increased net foreign assets moderated by government's savings at the central bank, continued to contribute to base money growth in the second half. With regard to the components of base money, reserves of commercial banks held at BOU decreased by 4.6 percent to Shs. 208.4 billion by the end of June 2006 compared to December 2005, currency issues grew only marginally by 0.6 percent to Shs. 837.7 billion over the same period, while commercial banks' holdings of BOU instruments fell from Shs. 30.0 billion to Shs. 15.0 between December 2005 and June 2006.

Table 6: Monetary Authority Balance Sheet (billion Shs)

Aggregate	June 2004	Dec. 2004	June 2005	Dec. 2005	June 2006
Total Liabilities	924.3	940.6	928.3	1081.2	1061.1
Base Money	867.1	924.6	928.3	1051.2	1046.1
Commercial Banks' Holdings of BoU Instruments	57.2	16.0	00.0	30.0	15.0
Total Assets	867.1	924.6	928.3	1081.2	1061.1
Net Foreign Assets	1680.5	1960.6	2050.8	2218.8	2624.8
Net Claims on Government	-489.6	-622.0	-833.4	-833.2	-959.2
Claims on Commercial Banks	85.8	84.0	86.7	76.9	95.5
Claims on Private Sector	23.9*	23.9	20.1	20.4	20.6
Claims on Parastatals	1.9	1.5	1.3	1.1	0.9
Other Items, Net	-435.5	-523.4	-397.3	-402.7	-721.4

* From June 2004, staff loans at BOU were reclassified from OIN to PSC.

Source: Bank of Uganda.

5.2 Broad money

Between December 2005 and June 2006, Broad Money (M3) (comprising of currency in circulation and all private sector deposits) grew by 5.5 per cent from Shs. 3,101.5 billion to Shs. 3,271.6 billion. This represents a slight deceleration compared to the 10.3 percent growth recorded in the previous half-year period. The growth in M3 can be traced to the robustness of residents' foreign denominated deposits as well as a rather strong growth in demand deposits during the period. The build-up of residents' foreign deposits was partly due to exchange rate effects. Between December 2005 and June 2006, foreign currency deposits grew by 6.1 percent, up from 1.9 percent in the previous half. In dollar terms, the growth accelerated from –2.4 percent in the six months to December 2005 to 3.5 percent. Currency in circulation grew by 4.9 percent, demand deposits by 7.3 per cent and time and savings deposits by 3.7 percent. Most of the growth in M3 was on account of a rise in the banking system's net foreign assets (NFA) and growth in private sector credit. Broad Money (M2A), which includes currency in circulation and shilling deposits, grew by 5.3 per cent within the half year to June 2006.

5.2.1 Net Foreign Assets (NFA)

The net foreign assets of the banking system increased by 12.9 percent between December 2005 and June 2006 from Shs. 2,730.4 billion to Shs. 3,084.4 billion. This outturn is far higher than the growth of about 3.1 percent observed for the previous half yearly period. The net foreign assets of BOU rose by 18.3 percent to Shs. 2,624.8 billion, of which foreign reserves rose by 7.5 percent. A major part of the increase in foreign assets constituted net inflows of donor budget support and IMF MDRI funds. At the level of commercial banks, net foreign assets declined by 10.2 percent to Shs. 459.6 billion over the same period. Table 7 summarizes these developments.

5.2.2 Net Domestic Assets (NDA)

During the period December 2005 to June 2006, the net domestic assets of the banking system (excluding revaluation) fell by 7.9 percent to Shs. 852.2 billion as at the end of June 2006 from Shs. 926.1 billion. The government position with the banking system at the end of June 2006 was a saving amounting to Shs. 80.7 billion, representing an improvement of Shs. 33.6 billion over the December 2005 position. This was due to the build up of Government deposits at Bank of Uganda associated with receipts of donor budget support and the transfer of project funds from commercial banks.

Claims on the private sector by the banking system grew strongly by 15 percent or Shs. 192.4 billion between December 2005 and June 2006. In terms of currency denomination, the highest growth in credit was in foreign currency loans, which grew by 19.6 percent (Shs. 71.7 bn), while Shilling denominated loans grew by 13.2 percent (Shs. 120.7). In comparison with the previous half-year period ending December 2005, foreign currency loans grew at about 21.5 percent, while Shilling denominated loans declined by 0.5 percent. The sectoral distribution of credit indicates that it was heavily weighted in favour of the trade and other services sector, which accounted for about 62.7 percent of the stock of loans in June 2006, up from 56.9 percent in December 2005 and 60.5 percent in June 2005. Table 8 summarised the developments in the sectoral distribution of credit.

On the liabilities side of the banking system, private sector deposits at commercial banks increased by 5.7 percent to Shs. 2,526.7 billion in June 2006, reflecting in part aggressive deposit mobilization by commercial banks and the continued improvement of confidence in the financial sector. Time and Savings deposits increased by 3.7 percent to Shs. 857.3 billion, private demand deposits increased by 7.3 percent to Shs. 961.5 billion, while foreign currency deposits increased by 6.1 percent to Shs. 706.6 billion. Additionally, financial depth as measured by the ratio of financial savings to Broad Money (M2) declined to 33.5 percent in June 2006, from 34.1 per cent in December 2005 (see Table 7). In numerical terms, financial savings rose significantly by 3.6 percent or Shs. 29.4 billion to Shs. 858.5 billion.

Table 7: The Monetary Survey (Shillings, Billion)

Aggregate	June 2004	Dec. 2004	June 2005	Dec. 2005	June 2006
Net Foreign Assets	2370.5	2559.0	2647.7	2730.4	3084.4
Monetary Authority (net)	1680.5	1960.6	2050.8	2218.8	2624.8
Foreign Reserves	2029.4	2273.1	2306.8	2440.1	2622.4
Commercial Bank (net)	690.1	598.4	596.8	511.6	459.6
Domestic Credit					
Central Government (net)	68.2	-12.3	-176.3	-47.1	-80.71
Parastatals	13.6	10.6	8.1	15.2	19.5
Private Sector	1010.0	1105.2	1222.5	1282.9	1475.3
Net Domestic Assets (net of revaluation)	660.5	587.0	689.2	926.1	852.2
Other Items (net)	-875.4	-1016.3	-890.3	-880.3	-1226.9
Broad Money – M3	2587.3	2646.7	2811.1	3101.5	3271.6
o/w Foreign Exchange Accounts	662.4	646.1	653.3	665.8	706.64
Broad Money – M2A	1924.9	2000.5	2157.9	2435.7	2564.9
Certificates of Deposit	2.0	2.0	2.0	1.9	1.2
Currency in Circulation	529.3	588.6	605.1	710.2	744.9
Demand Deposits	804.0	739.4	860.1	896.3	961.5
Time and Savings Deposits	589.6	670.5	690.7	827.1	857.3
Financial Savings					
Financial Savings (billion Shs) 1/	591.6	672.5	692.7	829.1	858.5
Financial Savings/M2 (%)	30.8	33.7	32.1	34.1	33.5

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	June 2004	Dec. 2004	June 2005	Dec. 2005	June 2006
Agriculture	11	11	10	12	9
Manufacturing	21	20	19	19	16
Trade & Other Services	57	59	62	57	63
Transport, Electricity & Water	8	6	6	7	6
Building and Construction	3	4	4	4	6
Mining and Quarrying	0	0	0	0	0
Total	100	100	100	100	100

Source: Research department, Bank of Uganda

6 GOVERNMENT FISCAL OPERATIONS

6.1 Revenue and grants

The preliminary developments in fiscal operations for first and second half of 2005/06 and the outturn for 2004/05 are shown in Table 9. According to provisional information from the Ministry of Finance, Planning and Economic Development (MFPED), domestic revenue during the second half of 2005/06 is estimated to have surpassed that of the first half by Shs. 77.9 billion to record Shs. 1,168.8 billion. This was largely attributed to the improvement in tax administration. However, total grants for both budget and project support declined by 0.5 percent to Shs. 460.2 billion in the second half largely on account of delayed disbursements by donors, particularly the World Bank. Overall, total revenue and grants grew by 4.9 percent to Shs. 1,629.0 billion in the second half of 2005/06 from Shs. 1,553.5 billion realised in the previous half. On a fiscal year basis, domestic revenue as a percentage of GDP increased by 0.4 percentage points from 12.9 percent in 2004/05 to 13.3 percent in 2005/06.

6.2 Expenditure

Total government expenditures and net lending for the second half of 2005/2006 is estimated at Shs. 2,153.0 billion, up from Shs 1,623.6 billion recorded in the previous half. The expenditure on wages and salaries is estimated at Shs. 442.4 billion, an increase of Shs. 34.6 billion from that registered in the first half of 2005/06. The expenditures on other non-wage recurrent activities amounted to Shs. 213.9 billion against Shs. 166.1 billion in the previous period, while interest payments remained relatively stable at about Shs. 127.3 billion. In addition, development expenditure increased from Shs. 539.0 billion in the first half to Shs. 927.5 in the second half. However, the estimate of total expenditure as a percentage of GDP declined to 22.2 percent in 2005/06 from 22.4 percent of GDP realised in 2004/05.

6.3 Overall budget balance

The overall budget balance including grants during the second half of 2005/06 is estimated to have worsened to deficit of Shs. 524.0 billion from a deficit of Shs. 70.1 billion in the first half. Excluding grants, the deficit is estimated to have worsened to Shs. 984.3 billion from a deficit of Shs. 532.7 billion in the previous period. Over 2005/06, the deficit excluding grants as a percentage of GDP was estimated at 8.9 percent, down from 9.5 percent in 2004/05. On a commitment basis, the deficit was estimated at 3.5 percent of GDP in 2005/06, up from 0.9 percent of GDP in 2004/05.

Table 9: Fiscal operations: 2004/05 – 2005/06 (Shs bn)

Categories	FY 2004/05	FY 2005/06	H1 2005/06	H2 2005/06
Revenue and grants	3,252.3	3,182.5	1,553.5	1,629.0
Revenue	1,948.1	2,259.7	1,090.9	1,168.8
Grants	1,304.2	922.8	462.6	460.2
Total expenditure and net lending	3,460.3	3,776.6	1,623.6	2,153.0
Recurrent expenditure	2,014.1	2,250.7	1,039.5	1,211.2
Wages and salaries	774.4	869.9	427.5	442.4
Interest	229.3	250.1	122.8	127.3
Other recurrent 1/	1,010.4	380.0	166.1	213.9
Development expenditure	1,385.5	1,466.5	539.0	927.5
Domestic	527.0	515.3	217.6	297.7
External	858.5	951.3	321.5	629.8
Net lending and investment	-6.0	-29.3	-13.5	-15.8
Domestic arrears repayment	57.4	88.7	58.5	30.2
Overall deficit(-)/surplus (+)	-208.0	-594.1	-70.1	-524.0
Excl. grants	-1,512.2	-1,516.9	-532.7	-984.3
Financing	208.0	594.1	70.1	524.0
Foreign (net)	294.1	509.0	156.1	352.8
Domestic (net)	-27.7	34.6	-2.4	37.0
Banking system	-238.0	95.6	129.2	-33.6
Non bank	210.2	-61.0	-131.7	70.7
GDP at factor cost (current prices)	15,156.5	17,013.8		
Memorandum items (% of GDP)				
Total revenue & grants	21.5	18.7	-	-
Domestic revenue	12.9	13.3	-	-
Grants	8.6	5.4	-	-
Expenditure and net lending	22.4	22.2	-	-
Recurrent	12.9	13.2	-	-
Development	9.1	8.6	-	-
Overall deficit	-0.9	-3.5	-	-
Overall deficit (excluding grants)	-9.5	-8.9	-	-

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 2005/06, the overall balance of payments recorded a surplus position of US$186.1 million, compared to a surplus of US$110.8 million recorded in the corresponding period in 2004/05. This is explained by improvements in the capital and financial account. The capital and financial account recorded a surplus of US$238.1 million in the period under review, compared to the US$181.7 million recorded in the corresponding period of 2004/05. On a fiscal year basis, the capital and financial account balance was at a surplus of US$ 428.5 million in 2005/06, which was 15.7 percent higher than the surplus of US$370.2 million recorded in 2004/05. However, the current account deficit worsened during the second half of 2005/06 to US$ 118.4 million, from US$70.8 million recorded in the second half of 2004/05. The decline in the current account was, to a large extent due to the increase in exports receipts from both goods and services, and current transfers relative to the corresponding period in 2003/04. Details of the developments in the balance of payments are shown in Table 10 below.

7.2 The current account

7.2.1 Trade balance

The trade balance deteriorated from a deficit of US$385.0 million in the second half of 2004/05 to a deficit of US$566.3 million in period under review. This deficit is largely accounted for by increase in imports, which more than offset the increase in exports[2]. This deficit was higher than the deficit of US$535.7 million realised in the first half.

[2] Imports rose by 25.1 percent while exports rose by 5.8 percent

Table 10: Balance of payments summary table (US $ m)

	H1 2004/5	H2 2004/5	FY 2004/5	H1 2005/6	H2 2005/6	FY 2005/6
CURRENT ACCOUNT BALANCE	-68.50	-70.81	-139.31	-124.03	-118.40	-242.43
Goods Account(Trade Balance)	-452.63	-385.04	-837.67	-535.71	-566.28	-1,102.00
Total Exports (fob)	346.95	439.36	786.32	424.92	464.92	889.84
Total Imports (fob)	-799.58	-824.40	-1,623.98	-960.63	-1,031.20	-1,991.83
Services Account(services net)	-178.45	-142.00	-320.45	-178.45	-192.04	-370.49
Inflows(credit)	177.32	244.62	421.94	233.61	271.16	504.77
Outflows(debit)	-355.77	-386.62	-742.39	-412.06	-463.20	-875.26
Income Account(Income net)	-86.84	-80.79	-167.63	-76.37	-58.41	-134.77
Inflows(credit)	16.24	25.77	42.01	24.04	29.44	53.48
Outflows(debit)	-103.08	-106.56	-209.64	-100.41	-87.85	-188.26
Current Transfers (net)	649.42	537.02	1,186.44	666.50	698.33	1,364.82
Inflows (Credit)	761.17	694.54	1,455.71	831.07	811.80	1,642.88
Outflows (Debits)	-111.75	-157.52	-269.27	-164.58	-113.48	-278.05
CAPITAL AND FINANCIAL ACCOUNT BALANCE	188.59	181.65	370.24	190.40	238.10	428.50
Capital Account	0.00	0.00	0.00	0.00	111.61	111.61
Capital Transfers inflows (credit)	0.00	0.00	0.00	0.00	111.61	111.61
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	188.59	181.65	370.24	190.40	126.49	316.89
Direct Investment	119.21	126.68	245.89	130.38	130.38	260.76
Direct investment abroad	0.00	0.00	0.00	0.00	0.00	0.00
Direct investment in Uganda	119.21	126.68	245.89	130.38	130.38	260.76
Portfolio Investment	-7.79	-3.07	-10.87	-8.62	4.82	-3.80
Assets	0.00	0.00	0.00	0.00	0.00	0.00
Liabilities	-7.79	-3.07	-10.87	-8.62	4.82	-3.80
Other Investment	77.17	58.04	135.22	68.64	-8.71	59.93
Assets	7.63	17.43	25.05	-18.12	-56.16	-74.28
Liabilities	69.55	40.61	110.16	86.76	47.45	134.21
OVERALL BALANCE	120.09	110.84	230.93	66.37	119.70	186.07
RESERVES AND RELATED ITEMS	-120.09	-110.84	-230.93	-66.37	-119.70	-186.07
Reserve assets	-97.60	-84.58	-182.18	-7.01	-1.92	-8.94
Use of Fund credit and loans	-23.92	-27.76	-51.68	-14.89	-123.91	-138.80
Exceptional Financing	2.98	1.46	4.44	-29.32	-5.97	-35.30
Errors and Omissions	-1.56	0.04	-1.52	-15.14	12.11	-3.04

Source: Bank of Uganda

7.2.2 Exports

Table 11 shows the composition of Uganda's merchandise exports for 2004/05 and 2005/06. Total export earnings from goods were recorded at US$890.0 million in 2005/06 compared to US$786.3 million realised in 2004/05. Exports in the second half of 2005/06 were recorded at US$465.0 million compared to the US$439.4 million recorded in the corresponding period of 2004/05. There was an improvement in the performance of both coffee and non-coffee exports. Coffee export earnings during the second half of 2005/06 amounted to US$89.7 million up from US$88.0 million realised in the corresponding period of 2004/05. Although export volumes fell from 1.28 million (60 kg) bags during the second half of 2004/05 to 1.01 million bags in the corresponding half of 2005/06, the 29.6 percent increase in the realised average unit value more than offset the decline in export volumes[3].

Similarly, there was an in increase in receipts from non-coffee exports. Non-coffee export earnings amounted to US$362.5 million, about 5.5 percent higher than the US$343.6 million realised during the corresponding period of 2004/05. The increase in non-coffee export earnings is largely accounted for by improved performance in electricity, gold, fish and its products (international exports), hides & skins, simsim, maize, beans and cobalt[4].

The value of simsim exports continued to rise reaching US$3.6 million in the second half of 2005/06, compared to US$1.9 million in the first half. In the same vein, receipts from international fish exports were recorded at US$75.8 million, up from US$71.2 million in the preceding half of 2004/05. Receipts from hides and skins also rose to US$4.0 million in the second half compared to US$3.4 million in the first half of 2005/06 and US$3.8 million in the second half of 2004/05. Similarly export receipts from maize, beans and cobalt increased by 59.1 percent, 50.7 percent and 60.1 percent compared to the same period in 2004/05.

[3] The realised average unit value during the second half of 2005/06 was US$1.48 per kg, compared to US$1.15 per kg realised during the same period last year.

[4] Exports receipts from regional exports of fish and its products, cotton, tea, tobacco, and flowers declined,

7.2.3 Imports

Total imports are recorded at US$1,031.2 million during the second half of 2005/06, an increase of 7.3 percent and 25.1 percent over the level recorded in preceding half of 2005/06 and the corresponding period 2004/05 respectively. Increase in imports was largely on account of the continued growth in private sector imports of merchandise. Government imports declined to US$42.4 million in the second half of 2005/06, compared to US$77.1 million in the first half.

7.2.4 Services account

There was a continued increase in the receipts from exports of services. These were recorded at US$271.2 million in the second half of 2005/06, up from US$233.6 in the previous half and US$244.6 million in the corresponding period in 2004/05. Imports of services were recorded at US$463.2 million, 12.4 percent higher than those of the first half of 2005/06.

7.2.5 Income account

The income account recorded a deficit of US$58.4 million in the second half of 2005/06, an improvement of 30.0 percent over the deficit of US$76.4 million recorded during the preceding half of 2005/06. This deficit was also lower than the deficit of US$80.8 million realised during the corresponding period of 2004/05. This was on account of increased income earnings on other investments.

7.2.6 Current transfers

Net current transfers were recorded at a surplus of US$698.3 million in the second half of 2005/06, compared to the surplus of US$666.1 million and US$537.0 million in the first half and the corresponding period of 2004/05, respectively. This development is largely accounted for by increased private sector inflows relative to outflows.

Table 11: Exports of merchandise (US$ m)

	H1 2004/5	H2 2004/5	FY 2004/5	H1 2005/6	H2 2005/6	FY 2005/6
Total Exports	346.95	439.36	786.32	424.92	464.92	889.84
Coffee (Value of shipment)	56.56	87.97	144.53	83.72	89.66	173.37
Avg. unit value	0.76	1.14	0.96	1.28	1.48	1.37
Gross coffee shpmt (vol) ('000 60-Kg bags)	1.24	1.28	2.52	1.09	1.01	2.10
Non-Coffee exports	290.40	351.39	641.79	341.20	375.26	716.46
Electricity	5.97	2.28	8.25	2.12	2.57	4.68
Gold	39.84	31.49	71.33	41.52	60.03	101.55
Cotton	6.54	34.81	41.34	3.41	9.45	12.86
Tea	16.60	16.53	33.13	17.44	8.17	25.61
Tobacco	17.65	18.55	36.20	12.63	18.00	30.63
Fish & its prod. (excl. regional)	52.82	68.40	121.22	71.22	75.82	147.04
Fish & its prod. (regional exports)	21.09	27.31	48.39	22.30	23.87	46.18
Hides & skins	2.59	3.79	6.38	3.36	3.97	7.33
Simsim	0.25	2.82	3.07	1.92	3.59	5.52
Maize	6.10	7.20	13.29	12.28	11.45	23.73
Beans	1.69	2.64	4.33	4.30	3.98	8.28
Flowers	14.23	17.47	31.71	16.33	16.34	32.67
Oil re-exports	15.60	17.45	33.05	14.02	15.59	29.61
Cobalt	7.31	6.40	13.70	9.18	10.25	19.42
Others	82.14	94.26	176.40	109.18	112.18	221.35

Source: Bank of Uganda

7.3 The capital and financial account

Net inflows of foreign direct investment increased to US$130.4 million, up from the US$126.7 million recorded during the corresponding period of 2004/05. There was a US$59.1 million run down in holdings of currency and deposits assets during the review period, vis-à-vis the build-up of US$17.3 million recorded in the same half of 2004/05. All in all, the capital and financial account generally improved to a surplus of US$238.1 million in the second half of 2005/06, from US$181.7 million in the corresponding period of 2004/05, mainly due to debt forgiveness from the IMF resulting from the multi lateral debt relief (MDR).

7.4 Foreign reserves

Gross foreign exchange reserves were recorded at US$ 1,408.1 million as at end-June 2006, an increase of US$82.6 million from the level recorded in June 2005. These reserves are estimated to cover 6.5 months of future imports of goods and services, up from the 6.1 months of import cover registered during June 2005. The build up of reserves during this period is largely due to increased budget support, less than projected sale of foreign exchange in the IFEM and debt forgiveness from IMF, amounting to US$126 million.

7.5 External debt

During the second half of 2005/06, maturities falling due on medium and long-term public and publicly guaranteed debt (excluding IMF credit) were estimated at US$61.2 million. Debt owed and paid to the International Monetary Fund (IMF) was US$0.029 million, consisting entirely of interest payments and other charges.

Total cash payments of medium and long-term public and publicly guaranteed debt (excluding IMF) during 2005/06 amounted to US$95.4 million compared to US$82.8 million in 2004/05. Of the total debt service payments, US$28.7 million is from the HIPC debt relief initiative. External debt indicators up to end June 2005/06, indicate that the total debt stock was approximately US$4,464.4 million.

Table 12: Key debt indicators (% of GDP unless otherwise stated)

Memorandum items:	FY 2004/05	H1 2004/05	H2 2004/05	FY 2005/06	H1 2005/06	H2 2005/06
Exports of Goods and Services	786.32	346.96	439.36	886.62	424.93	461.68
Debt Stock	4,416.30	4,753.79	4,416.30	4,464.38	4,347.11	4,464.38
Debt Stock/Exports of Goods and Services	561.6%	1370.2%	1005.2%	516.9%	1023.0%	967.0%
Debt Service/Exports of Goods and Services	14.6%	18.5%	15.3%	18.3%	11.2%	25.0%

Source: Bank of Uganda

8. REAL ECONOMY DEVELOPMENTS

8.1 Economic growth

Real Gross Domestic Product is estimated to have grown by 5.3 percent in 2005/06, down from 6.6 percent recorded in 2004/05. Gross Domestic product in real value terms stood at Shs. 11,949.0 billion in 2005/06 compared to Shs. 11,353.0 billion recorded for 2004/05. Consequently, real per capita income rose to Shs. 444,201 from Shs. 422,040 in 2004/05.

The slow down in the economy mainly resulted from dismal performance in both the agricultural and industrial sectors, which was mainly attributed to the prolonged drought and the resultant decline in hydro electricity generation capacity. The prolonged drought, which severely affected large parts of East Africa, had a detrimental effect on water levels and agricultural production. The agricultural sector grew by 0.4 percent in 2005/06 compared to 1.5 percent in 2004/05. The largest decline in the agricultural sector was recorded in the cash crops sub sector where production declined by 7.4 percent in 2005/06 compared to a growth rate of 4.2 percent in 2004/05. The decline in the cash crops sub sector was on account of a fall in cotton production as a result of the drought and low farm gate prices, and also a decline in the production of tobacco due to difficulties in contract negotiation between buyers and farmers.

The industrial sector grew by 4.5 percent in 2005/06 down from 10.8 percent registered in 2004/05. The slowdown was mainly on account of dismal performance in mining and quarrying, manufacturing and electricity and water sub sectors. This slowdown was largely attributed to the drought that lowered water levels and consequently reduced hydropower generation capacity. In the manufacturing sub sector, due to power rationing, some companies closed down, others reduced production, while those that opted to employ generators had their costs of production increasing to unprecedented levels.

The robust growth of the services sector however continued, rising to 9.2 percent in 2005/06 from 8.7 percent recorded for 2004/05.

8.2 Index of Industrial Production

The performance of the manufacturing sector as measured by the Index of Industrial Production[5] showed substantial improvement in the second half of 2005/06. The All Items Index grew by 6.6 percent from 175.0 during the second half of 2004/05 to

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

186.5 during the second half of 2005/06 and declined by 1.9 percent when compared to 190.1 during the first half of 2005/06.

There are sectors, however that showed a decline in production as measured by their indices, during this period. These items included: soft drinks, cigarettes, textiles, laundry soap and metal products. Significant reduction was mostly notable in the production of cigarettes (Table 13 below). Production of cigarettes ceased in April 2006, following the two cigarette-producing companies relocating their production activities to neighbouring Kenya and Rwanda. Presently, British American Tobacco Uganda Limited and Mastermind Uganda Limited are engaged in exporting unprocessed tobacco leaves.

Figure 7: Trends of the major index of industrial production

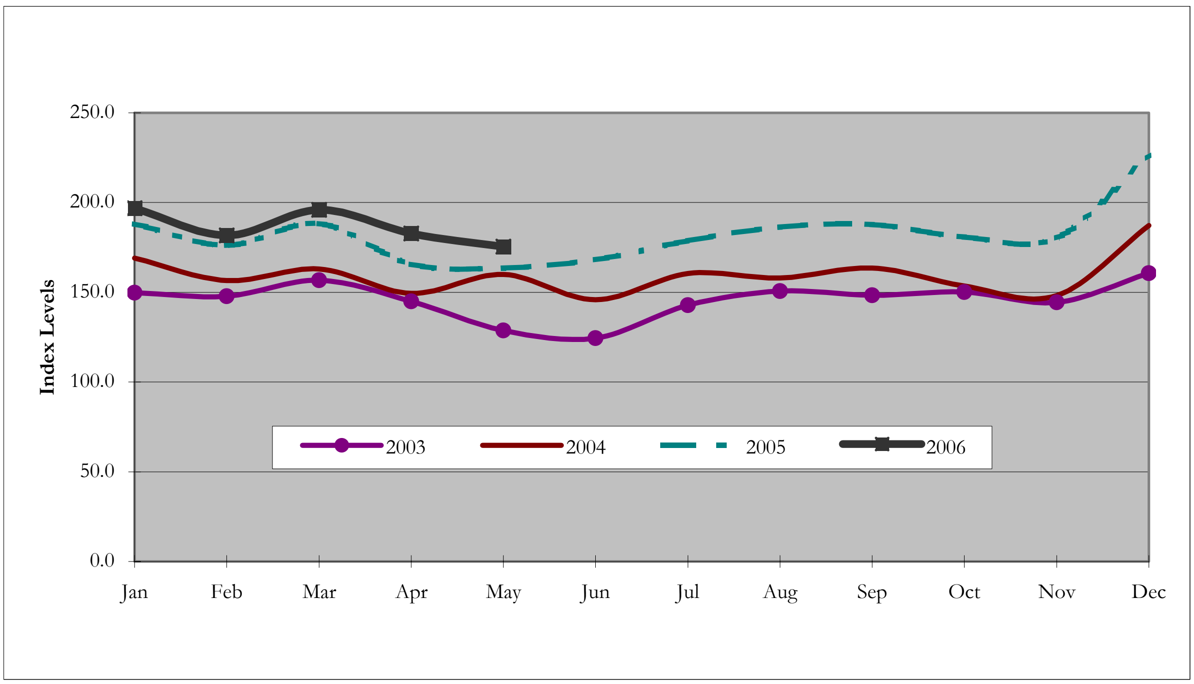


Table 13: Index of Industrial Production: 2004/05 – 2005/06

	H2 2004/05	H1 2005/06	H2 2005/06	H2 2004/05 - H2 2005/06	H1 2005/06 - H2 2005/06
Sugar	184.0	204.8	199.4	8.3%	-2.6%
Beer	122.3	151.0	158.3	29.5%	4.9%
Soft Drinks	225.9	262.1	224.7	-0.5%	-14.3%
Cigarettes	64.9	74.7	41.2	-36.5%	-44.8%
Textiles	120.8	118.1	94.5	-21.8%	-20.0%
Cement	226.1	237.1	270.1	19.4%	13.9%
Laundry Soap	202.1	205.8	201.3	-0.4%	-2.2%
Edible Oil	159.5	164.5	172.5	8.2%	4.9%
Metal Products	245.3	245.6	172.5	-29.7%	-29.8%
All Items	175.0	190.1	186.5	6.6%	-1.9%

Source: Uganda Bureau of Statistics

8.3 Fuel imports and sales

Imports of major fuel[6] products in the second half of 2005/06 increased compared to the second half of 2004/05. However, compared to the first half of 2005/06, imports of all three products declined. This may be attributed to the rise in international oil prices to an average of US$ 65.9 per barrel in the second half of 2005/06 from the averages of US$ 47.2 and US$ 59.2 in the second half of 2004/05 and first half of 2005/06, respectively. Table 14 below shows the changes in imports of the 3 major fuel products.

The consumption as measured by sales volumes, on the other hand, increased between the second half of 2005/06 and the corresponding half of 2004/05 as shown in Table 14. It was only the consumption of kerosene that declined during this period. Given that kerosene is mainly consumed by the low income groups, increase in the pump prices of fuel products, especially kerosene, to the levels witnessed in the second half of 2005/06, may have led to this decline. Despite the zero change in excise duty paid on Kerosene as a fuel product, following the 2005/06 budget speech, the pump price of kerosene rose by 9.4 percent from the average level of Shs. 1,488 per litre in the second half of 2004/05 to Shs. 1,628 in the first half of 2005/06, and rose again by 5.9 percent to an average level of Shs. 1,719 in the second half of 2005/06.

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

Table 14: Imports and sales volumes of major fuel products: 2004/05 – 2005/06

Imports (Litres)

	H2 2004/05	H1 2005/06	H2 2005/06	H2 2004/05 - H2 2005/06	H1 2005/06 - H2 2005/06
Premium	119,326,543	138,575,527	128,153,070	7.40%	-7.52%
Kerosene	28,556,205	34,577,635	32,538,607	13.95%	-5.90%
Gas Oil	183,947,332	243,705,985	240,206,451	30.58%	-1.44%

Sales ('000 Litres)

	H2 2004/05	H1 2005/06	H2 2005/06	H2 2004/05 - H2 2005/06	H1 2005/06 - H2 2005/06
Premium	91,785.40	82,268.70	95,622.60	4.18%	16.23%
Kerosene	18,345.40	21,490.90	19,493.70	6.26%	-9.29%
Gas Oil	152,002.30	167,571.30	187,901.00	23.62%	12.13%

Source: Ministry of Energy and Mineral Resources

8.4 Electricity consumption

The prolonged drought experienced in the last half of 2005 reduced the country's effective hydropower generation capacity from 180 MW to 135 MW by the beginning of 2006. Indeed Table 15 below shows that in the second half of 2005/06, UMEME Limited purchases in GWH dropped by 14.8 percent and by 18.9 percent compared to the volumes purchased in the second half of 2004/05 and the first half of 2005/06, respectively.

The decline in electricity generation and distribution was further exacerbated by the rise in demand for hydropower as is indicated by the rise in the number of live customers by 7.2 percent and 1.8 percent over the same period.

Further more, in October 2005, the average tariff rate rose by 2 percent to Shs. 171.5 from Shs. 168.5 in April 2005. In June 2006, the rate rose by another 44.2 percent to Shs. 247.3. This high price of electricity coupled with the power-rationing schedule which was reintroduced in October 2005, may explain the decline in consumption. Since the reintroduction of load shedding to ensure more equitable distribution of limited power supply, consumers have resorted to the use of generators to cover the Shortfall.

Table 15: Electricity consumption by category of consumer: 2004/05 – 2005/06

	H2 2004/05	H1 2005/06	H2 2005/06	Average Year-on-Year growth	Average Half Year growth
Number of live customers					
Domestic	246,797	258,797	267,039	8.2%	3.2%
Commercial	24,822	27,347	24,167	-2.6%	-11.6%
Industrial	796	834	942	18.3%	12.9%
StreetlLighting	321	320	325	1.4%	1.5%
Total	**272,735**	**287,298**	**292,473**	**7.2%**	**1.8%**
Consumption in GWH					
Domestic	31.13	34.53	25.48	-18.1%	-26.2%
Commercial	11.61	13.61	9.92	-14.5%	-27.1%
Industrial	47.92	60.37	44.87	-6.4%	-25.7%
Street lighting	0.05	0.12	0.07	43.7%	-38.5%
Total	**90.71**	**108.64**	**80.35**	**-11.4%**	**-26.0%**
Purchases in GWH					
UMEME purchases from UETCL	142.86	149.99	121.65	-14.8%	-18.9%
Disconnections & Reconnections					
Disconnections	30,941	34,058	28,085	-9.2%	-17.5%
Reconnections	12,590	14,055	9,455	-24.9%	-32.7%
Net Disconnections	**18,351**	**20,003**	**18,630**	**1.5%**	**-6.9%**

Note: No data exists on the number of customers in January and February 2006 because of the transition that was made from UEDCL to UMEME. So accordingly, March numbers were used to represent the quarter. Figures for consumption for the same period are only estimates.

Source: UEDCL and UMEME (UMEME statistics start March 2006)

8.5 Investment

In the second half of 2005/06, the number of projects licensed[7] increased by 70.4 percent and 11.5 percent relative to the levels recorded in second half of 2004/05 and the first half of 2005/06, respectively, as shown in Table 16. Planned investment however, declined by 16 percent compared to the second half of 2004/05 but rose by 52.8 percent compared to the first half of 2005/06. The observed decline in planned investment may be attributed to the economic problems that the country faced over

[7] 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.

2005/06, namely the drought in the first half of 2005/06 and the energy crisis that might have dipped investor confidence. The positive growth between the second half of 2005/06 and the previous half may be attributed to a boost in investor confidence owing to government's commitment to address the different issues facing the economy. Details of investment performance are shown in Table 16.

Table 16: Uganda Investment Authority (UIA) performance indicators: H2 2005/06

SECTOR	No. of Projects	Planned Inv. (USD)	Planned Empt	Percentage of planned.invest-ment
AGRIC, FORESTRY & FISHING	30	108,935,000	7,723	23.6%
CONSTRUCTION	12	10,483,500	1,011	2.3%
MANUFACTURING	59	53,726,500	3,600	11.6%
MINING & QUARRYING	4	6,930,000	204	1.5%
OTHER BUSINESS SERVICES	15	12,808,000	824	2.8%
PROFESSIONAL SERVICES	21	14,080,000	890	3.0%
REAL ESTATE	6	68,103,000	1,274	14.7%
TOURISM	22	156,504,000	1,272	33.8%
TRANSPORT, COMM & STORAGE	7	10,610,000	486	2.3%
WATER & ENERGY	8	20,345,148	531	4.4%
Totals	**184**	**462,525,148**	**17,815**	**100%**
H2 2004/05	108	550,882,631	11,910	
H1 2005/06	165	302,701,000	15,718	
H2 2005/06	184	462,525,148	17,815	
H2 2004/05-H2 2005/06	70.4%	-16.0%	49.6%	
H1 2005/06-H2 2005/06	11.5%	52.8%	13.3%	

Source: Uganda Investment Authority

8.6 Activity at the Uganda Securities Exchange (USE)

The Uganda Securities Exchange (USE) recorded substantial gains in activity in the second half of 2005/06 compared to the second half of 2004/05 and the first half of 2005/06. Total turnover grew by 68.1 percent and 117.9 percent respectively, over the observation period. The number of shares traded however, declined over the same period as can be seen from Table 17. The growth in turnover may be explained by the average equity price at the USE that grew by 76.6 percent and 21.3 percent respectively, during this period.

In the second half of 2005/06, Market Capitalization of the USE grew by 70.5 percent compared to the corresponding half of 2004/05. Consequently, the USE All Share Index rose over the same period as can be seen from Table 18.

The second half of 2005/06 saw the listing of another Kenyan-based Insurance Company - Jubilee Holdings limited, which listed on February 14, 2006. This brings to 8 the number of listed companies and to 3 the number of cross-listed companies on the USE. Another development at the USE was the increase in the number of trading days from 2 to 3 days per week. The trading days are now Monday, Tuesday and Thursday. The increase in the number of days is attributed to increased demand for trading opportunities resulting from improved awareness by the population about the functions and operations of a Securities Exchange. In the same vein, to further encourage savings and promote the capital market, the government reduced withholding tax on dividends distributed by companies listed on the Stock Exchange and exempted the income of the investor compensation fund from taxation, effective July 2006.

Table 17: Trading at Uganda Securities Exchange for 2002/3 – 2005/6

	H2 2004/05	H1 2005/06	H2 2005/06	H2 2004/05 - H2 2005/06	H1 2005/06 - H2 2005/06
Turnover (UShs.)	529,658,870	408,641,988	890,338,614	68.10%	117.88%
Number of Shares traded	1,233,792	965,285	856,085	-30.61%	-11.31%
Mkt Capitalisation (Bn UShs.)	2238.92	3426.28	3817.31	70.50%	11.41%
Average trading price (UShs.)	2,179	3,173	3,848	76.59%	21.27%
USE-All Share Index	478.80	698.89	756.40	57.98%	8.23%

Source: Uganda Securities Exchange (USE)

8.7 Leasing activity

The value of assets disbursed in the second half of 2005/06 declined by 3.7 percent and 32.7 percent compared to what was disbursed in the corresponding period of 2004/05 and the first half of 2005/06 respectively. Transport, Commerce and trade sub sectors were the consistent beneficiaries of this credit over the period under review. However, manufacturing and Agriculture sectors also featured prominently.

Table 18: Value of Assets leased: 2004/05 – 2005/06

Sector	Leasing disbursements in million Shs. H2 2004/05	H1 2005/06	H2 2005/06	H2 2004/05 - H2 2005/06	H1 2005/6 - H2 2005/06
Transport	2,105.62	3,973.47	953.86	-54.7%	-76.0%
Commerce & Trade	1,472.38	4,002.62	1,699.00	15.4%	-57.6%
Mining & Construction	277.60	84.50	1,060.38	282.0%	1154.9%
Tourism	-	26.50	102.34	-	286.2%
Health	226.61	538.71	131.82	-41.8%	-75.5%
Agriculture	197.31	76.17	294.30	49.2%	286.4%
Manufacturing	762.21	240.19	1,615.50	112.0%	572.6%
Education	187.65	56.39	442.93	136.0%	685.4%
Banking	321.83	543.77	5.28	-98.4%	-99.0%
Real Estate	-	-	58.56		
Other Services	1,413.80	426.60	343.70	-75.7%	-19.4%
TOTAL	**6,965.01**	**9,968.92**	**6,707.69**	**-3.7%**	**-32.7%**

Source: Bank of Uganda

9.0 MEDIUM-TERM OUTLOOK AND CHALLENGES

The medium-term outlook is promising. GDP is projected to grow at an average rate of about 6.0 percent over the next three years and both annual underlying and annual headline inflation rates are expected to stabilize at or below the percent level. Gross national savings and domestic investment are expected to rise to more than 22 percent of GDP. Revenue performance is also projected to rise to about 14 percent of GDP, while gross reserves are projected to remain at a level of more than 6 months of future imports of goods and non-factor services. Export receipts are projected to increase by about 10 percent per annum, while the terms of trade are expected to improve as the drive to diversification gains momentum.

The Government is committed to addressing the current energy crisis. Plans are also underway to construct 2 hydropower projects at Bujagali and Karuma and to procure additional thermal power. For immediate alleviation of the energy crisis, import taxes on generators were waived in the 2006/07 budget.

Notwithstanding the promising medium-term outlook however, significant challenges still lie ahead in the near term. First, sustaining high economic growth rates and macroeconomic stability remain the key objectives of economic policy in the medium-term. Any policy slippage will be detrimental to the national development aspirations. Secondly, sustaining high growth and low inflation in an environment of ever increasing international oil prices amidst persistent power shortages on the domestic scene calls for concerted efforts by government to address the energy crisis. Otherwise, the risks to the medium-term growth posed by energy problems are real and could spill over to inflationary pressures.

Going forward, Bank of Uganda recognises the need to further deepen the financial sector in order to make it more robust and resilient to shocks that could emanate from domestic and/or external sources. In addition, it is mindful of the challenges it has in supporting governments poverty reduction efforts through achieving and sustaining a growth rate of 7.0 percent per annum, and increasing access of the poor to financial services.