East Africa Quarterly Bulletin

VOLUME 1, ISSUE 2

SECOND QUARTER 2012

CONTENTS

REGIONAL OVERVIEW 3

COUNTRY UPDATES 5

TOPICAL THEME 28

STATISTICAL ANNEX 34

- BURUNDI
- KENYA
- RWANDA
- SEYCHELLES
- TANZANIA
- UGANDA

Special Theme: Natural Gas Discoveries in Tanzania: Prospects and Challenges
The East Africa Quarterly Bulletin is produced by country economists attached to the African Development Bank Group’s (ADB) East Africa Department. The publication covers all five member states of the East African Community (EAC) as well as the islands of The Seychelles. It is part of the ADB’s surveillance of economic and policy developments across the continent and provides summary information on the previous quarter’s major developments across the region for which quarterly data are available on a timely basis. Where appropriate, the report also attempts to draw some implications of those developments. The report is deliberately crafted to be succinct and in non-technical language for wider circulation. Each issue also includes a dedicated section in which a topical subject (either about a single country or several of them) is explored.

This issue is produced from information gathered through consultations, review of country documents, and other relevant sources. Contributors to this issue include Bernis Byamukama, Prosper Charle, Peninah Kariuki, Alex Mubiru, Edward Sennoga, Joel Tokindang, Walter Odero, and Richard Walker, under the general guidance of Gabriel Negatu, Director of the ADB’s Eastern Africa Regional Center (EARC) in Nairobi, Kenya, as well as the respective Resident Representatives of the ADB in Burundi (Abou Ba), Rwanda (Negatu Makonnen), Tanzania (Tonia Kandiero), and Uganda (Patrick Khaemba). The thematic section in this issue was written by Prosper Charle.
MACROECONOMIC DEVELOPMENTS

Macroeconomic policies implemented since the last quarter of 2011 resulted in stable and declining inflation and reduced exchange rate stability, two of the primary challenges that were experienced during the second half of 2011. East African governments are expected to sustain the use of judicious monetary and fiscal policy tools to control inflation, sustain exchange rate stability while promoting expansion of credit to the private sector so as to bolster economic growth.

Growth figures for the first quarter of 2012 reveal that the Eastern Africa region has sustained the strong end-2011 economic growth momentum. Real GDP increased by more than 7 percent during the first quarter in Rwanda and Tanzania and strong performance was also reported for Seychelles and Uganda. Uganda posted a positive real GDP growth rate in the first quarter of 2012 following negative growth in the last quarter of 2011. Burundi continues to be adversely affected by a series of negative shocks including high inflation, falling public revenue collections, and receding development partner support. Economic data from the region indicates several drivers of growth during the first quarter including services (Rwanda), industry (Uganda and Tanzania) and tourism (Seychelles).

Fiscal Stance

Diverse fiscal policies were implemented during the quarter under review. For instance, countries with an IMF supported Policy Support Instrument programme – Rwanda, Seychelles, Tanzania, and Uganda – implemented fiscal consolidation strategies emphasizing the prioritization of public spending and increased domestic revenue mobilization. A combination of domestic factors, largely due to a fragile political environment and external factors including reduced aid commitments and rising fuel prices precipitated the revision of the FY 2011/12 budget in Burundi in June 2012, at a time when the other EAC partner states where tabling their FY 2012/13 budgets.

In Kenya by contrast, policymakers continued the expansionary fiscal policy of the last several quarters of 2011, largely the result of higher expenditures on infrastructure, the public sector wage bill as well as the continued costs of implementing the country’s new constitution.

National expenditure policies for FY 2012/13 have been informed by the respective countries’ national development plans, demonstrating a clear linkage between development planning and budget priorities. Thus, infrastructure development, strengthening productive capacities in agriculture and industry and consolidating gains in human development are among the core priorities for FY 2012/13.

Monetary and Financial Sector

Policy makers in the East African economies implemented cautious monetary policy during the quarter under review to further counteract the inflationary pressures

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1 Second quarter GDP growth data were not yet available at the time of publishing this report.
that plagued the sub-region’s three largest economies—Kenya, Tanzania and Uganda—during the second half of 2011. As indicated in Chart 1, while still double-digits, headline inflation decreased consistently through the second quarter of 2012 an indication of the effectiveness of these monetary policies. The other drivers of the receding inflationary pressures included lower oil prices and good food harvests resulting from favorable weather and productive capacity enhancing strategies such as the Crop Intensification Programme in Rwanda and Kilimo Kwanza in Tanzania. Stable exchange rates also minimized the exchange rate pass-through effects on domestic inflation.

Stronger domestic demand and depreciation of the rupee contributed to the rising inflation in Seychelles during the quarter under review while bad-weather-induced poor food harvests led to an increase in inflation in Rwanda in May. However, inflation remains in single-digits in both countries.

![Chart 1: Regional Inflation Developments (percentage)](chart)

**Source:** National Statistics Bureaus (various countries)

**External Sector**

All EAC partner states reported an increase in export earnings during the quarter under review. However, rising import demand, ranging from finished manufactured goods to intermediate and capital goods imports to support strategic public sector investments (Rwanda) and oil and gas exploration in Kenya, Tanzania, and Uganda contributed to rising trade deficits. Thus, implementation of export diversification strategies remains critical.

Section II provides more details on major macroeconomic developments across the region. Following this, Section III examines the prospects and challenges of the recent natural gas discoveries in Tanzania and concludes with a discussion on possible opportunities for support and collaboration with various stakeholders including development partners.

- While still in single digits, depreciation of the rupee led to rising inflation in Seychelles during the second quarter while poor harvests contributed to a spike in inflation in Rwanda in May.

- Rising export receipts were offset by high import bills in the East African economies resulting in higher trade deficits.
II | COUNTRY UPDATES
MACROECONOMIC DEVELOPMENTS

Economic Growth

A series of negative shocks, observed at the beginning of 2012, continue adversely affecting Burundi’s economy. For the year 2012, the real GDP growth will be driven by agriculture, construction and tourism sectors, and improved electricity supply, is expected to reach 4.8 percent compared to 4.2 percent in 2011. This growth scenario assumes a successful reform of the coffee sector and increase the value added in the sectors of construction and tourism. All these growth drivers are not sufficiently implemented since the beginning of 2012 and the situation observed in Q2 is not different from Q1 in terms of growth. Budget support has declined, limiting the government’s ability to maintain public spending levels. Revenue performance was disappointing during the first half of 2012, and economic growth is likely to reach only 4.2 percent in 2012, and less than the initially projected 4.8 percent. Continued uncertainty in the external environment, due to weaker growth in trading partners, lower aid flows, and high oil and food prices, add downside risks to this economic outlook.

Fiscal Stance

Food and fuel price shocks have continued to put pressure on public finance management. High oil prices, combined with the partial pass-through to domestic prices, have impacted on the performance of the Burundi Revenue Authority (OBR) with only 47.8 percent of projected revenues collected at end-June 2012. The yield loss of excise taxes is estimated at 0.6 percent of GDP in Q2 alone. Furthermore, the government decision to suspend taxes on some food products, until the end of the year, also generated revenue losses estimated at Burundian Francs (FBU) 10 billion (0.3 percent of GDP). On the expenditure side, expenditure over-runs amounting to about 0.5 percent of GDP were recorded mainly due to the weak control of the wage bill and increased expenditures in some sectors.

2 Quarterly GDP growth rates not available.

HIGHLIGHTS

- A series of negative shocks including high inflation, falling public revenue collections, and receding development partner support continue to adversely affect Burundi’s economy.
- The Government undertook corrective measures to address the revenue shortfalls and expenditure slippages and adopted a revised budget in June 2012.
The authorities undertook corrective measures to address the revenue shortfalls and expenditure slippages by adopting a revised budget in June 2012. The revised revenue and grants are estimated at FBU 1123.2 billion (US$ 784.5 million), an increase of 2.4% over the initial budget, and the revised total expenditures are 1196.8 billion FBU, a decrease of 1.3% from the initial budget. The overall deficit of the revised budget is FBU 73.5 billion (US$ 105.2 million) and will be funded from external loans (FBU 1.5 billion) and net domestic financing (FBU 72 billion). Revenue enhancement measures were also identified comprising an increase in taxes on income, excise taxes on alcohol, tobacco, telecoms and duties on used cars (0.8 percent of GDP). Privatization receipts from the sale of coffee washing stations and other assets (0.2 percent of GDP) will also complement the public revenues. However, these revenue measures will not fully compensate for revenue slippages and additional expenditure cuts amounting to 0.5 percent of GDP will be required.

**Monetary and Financial Sector**

The Burundian franc (FBU) continued its depreciation against the U.S. dollar in Q2 2012, from FBU 1,400 to the dollar on 1 April to FBU 1,450 on 30 June. Weak economic fundamentals and higher demand for foreign currency are among the key drivers of this depreciation. In addition, declining inflows of donor financing creates speculation and encourages the use of black market. The authorities have agreed with the IMF on the need to focus monetary policy on containing inflationary pressures and maintaining exchange rate flexibility to safeguard the competitiveness of the economy.

Inflation fell in Q2 2012, but remains in double digits. Burundi’s year-on-year inflation rate dropped from 25.2 percent in April (the highest in East Africa) to 17.3 percent in June due to falling food prices. The slowing of food price inflation was due to the government’s decision to lift taxes on basic imported foods. This measure, which entered into force on May 15 and runs until December 31, covers 13 products including cassava flour, maize flour, wheat flour, beans, rice, potatoes, fish and palm oil. Good food harvests also contributed to the reduction in food prices. However, higher transportation costs have a significant effect on import and domestic prices in Burundi.

**External Sector**

Burundi suffers from an acute imbalance between imports and exports. Burundi’s import bill rose 25 percent in the first half of 2012 compared to the same period the previous year, driven up by fuel and food imports which accounted for more than half of total imports. Imports amounted to FBU 511.9 billion (US$ 732.9 million or 15 percent of GDP) during the first half of 2012, up from FBU 410.1 billion during the same period of 2011.

Export earnings rose to US$ 86.8 million (2 percent of GDP) during the first half of 2012, 24 percent higher than the levels recorded during the same period the previous year. The major export crops, tea and coffee, posted strong growth during this period. Tea exports increased to US$13.9 million during the first half of 2012 compared to US$ 12.6 million during the same period in 2011. Export receipts from coffee were estimated at US$ 372.6 million exceeded those of the same period in 2011 by 8.3%.

- Year-on-year inflation eased to 17.3 percent in June from 25.2 percent in April due to falling food prices.
- Receding development assistance inflows and speculation contributed to the depreciation of the Burundian Franc against major currencies.
- The 24 percent growth in export receipts during the first half of 2012 was insufficient to offset the trade deficit.
OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

The security situation remains fragile due to sporadic killings across the country. The murders are alleged to have been committed by both the government and opposition forces. This situation remains a major concern to the international community and has also reflected the widespread impunity and inefficiency of the judicial system in Burundi. Moreover, there are deteriorating governance and corruption trends, and concerns over a looming civil strife. The conflict in eastern DRC is not having a significant impact on the security situation in Burundi. However, the government has deployed a battalion at the border and remains ready to react, if needed, in order to prevent a further deterioration on this front.

The socio-political situation remains delicate. In June, Burundi’s opposition Party of Workers and Democracy began a countrywide campaign against the liberalization of the coffee industry by the Government. The Government plans to privatize all 145 coffee-washing stations to meet a World Bank general budget support conditionality. In late March, civil society and trade unions led a strike to protest against rising electricity rates and fuel prices. Several discussions held to resolve the situation are yet to bear fruit and there is a risk for renewed strikes. Moreover, the recent imprisonment of journalists and civil society activists, on what observers have referred to as tramped-up charges, has further eroded trust in the country’s judicial system.

An executive clemency was granted in June 2012 to pardon certain prisoners (estimated at 4000) including pregnant or breastfeeding women, prisoners with terminal illnesses and at an advanced age, and juveniles and persons aged less than 18 years. Prisoners sentenced to less a maximum of 5 years, except for those convicted of rape, armed robbery, being part of organized gangs, being in illegal possession of firearms and those who breached internal security will also benefit from this clemency which is also aimed at reducing congestion in the prisons. Prior to this clemency, the total prison population was estimated at 10,484 and in excess of the 4,050 prison capacity.

Private Sector Activity

The government continued to implement the investment climate reforms aimed at improving the business environment so as to bolster private sector development. In May-June 2012, the World Bank Investment Climate team conducted a joint scoping mission with Government to determine the feasibility of tourism investment opportunities. Several areas were identified during this mission including the Ruvubu National Park; the south-eastern highlands; the coastal strip of Lake Tanganyika and the capital Bujumbura.

Institutional Reforms

The government adopted, in June 2012, the new PFM strategy, which aims to foster greater transparency and accountability in public finances and, thus, encourage further donor support. The new PFM strategy, based on the results of the PEFA evaluation and on IMF technical assistance, proposes the adoption of a multi-year
approach to budget preparation for 2012–15, modernization of the legal framework, better control of budget execution, including the wage bill, and strengthening the institutional arrangements governing the OBR. The implementation of the strategy will be supported by TA provided from development partners (IMF, AfDB), with a focus on training and capacity building.

**Donor Relations**

Weak commitment from budget support donors has had a negative impact on the management of public finances. While multilateral donors (WB, AfDB, and EU) continue to provide budget support, albeit with stronger conditionality, bilateral donors have become less engaged. Perceived lack of progress on human rights and rule of law remain key concerns for donors, particularly the bilateral donors. External assistance is projected to finance nearly 45% of the budget in 2012. In addition to measures already taken by the Government, in the short term this situation could lead to higher pressures to improve revenue mobilization, administration and collection, and to rationalize and contain fiscal expenditures. The decline in total revenues (due to lower grants for budget support) could have an impact on growth and inflation.

The authorities and the IMF held discussions took place in May and June 2012 within the framework of the IMF’s Article IV consultations and the first review of the government’s Economic and Financial program. The program, which is supported through the IMF’s Extended Credit Facility (ECF), is aimed at increasing the country’s competitiveness so as to increase growth and economic development. The discussions focused on the necessary economic policy responses to the shocks with a view to maintaining economic stability and accelerating poverty reduction. Compensatory measures to offset the decline in budget support and revenue slippages, while preserving pro-poor spending, were also discussed. The IMF encouraged the authorities to strengthen the fiscal position by accelerating revenue mobilization efforts and strengthen public financial and debt management. The IMF Executive Board will consider the Article IV Consultations and first review of the ECF in July 2012.
MACROECONOMIC DEVELOPMENTS

Economic Growth

Real GDP grew by 3.5 percent in the first quarter of 2012, compared to 5.4 percent during a similar period in 2011. Leading economic indicators for the second quarter of 2012 points to continued growth to be in line with the growth projection of 5.2%. The main sectors driving the growth include Electricity and Water, Transport and Communication, and Agriculture and Forestry. Growth in 2012 is still projected at between 3.5 percent and 4.5 percent.

Fiscal Stance and Public Debt

The cumulative overall fiscal balance, on a commitment basis (excluding grants), amounted to a deficit of KShs. 199.6 billion (equivalent to 6.0 percent of GDP), as at end-June 2012, compared with a deficit of KShs. 144.3 billion (equivalent to 5.2 percent of GDP) in a similar period in 2011. At the end of the first Quarter 2012, the balance amounted to a deficit of KShs. 141.9 billion (equivalent to 4.3 percent of GDP).

The central government cumulative revenue collection including at end of June 2012 amounted to KShs. 748.2 billion (equivalent to 22.6 percent of GDP) against a target of KShs. 804.5 billion. At the end of March 2012 Revenue stood at KShs. 504.8 billion (equivalent to 15.3 percent of GDP) against a target of KShs. 552.5 billion. By contrast, central government cumulative expenditure and net lending stood at KShs. 646.7 billion and KShs. 947.8 billion at end of the first and second quarters respectively.

Gross public debt increased from KShs. 1,387.1 billion at end-June 2011 to KShs. 1,633.6 billion at end-June 2012, of which, 47.4 percent was external debt and 52.6 percent domestic debt. Gross public domestic debt increased from KShs. 859.2 billion to KShs. 764.2 billion during this period. The total external debt stock stood at KShs. 774.6 billion at end-June 2012 compared to KShs. 676.3 billion at end-March. The external debt stock comprised multilateral debt (59.8 percent), bilateral debt (31.8 percent), Export Credit debt (1.9 percent) and Commercial banks (6.5 percent). China’s lending to Kenya increased to KShs. 109 billion (US$ 1.4 billion).

HIGHLIGHTS

- The economy continued to experience macroeconomic stability in the second quarter of 2012 with inflation easing and exchange rate stabilizing.
- The fiscal balance excluding grants increased from 6 percent of GDP at end-June 2012 up from 5.2 percent during the same period last year due to underperformance in revenue collections.
This followed the signing of a KShs. 6 billion concessional loan to finance the National Fibre Optic Backbone Infrastructure.

The Government presented the 2012/13 budget in June, with emphasis on pro-poor spending; enhanced equity; and private sector growth. The budget increased expenditure on education, health and social protection with additional spending targeting the elderly, orphans and vulnerable children and the girl child. In terms of enhanced equity, about 10% of the overall budget is set aside to finance County Government operations and activities, the first time such an allocation is made in the budget. Finally for private sector growth, taxation measures were proposed to cushion domestic industries including (i) raising of duty on galvanized wire from 0% to 10% and (ii) zero rating all imported software to encourage growth of ICT.

**Monetary and Financial Sector**

Headline inflation declined from 15.6 percent in March 2012 to 10.0 percent in June 2012 reflecting further easing of food and fuel inflation. Previously, inflation had eased to 18.3 percent in January 2012 from the peak rate of 19.7 percent at the end of November 2011. Reduction in fuel pump prices by the Energy Regulatory Commission, declining maize and sugar prices, falling global prices, and a stable exchange rate are some of the factors behind the easing of overall inflation. In addition, the tight monetary policy adopted by the Central Bank of Kenya since November 2011 also contributed to the easing of the inflation. The outlook is for continued easing of inflation at single digit levels in months ahead due to further reduction in fuel prices and stabilized food supply.

The Kenya shilling exhibited relative stability against major international currencies standing at KShs. 83.06 per US dollar at the end of March 2012 and KShs. 84.10 per US dollar in the week ending June 28, 2012. This followed an all-time low of KShs. 107 to one US Dollar in October 2011. The appreciation and relative stability of the Kenya Shilling against the dollar is still mainly supported by relatively tight liquidity in the domestic money markets after the Central bank Rate was raised to 18 percent on 1st December 2011. The rate has since been lowered marginally to 16.5 percent at the end of June 2012.

The non-encumbered official foreign exchange reserves held by the Central Bank stood at US dollar 4,924 million (equivalent to 4.13 months of import cover) as at June 28, 2012. This reflected a marginal rise from USD 4,365 million (equivalent to 3.84 months of imports) at the end of March 2012 having risen from USD 4,248 million (end-December 2011).

**External Sector**

Kenya’s overall Balance of Payments position improved from a surplus of US$ 261 million in the year to June 2011 to a surplus of US$ 841 million in the year to June 2012. The current account deficit grew to US$ 3,893 million in the year to June 2012 from US$ 2,800 million in the year to June 2011 resulting from a 21.1 percent or US$ 1,706 decline in the Merchandise account. The surplus in the services account increased by 11.6 percent or US$ 613 million to US$ 5,919 million in the year to June 2012 mainly due to growth in the Non-factor services account and the Current Transfers Account. Income account inflows declined by US$ 20 million to US$ 199 million in the year to June 2012, resulting from a decline in receipts from investment income.
OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

The 4th March 2013 was finally agreed as date when Kenyans will vote in their next president and members of the legislative assembly. Full preparations were in progress during the second quarter, with several pieces of legislation passed that will guide elections ensuring that violence which occurred after the last elections is avoided.

Institutional reforms

Having accomplished most of the Agenda IV (long term) reforms agreed after the post-election crisis of early 2008, including adoption of a new constitution (August 2010), Parliament has this quarter adopted and passed key legislation including the (i) National Land Commission Bill, (ii) Land Bill 2012 and (iii) Land Registration Bill. These laws will help forestall the land related crises that were identified under the long term Agenda IV reforms. Similarly, Parliament passed two key legislations required for the implementation of the devolved systems of government. These were the Public Finance Management Bill and the County Government Bill. The two bills will govern the operationalization of the devolved government systems.

Private Sector Activity

The syndicated loan agreed during the first quarter between the Government and a consortium of international banks including Citibank and South Africa’s Standard Bank Government worth US$ 600 million (Kshs. 50 billion), were disbursed during the second quarter.

The banking sector channeled its credit largely to the private sector which accounted for 78.5 percent of total lending in June 2012 compared with 77.7 percent in similar period in 2011. The net increase in private sector credit in the year to June 2012 was Kshs. 172.2 billion compared with Kshs. 245.5 billion recorded in the year to June 2011. This translated into an annual growth rate of 16.5 percent compared with 30.7 percent in the year to June 2011 and corresponding target of 16.8 percent in June 2012.

Donor Coordination

During the month of June 2012, the Government and Development Partners held the first biannual Partnership Forum under the Chairmanship of the Prime Minister. The meeting agreed on a set of twelve deliverables to be achieved within the next six months. They include setting up of structures to ensure free and fair elections; setting up institutions and enacting legislation to facilitate fiscal decentralization; addressing climate change, social protection, gender equity and health policy issues as well as communication on infrastructure investments (especially on the ports of Mombasa and Lamu).
Real GDP increased by 7.7 percent during Q1 2012, lower than the 8.4 percent registered in Q4 2011 but higher than the 6.5 percent achieved in Q1 2011. The service sector was the key driver of the expansion in Q1 2012, growing by 14.2 percent compared to 6 percent during the same period the previous year. Growth in services sector, which accounts for 48 percent of GDP, was driven by growth in transport and communication services (19.2 percent) and public expenditure led services (14.2 percent) including; health, education and public administration.

The agriculture sector, which accounts for 32 percent of GDP, recorded a modest growth of 3 percent on account of a weaker performance from exports crops. Heavy rains destroyed the tea plantations and reduced production in the first half of 2012 by 7 percent compared the same period the previous year.

Industrial growth was weak at 1.1 percent compared 14 percent in Q1 2012. Mining and construction, the two dominant subsectors in industry, stagnated. Production in the mining subsector returned to its trend level after the stock piled minerals – resulting from the implementation of mineral certification program3 – were exhausted at the end of 2011. The construction sector contracted by 0.7 percent due to delays in obtaining construction permits from Kigali City Council following the introduction of new urban planning guidelines.

Fiscal Stance and Public Debt

Fiscal consolidation through increased domestic revenue mobilization and expenditure prioritization to close the fiscal gap remains the key thrust of Government’s fiscal policy stance in 2012. In line with this objective, Tax collection in Q2 in 2012 edged upward from RWF 145.1 billion in Q1 to RWF 154 billion achieving a growth rate of 7 percent compared to the 5 percent attained during the same period in 2011. Total domestic revenue for the first half of 2012 reached RWF

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3 The Mineral certification program came into effect in 2011 following the passing of Frank DODD legislation by the US congress prohibiting mineral imports from conflict areas.
300 billion (US$ 492 million) exceeding the targeted RWF 285.2 billion (US$ 467.6 million). Revenue collection was driven mainly by direct taxes and taxes on goods and services which jointly accounted for 93 percent of the total tax revenue. International trade taxes accounts for a small share of 7 percent due to losses in import duties on goods originating from the EAC customs union especially consumer goods which attract a zero tariff.

The Rwanda Revenue Authority has planned additional tax measures to further bolster domestic revenue mobilization efforts. The new measures include; increasing the flat tax rate on construction materials from the 5 percent to 10 percent, introduction of a gaming tax and a flat tax on SME based on turnover, introduction of Electronic Tax Registers for VAT and streamlining the exemptions under investment code. Jointly, these revenue enhancing measures are expected to yield US$ 45 million in additional tax revenues during FY 12/13, increasing the revenue/ GDP ratio to 14% up from 13.8 percent FY 11/12.

The June 2012 Debt sustainability analysis concluded that; at an external debt stock level of US$1.1 billion or 18 percent of GDP, Rwanda is still assessed at a moderate risk of debt distress. As a result, Rwanda’s request for an increase in the non-concessional borrowing ceiling from US$ 240 million US$ to 255 million was approved by the IMF board in June 2012. However, vulnerabilities to adverse external shocks remain due to the country’s narrow export base and underscore the need for the Government to fully implement the national export strategy so as to expand the export base.

**Monetary and Financial Sector**

Implementation of monetary policy was guided by the central bank’s objective of achieving low and stable inflation while allowing adequate growth in the private sector credit to support economic growth. In line with this objective, the central bank increased its policy rate from 7 percent held since November 2011 to 7.5 percent in May 2012.

Headline year-on-year headline inflation decreased from 8.34 percent at end-December 2011 to 8.18 percent at end-March 2012 and further to 5.92 percent at end-June 2012. Core inflation mirrored similar trends, decreasing to 3.65 percent at end-June from 5.27 percent and 8.25 percent at end-March 2012 and end-December 2011 respectively. Increased food production and the increase in the central bank’s policy rate contributed to this reduction in inflationary pressures. The Central Bank of Rwanda is expected to continue applying appropriate policy instruments to achieve its dual objective of low average headline inflation targeted at 7.5 percent in 2012 and growth in private sector credit of 18.4 percent.

Financial sector stability was aided by creation of a permanent financial sector stability committee in May 2012. The mandate of this committee will comprise conducting systematic analysis of potential risks to financial sector stability so as to recommend timely mitigation measures. Moreover, the strengthening of the central bank’s supervisory function has contributed to improvements in various indicators of financial stability. For instance, the capital adequacy ratio of the total banking sector improved to 25.4 percent in June 2012 from 25 percent attained in December 2011 while the non-performing loans (NPL) ratio decreased to 6 percent in June 2012 from 6.5 percent in March 2012 and 8 percent in December 2011. Growth indicators for the banking sector improved with total assets, deposits and gross loans increasing by 11 percent, 13 percent, and 20 percent between December 2011 and June 2012.

- The IMF increased the non-concessional borrowing ceiling from US$ 240 million to US$ 255 million due to the country’s sustained moderate-debt stress risk rating.
- Headline inflation continued to decrease, falling from 8.18 percent for the year ended March 2012 to 5.92 percent at end-June.
- Financial sector stability indicators improved and the sector’s soundness was further consolidated by the creation of a permanent financial sector stability committee in May 2012.
and June 2012. The Microfinance sector also exhibited improved performance with total assets increasing by 22 percent (to RWF 94.6 billion at the end of June 2012 from RWF 77.4 billion in December 2011). The sector's NPL ratio also improved from 12 percent to 8.3 percent during this period.

Findings from the Finscope survey conducted in March 2012 indicate that the percentage of adult population with access to formal and informal banking services has increased to 71.8 percent in 2012 from 47.5 percent in 2008. This rise in financial inclusion is attributed to the financial sector development policies implemented since 2008 including the establishment of 416 Savings Cooperatives across the country and financial literacy campaigns. Moreover, the findings from central bank's SME financing survey indicate that SMEs account for 17 percent of the total lending portfolio.

**External sector**

Total export earnings in the first half of 2012 increased to US$ 195.23 million and were 25 percent higher than US$ 156.02 million recorded during the same period in 2011. The increase in export earnings was mainly driven by coffee, tea and minerals which jointly account for 57 percent of the export earnings. The volume of coffee exports increased by 51.8 percent in the first half of 2012 compared to the same period the previous year offsetting a decline in the average international prices for coffee from US$ 3.62/Kg in 2011 to US$ 3.53/Kg in 2012. Imports increased to US$ 851.3 million during the first two quarters of 2012 up from US$ 701.1 million recorded in the corresponding period in 2011. Imports of capital goods accounted for 42.3 percent of the total imports driven by demand from private and government’s strategic investment projects. This contributed to an increase in the trade deficit from US$ 545.1 million to US$ 656.1 million in the first half of 2012 relative to the same period last year.

Rwanda’s trade with the EAC region increased. Exports to the EAC increased to US$ 57.3 million during the first half of 2012 from US$ 36 million during the first two quarters of 2011 while imports increased to US$ 397.2 million from US$ 365.9 million during the same period. Informal cross border exports reached US$ 51.02 million during the first two quarters of 2012, accounting for more than one third of the formal exports, up from US$ 30.52 million during the same period in 2011. Informal cross border imports amounted to US$ 10.48 million. However, the informal trade balance recorded during the first half of 2012 at US$ 40.56 million was less than the US$ 176.3 million recorded during the first six month of 2011.

The central bank continued to implement a market driven exchange rate policy, intervening in the market only to smooth exchange rate volatilities. The local unit exhibited minimal fluctuations during the second quarter, depreciating by 0.2 percent against the USD and appreciating against the Kenya Shilling (2 percent) and Tanzanian Shilling (1 percent). The Rwanda Franc was stable against other major and regional currencies.

**OTHER NOTABLE DEVELOPMENTS AND UPDATES**

**Political Developments**

Fighting in eastern Democratic Republic of Congo (DRC) erupted in April 2012 and has since displaced more than 250,000 people in the region with the majority...
fleeing to Rwanda and Uganda. The instability in eastern DRC has several implications for Rwanda and the region. The major impact is exacerbating political instability in the region and the subsequent adverse economic effects especially given that DRC is among Rwanda's major trading partners. A protracted conflict could also negatively affect tourism in the Virunga national park, a trans-boundary habitat cutting across Rwanda, DRC, and Uganda and also the only home to the World's remaining mountain gorilla population.

Several measures have been explored both within the framework of the African Union (AU) and the International Conference of the Great Lakes Region (ICGLR). For instance, Rwanda and DRC agreed to work with the AU and the United Nations on the immediate establishment of a neutral international force to eradicate armed groups in eastern DRC during the 19th AU Summit in Addis Ababa. Follow-up meetings to agree on the composition and mandate of this international force were held in Khartoum in July (for regional Ministers of defense and security chiefs) and in Kampala in August (ICGLR summit). It is expected that these on-going efforts will contribute to lasting security solutions to the lightly governed regions in the Great Lakes region.

Institutional Reforms

The operations of Gacaca courts were officially closed on the 18th June 2012 bringing to a close the Rwandan traditional Justice system introduced in 2002 to adjudicate genocide related cases. The Gacaca courts adjudicated 2 million genocide cases in a span of 10 years and contributed to unity and reconciliation. Its success in responding to difficult post genocide questions underlies Rwanda's new approach to using home grown solutions to solve her domestic challenges.

Donor Relations

The Executive Board of the IMF approved on June 7, 2012, the 4th review of the Policy Support Instrument (PSI) for Rwanda. The review noted that Rwanda’s real GDP growth rate at 8.6 in 2011 was strong and inflation at 8.3 percent in March was modest and the lowest in EAC. The assessment concluded that the program supported under the PSI remains on track and all quantitative assessment criteria for end-December 2011 including fiscal and monetary targets were met. Most structural benchmarks were also met, albeit some with delays. The assessment however noted that elevated risks due to the slowdown in the global economy and high fuel prices could jeopardize the 7.7 percent projected real GDP growth rate for 2012. In this regard, the review recommended vigilance in the exercise of monetary policy to ensure low and stable inflation. In addition, the review recommended that GoR should continue to pursue fiscal consolidation in line with the PSI objectives.

Government and Budget Support Development Partners held the 15th Joint Budget Support Review (JBSR) in May 2012 to discuss and agree on targets and strategic priorities for FY 12/13. The JBSR concluded that the FY 11/12 reform programme was on track and commended the manner in which the previous forward looking review was conducted. The JBSR in particular noted that the significant amount time which was allocated to the process of quality assurance to the joint sector review ensured a better quality of the sector summary reports and the Common
Performance Assessment Framework (CPAF) of the EDPRS. In addition, the JBSR considered and agreed upon the priorities to achieve the Economic Development and Poverty Reduction Strategy (EDPRS) targets including fiscal consolidation, anchored on public expenditure prioritization and enhanced domestic revenue mobilization; infrastructure development particularly in energy. The other priorities included job creation and enterprise development; human capital development; harnessing tourism and mining potential, and promoting diversified local economic development.

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4 The CPAF is the basis for a joint annual assessment of the Government’s performance in the implementation of the EDPRS.
Economic Growth

Performance of tourism, which accounts for 25% of GDP, continued to be buoyant in the second quarter of 2012 (Q2) with tourist arrivals increasing by 5.3 per cent to 48,836 from 46,386 in the corresponding quarter of 2011. This mainly reflects an increase in tourists from non-traditional markets such as Russia and Asia due to the country’s successful marketing efforts, as the crisis in the Euro area has led to lower numbers from the traditional key European markets including France, Italy and the UK. However, the higher numbers have not translated into increased tourism earnings as the average number of nights declined from 9.7 in the second quarter of 2011 to 9.4 in the quarter under review.

Fiscal Stance and Public Debt

The fiscal outturn resulted in a lower surplus of SCR 109 million (0.8 per cent of GDP) at the end of May 2012 compared to the level of SCR 151 million (1.1 per cent of GDP) at the end of March. Gross public debt increased from SCR 10.3m at the end of March 2012 to SCR 10.6 million at the end of May 2012, of which the bulk was external debt at 59.8 per cent of the total. The increase in the debt stock was mainly due to an increase in domestic debt (from both Treasury bills and bonds) as external debt declined during the period. In terms of the ratio to GDP, external debt declined from 47.1 percent to 46.7 per cent, while domestic debt increased by 2.7 percentage points from 28.7 percent to 31.4 percent. Commercial debt remains the most significant source of external debt, accounting for 51 percent of the total, while bilateral and multilateral creditors account for 33 percent and 16 percent respectively.
Monetary and Financial Sector

The upward trend in inflation continued in the quarter under review, although the rate remained within single digits. The annual average rate rose consistently from 3.9 percent in March 2012 to 5.5 percent in June, while the year-on-year rate rose from 5.9 percent to 8.9 percent during the same period, thus reaching a new high since October 2009. The causes of the inflationary pressures include higher food and fuel prices, stronger domestic demand (spurred by tax cuts) and a depreciation of the rupee that is pushing up import costs.

With regard to interest rates, the 91-day Treasury-bill rate continued to exhibit the marginal increase since the last quarter and ended at 5.61 per cent in June 2012. This upward trend in the rates for Government securities is expected to continue during 2012-13 owing to the inflationary pressures, but it is unlikely that they will go into double digits. Commercial banks’ lending rates are tracking the rates on Treasury bills and rose to 11.6 percent in June 2012.

Commercial banks’ credit to the economy declined marginally from SCR 3.0 billion in March 2012 to SCR 2.9 billion in May 2012. The tourism sector remained the main beneficiary, with 24 percent of the total credit. The other sectors that received significant credit were private households (15 percent) and real estate (12 percent).

External Sector

The Seychelles Rupee continued to depreciate steadily in the quarter under review, to trade at 14.45 against the US dollar at the end of June 2012 from 14.04 at the end of March 2012. The depreciation largely reflects the adverse impact of the crisis in the Euro zone on tourism earnings. Although it does not seem likely that the large currency swings that occurred after the rupee’s free flotation in October 2008 will recur, a possible downturn in tourism can be expected to adversely affect the value of local currency. The official foreign exchange reserves held by the Central Bank of Seychelles rose to USD 303 m (2.8 months’ of imports) from USD 292m by end-March 2012 (2.7 months’ of imports).

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

A number of developments during the quarter indicated that the authorities had adopted a new and positive leadership strategy. First, President Michel met with the leader of the opposition, David Pierre, in line with their agreement to meet once a month to discuss issues of national importance. Among the issues that the two leaders discussed were the rising cost of living in the country, and the need to boost employment opportunities. Second, the President also chaired a meeting of the National Economic Council and discussed concerns of the Seychelles Chamber of Commerce and Industry (SCCI) with regard to key economic issues such as the introduction of the Value Added Tax (VAT), the rate of inflation, the liquidity situation, as well as the state of the tourism industry and unavailability of economic data. The discussions appear to have influenced the Government’s announcement to delay the introduction of the VAT in July saying that the business community is not ready. However, it remains to be seen whether the

- The upward trend in inflation continued during the second quarter but remained within single digits.
- The Seychelles Rupee continued to depreciate, trading at 14.45 against the US dollar at end-June 2012 from 14.02 at end-March.
move signals an easing of the reform programme that has been adopted since 2008.

Private Sector Activity

The Government announced the creation of a new finance institution, the Small Business Financing Agency (SBFA), to replace the Concessionary Credit Agency. The role of the SBFA will be to provide key support for the activities undertaken by small enterprises to enable them to contribute to the realization of a stable and vigorous economy. The board members include officials from the Seychelles Chamber of Commerce and Industry, Ministry of Finance, and the Bankers’ Association.

Donor Coordination

The issue of fighting piracy continued to attract considerable attention. The US Secretary of the Navy and Marine Corps made a two day visit to Seychelles and held discussions with Vice-President Danny Faure. He commended Seychelles for the efforts in combating piracy and reiterated the United States’ commitment to contribute towards the setting up of the Anti-Piracy Coordination Centre in the country as agreed recently during a meeting in London on Somalia. In addition, a high level delegation from the State of Puntland, Somalia, visited Seychelles to discuss areas of cooperation in the field of maritime security and the fight against piracy. Among the issues discussed was the release of two Seychellois fishermen being held hostage by Somali pirates since November 2011 and the repatriation of Somali pirates imprisoned on the island.

The country also held discussions with a number of delegations from bilateral donors. The Indian President, Mrs. Pratibha Devisingh Patil, visited Seychelles and offered the country financial support amounting to US $75 million. Her discussions with President Michel also included defence cooperation in the joint fight against Indian Ocean piracy, opportunities for bilateral economic cooperation, as well as human resource development. A leading Chinese firm met with Vice President Danny Faure and expressed interest in supporting infrastructure development in Seychelles. The projects to be considered include the upgrading of the Public Utilities Corporation power distribution network, and the Grand Anse dam project. Seychelles and China also signed a Memorandum of Understanding aimed at enhancing cooperation in the fields of tourism, culture, and economic affairs.

Among the multilateral donors, the European Union (EU) announced that Seychelles will continue benefitting from 0% trade tariffs for its exports to the EU under an interim Economic Partnership Agreement, which came into force on 14 May. The agreement is the first of its kind to be implemented in Africa and is a continuation of the Cotonou Accord, which replaced the Lomé Convention linking the EU to the ACP (African, Caribbean and Pacific) states.

At the regional level, Mauritian Prime Minister Navinchandra Ramgoolam made an official visit to Seychelles. He met with President Michel and the two leaders signed an agreement to jointly manage the Mascarene plateau. They also held discussions on enhancing cooperation in health and education.

- President Michel held the first monthly meeting with the leader of the official opposition in a display of a positive change in leadership style and discussed matters of national importance.
- The Government postponed the introduction of the proposed VAT after a meeting with private sector stakeholders. However, it remains to be seen whether the move could signal a slackening of the reform agenda.
- The country hosted diverse donors and discussed bilateral economic cooperation in a wide range of sectors.
Economic Growth

Following annual growth of 6.4 percent in 2011, Tanzanian economy sustained the momentum posting a 7.1 percent growth during the January – March period. Growth was driven by: mining and quarrying subsector (14.3 percent) – courtesy of double increase in gold production and four-fold increase in diamond production; wholesale and retail trade (9 percent) as a result of increase in traded domestic manufactured goods and imports of merchandized goods; manufacturing (4.8 percent) – following improved power situation in the country; financial intermediation (15 percent) – attributable to increase in the levels of deposits and lending by commercial banks; electricity, gas and water (9 percent) – attributable to increase in electricity generation; and agriculture, including crops, livestock and forestry (1.4 percent) – due to favorable weather and Government’s initiative through provision of subsidized farm inputs. Although the official growth figures for the second quarter of 2012 are yet to be released, the continued favorable weather conditions and stable energy situation should help maintain the economy at a reasonable growth path. Growth will continue to be driven by trade, tourism, manufacturing and services.

Fiscal Stance and Public Debt

By end of June 2012, cumulative domestic revenue – excluding Local Government Authorities’ own sources – was TZS 7,056.6 billion, 4.1 percent higher than the target for fiscal year 2011/12. Tax revenue was 4.8 percent higher than the target and accounted for 98 percent of total domestic revenue. Domestic revenue was 17.9 percent of GDP compared to the target of 17.2 percent for fiscal year 2011/12. This development has come after three consecutive fiscal years of revenue shortfalls. The continued good revenue performance was a result of the administrative measures adopted by the Tanzania Revenue Authority, including; effective implementation of block management activities, intensified tax audits, recoveries of tax arrears and implementation of electronic fiscal device enforcement programs.
Cumulative Government expenditure for fiscal year 2011/12 amounted to TZS 10,279.9 billion by June 2012, equivalent to 81.3 percent of the budget estimates. Recurrent expenditure was TZS 6,929.6 billion and development expenditure TZS 3,350.3 billion, equivalent to 89.8 percent and 68 percent of the estimates, respectively. The low execution of the development budget is partly explained by low outturn of external grants of about TZS 1,619.4 billion compared to the projected amount of TZS 2,717.9 billion. And, based on the preliminary figures (as of June 2012), government budgetary operation for 2011/12 resulted in an overall deficit of TZS 1,796.9 billion, which was financed by foreign loans and domestic borrowing.

Tanzania’s external debt stock stood at US$ 10,354.6 million as at the end of June 2012, equivalent to a 5 percent increase over the US$ 9,899.0 million at the end of first quarter in March. The increase in external debt resulted largely from newly disbursed external debt to the Government and accumulation of interest arrears by the private sector. With these developments, by the end of June 2012 Tanzania’s external debt stood at 43.0 percent of GDP in nominal terms. According to the preliminary results of the recent Debt Sustainability Analysis (DSA), the present value of external debt to GDP was 18.9 percent against the sustainability threshold of 50 percent, suggesting that the country is not facing any risk of debt distress.

**Monetary and Financial Sector**

Money supply growth was contained in line with the Monetary Policy objectives of supporting economic growth and maintaining price stability. As a result, growth in reserve money (11.2 percent) and broad money (14 percent) was lower than the 19 percent target. Private sector credit grew by 24.0 percent, exceeding the target of 20.8 percent, with most of the credit held in personal activities, trade, manufacturing, agriculture and transport and communication activities. Improved food and energy situation, coupled with prudent monetary policy have helped ease inflationary pressures in the economy, with annual headline inflation falling consistently from 19 percent in March 2012 to 17.4 percent in June 2012. Core inflation averaged 8.8 percent during the quarter under review.

During the second quarter, Tanzania continued to enjoy currency stability, with the weighted average exchange rate reported by the Bank of Tanzania fluctuating between TZS 1,576.72 and 1,585.13 per US Dollar throughout the period. This represents a modest strengthening compared to the first quarter when the shilling fluctuated between TZS 1,550 and 1,600 per US Dollar. The gradual strengthening of the Shilling against the major currencies and relative stability was a result of good export performance driven by gold, and the continued close watch by the Bank of Tanzania to ensure that foreign exchange market operates according to regulations and remains sound.

**External Sector**

Tanzania’s exports of goods and services reached USD 7,990.2 million at the end of June 2012, equivalent to 13.3 percent increase over the USD 7,050.7 million recorded during the year ending June 2011. Gold exports, which exceeded USD 2.33 billion, continued to dominate the export proceeds, accounting for about a third of total exports. Imports of goods and services reached USD 12,958.7 million – about 30 percent increase over the value recorded in the corresponding period in 201.
Escalating oil prices in the world market coupled with an increase in domestic demand for oil for thermal power generation were the main drivers of imports. The import bill was further increased by the importation of machinery and equipment for gas and oil exploration. Following these developments, and taking into account the decline in official current transfers, current account deficit widened to USD 4,296.1 million compared to USD 2,258.7 million in the corresponding period in 2011. Gross official reserves amounted to USD 3,786.7 million by the end of June 2012, sufficient to cover about 4 months of projected imports of goods and services.

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

In May, President Kikwete made a major Cabinet reshuffle, in which 6 ministers lost their ministerial posts and 6 new ministers were appointed. The reshuffle came following the reports by the Control and Auditor General (CAG) Parliamentary Committees for public accounts, parastatal organizations accounts and local authorities’ accounts which revealed widespread corruption and embezzlement of public funds in several Ministries, Departments, Agencies and Local Government Authorities. The reports sparked heated debate in the Parliament, and for the first time in Tanzania’s history of multiparty democracy, the parliamentarians from both the ruling party CCM and opposition pressed for the resignation of 8 ministers who were associated with the malpractices. Following the reshuffle, the 6 new appointments were for the Ministry of Finance, Ministry of Energy and Minerals; Ministry of Tourism and Natural Resources; Ministry of Transport; Ministry of Industries and Trade; and Ministry of Information, Youth and Sports.

Private Sector Activity

During the second quarter, some of the world’s leading oil and gas exploration companies continued to scale up their operations in Tanzania for the exploration work. Statoil and ExxonMobil exploration companies announced major discoveries of gas deposit at the Lavani, which increased Tanzania’s recoverable natural gas reserves to an estimated 28.74 trillion cubic feet (tcf). Other companies licensed to carry out prospecting activities in Tanzania include the UK’s BG Group, Ophir Energy, Royal Dutch Shell, Irish exploration firm Aminex Plc and Brazil’s Petrobras. According to experts’ estimates, Tanzania could see an increase in revenue of up to USD 3 billion a year following the major offshore gas discoveries. The government is currently preparing a new legislation to regulate the gas industry, and sovereign wealth fund could be established to ring-fence government earnings from the sector.
Macroeconomic Developments

Economic Growth

The latest quarterly GDP estimates show the economy recovered during the quarter ending March 2012. The economy is estimated to have grown by 2.3 percent in real terms compared to a decline of 2.6 percent growth in the preceding quarter. This reflected growth in the industrial sector which recovered to 9.2 percent from the decline of 8.7 percent in the previous quarter arising from a recovery in construction and manufacturing sub-sectors. However, the impact of the improved performance of industrial sector on overall growth was dampened by declines in the agricultural and services sectors of 0.5 percent and 0.2 percent respectively during the quarter.

Fiscal Stance

The Government presented its budget for FY 2012/13 in June 2012 in which the total amount of resources is estimated at UGX 11.15 billion. Of this, domestic resources, including tax collections and domestic borrowing will finance about 75 percent, while 25 percent will be provided by development partners. The budget priorities outlined include: (i) Removing infrastructure constraints in transport and energy to facilitate private sector development as the engine of growth; (ii) Promoting support to the critical productive sectors of the economy including Agriculture and Tourism in order to generate employment and increase production; (iii) Improving the quality of social services focusing on education, health and access to water; and (iv) Public Sector Management for efficient service delivery. The specific revenue measures that are proposed include: (i) increasing the withholding tax on Government paper from 15 percent to 20 percent; (ii) an additional 10 percent pay as you earn (PAYE) tax on individuals in the income bracket of UGX 120 million per year; (iii) reinstatement of 18 percent VAT on piped water; (iv) an increase on excise duty on spirits made from locally made raw materials from 45 percent to 60 percent.

Highlights

- The economy recovered from a slump registering a real GDP growth rate of 2.3 percent in March 2012 up from a decline of 2.6 percent the previous quarter.
- The government presented a UGX 11.2 billion FY 2012/13 budget to parliament in June. Domestic revenues are expected to finance about 75% of this budget which places emphasis on infrastructure development and supporting productive sectors including agriculture.
percent. To cushion low income earners, the PAYE threshold will be increased from UGX 130,000 to UGX 235,000 per month.

**Monetary and Financial Sector**

The Bank of Uganda (BoU) has started to slowly ease the tight monetary policy that had been adopted for most of 2011. During the quarter under review, the BoU reduced the Central Bank Rate (CBR) from 21 percent in March to 20 percent in June 2012. This was motivated by the decline in inflation and the need to boost economic activity. The lowering of the CBR thus reflected efforts by the BoU to encourage commercial banks to reduce their lending rates in order to increase the growth of their lending to the private sector which has remained weak since September 2011 due to high lending rates. In response, the commercial banks reduced their lending rates marginally from 27.6 percent in March to 27 percent in June 2012.

Inflationary pressures continued to ease during the quarter under review although the rates remained at double digits. Headline inflation fell consistently from 21.2 percent in March 2012 to 18 percent in June 2012, while core inflation also declined from 23.6 percent to 19.5 percent in the same period. Food inflation continued the downward trend that began in March, and ended at 12.7 percent in June reflecting improved supplies with the onset of the rainy season. The most spectacular decline, however, was inflation in Electricity, Fuel and Utilities (EFU) in which the rate fell by 8.3 percentage points to end at 12.9 percent in June 2012. This mainly reflected a decline in oil prices that had risen early in the first quarter but have been steadily falling since April to an 18-month low in June.

**External Sector**

The total value of exports during the quarter increased by 15.3 percent to US $ 727.3 million from US $ 630.8 million in the corresponding period of 2011. Non-traditional exports increased by 25.8 percent during the period under review but the overall effect was offset by traditional exports that declined by 11.0 percent. This reflected lower values in proceeds from coffee and tea that declined by 24.5 percent and 2.1 percent respectively. By contrast, cotton and tobacco exports increased by 35.2 percent and 23.9 percent respectively. However, the trade balance deteriorated as the value of imports remained higher than that of exports, increasing by 16.0 percent from US $ 1201.7 million in the second quarter of 2011 to US $ 1398.2 million in the corresponding period of 2012.

During the quarter under review, the shilling held almost steady against the US dollar to trade at UGX 2,484.36 in June 2012 from UGX 2,485.02 in March 2012. This marked a reversal in the trend as the shilling, on an average basis had steadily appreciated since October 2011. This points to a recovery in capital inflows and a reduction in demand for foreign exchange from the major sectors (energy and telecommunications) that made it possible to meet the available supply.

**OTHER NOTABLE DEVELOPMENTS AND UPDATES**

**Political Developments**

The debate around the successor of President Museveni that had started in the last quarter continued into the quarter under review following press reports that the President had mentioned his preference for his wife Janet Museveni as his possible successor during a meeting with top army generals. The move allegedly elicited...
discomfort and silence among the generals and it remains to be seen how this will fan out given that some generals have been expecting one of their own to be the President’s successor. Moreover, the President is also on record as having voiced his backing for Prime Minister Mbabazi and Vice President Ssekandi.

Another important development was President Museveni’s delivery of his State of the Nation address in June. He assured the country that his government can overcome declining growth, inflation and unemployment and decried that progress has been hampered by delays in prioritization of expenditure, political sabotage of government programmes, as well as corruption and selfishness among the population including political leaders.

With regard to peace and security matters, the country got a boost from an announcement by the African Union (AU) announcement that it had joined the hunt for the Lord’s Resistance Army rebels in the Central African Republic tasked to kill, capture or force the rebel leader Joseph Kony to surrender. The AU said it would send 5000 extra soldiers to join US soldiers that are currently engaged in gathering intelligence and offering other logistical support in the hunt for Kony.

**Private Sector Activity**

The 250 MW Bujagali Hydropower Plant that started supplying electricity to the national grid in February added another 100 MW to the grid during the quarter, bringing the total supply from the plant to 200 MW. The project is thus on track for completion and commissioning in September 2012.

Other notable developments were recorded with regard to the oil sector. The Government released an environment monitoring plan and guidelines that will be followed in the extraction of oil and gas in the Albertine region. This is in recognition of the fact that the region is a sensitive ecosystem that includes game parks, wild life reserves, fresh water lakes, rivers and swamps. In addition, the Attorney General travelled to London to hold talks on the long-standing multibillion shilling arbitration tax dispute between the Government and a British oil exploration firm, Heritage Oil. The dispute dates back to 2010 when another British firm, Tullow Oil, sold part of its stake to Heritage Oil and Government of Uganda demanded a payment of US $ 404 million (UGX 969 million) as capital gains tax.

**Donor Coordination**

In June, the Local Development Partners’ Group held a meeting with the Prime Minister to discuss the implementation progress for the Peace Recovery and Development Plan (PRDP) for Northern Uganda. The Group commended the Government for the substantial achievements during the implementation of the first phase (PRDP 1) including construction of over 3000 schools and health centres, rehabilitation and or construction of over 2000 boreholes and rehabilitation of over 3000 km of roads. They reiterated their decision to launch PRDP 2 in order to achieve the PRDP’s main objective which is to bring Northern Uganda on par with the rest of the country in terms of access to roads, health, education and other quality public services.

The IMF completed the fourth review of the 3-year Policy Support Instrument in June. The Fund noted that the programme remains on track and commended the Government for pursuing the appropriate macroeconomic policy. They also noted

- President Museveni publically declared his support for his wife Janet Museveni as a possible successor, eliciting surprise reactions from a section of his supporters and the public.
- The 250 MW Bujagali Hydropower plant added another 100MW to the national grid bringing the total supply from the plant to 200MW.
- Development partners commended the government for the notable achievements in the implementation of the Peace, Recovery and Development Plan for Northern Uganda and reiterated their commitment to support the second phase of the plan.
that the fiscal stance proposed in FY 2012/13 is commendable and economic growth can be expected to recover significantly next year.
III | TOPICAL THEME
Natural Gas Discoveries in Tanzania: Prospects and Challenges

Introduction

Tanzania is endowed with diverse energy sources including biomass, natural gas, hydropower, coal, geothermal, solar and wind power, much of which is untapped. Wood-fuel accounts for up to 92 percent of total energy supply with about 2 percent from hydroelectricity and 7 percent from oil-derived products. Nonetheless the downstream oil industry is an important sector of the country’s economy absorbing on average 55% of the country’s foreign exchange earnings. Government policies are directed at petroleum product substitution by exploiting indigenous resources. In the upstream oil industry, oil and gas exploration and production is also being encouraged. Onshore and shallow water discoveries of natural gas fields have been made in the vicinities of Songo-Songo Island, Mnazi Bay, Mkuranga, Kiliwani North and Nyuni. Currently, only two gas fields, Songo Songo and Mnazi Bay are in production. In addition, there have been major deep offshore natural gas discoveries, off the cost of Lindi and Mtwara regions more recently.

The government confirmed that Tanzania’s recoverable natural gas resources by the end of June 2012 were estimated at 28.74 trillion cubic feet (tcf) following the recent major discoveries by British Gas Group (BG), Ophir Energy, Statoil and ExxonMobil. These
discoveries continue to broaden investment prospects in the natural gas sub-sector in Tanzania, and in earlier in February, the BG Group revealed that it plans to step up its presence in gas exploration in Tanzania by investing $500 million in the sector in 2012.

Currently, the activities in the gas sector are guided by the Petroleum (Exploration and Production) Act 1980, which vests title to petroleum deposits within Tanzania in the State and is designed to create a favourable legal environment for exploration by oil companies. The mode in place is Production Sharing Agreement (PSA). Under Act, the state-run Tanzania Petroleum Development Corporation (TPDC) is granted the licences, and enters into PSAs with the companies. According to TPDC, “The Model PSA envisages good faith negotiations upon the discovery of gas in order to reach an agreement on its development, production and sale. In appropriate circumstances the Minister will extend the appraisal period”. Generally, the legislation was developed for petroleum, with gas featuring only lightly, and with as generous provisions as possible. Most crucially, there is no dedicated policy guiding the rapidly expanding activities in the gas sector.

Possible economic impact

The next decade will see significant expansion of the gas sector in Tanzania, and the scale of the required investments, both for prospecting activities, and leading to the production of Liquefied Natural Gas (LNG), will have huge impact on the Tanzanian economy. It is estimated that about US$ 15 – 20 billion of Foreign Direct Investment (FDI) could flow into the country’s oil and gas subsector in the next decade. Also, the experts estimate that Tanzania could see a rise in revenue of up to US$ 3 billion a year (about a third of the country total budget) from LNG export.

The Government is currently taking precautionary measures to avoid previous mistakes that were made in mineral sector, following which, despite Tanzania well-established gold mining industry, revenues from the gold sector have not met expectations due to relatively generous fiscal concessions granted to attract investment. With the already confirmed potential and the expected multi-billion dollar investments in the gas sector, the government has already initiated discussions on how to position the country to best take advantage of these developments. Currently, the government is preparing a Natural Gas Master Plan gas and petroleum revenue management bill to ensure that the country benefits from the resource. The government is also formulating a specific policy on natural gas sub-sector that will guide exploration, production and transportation of the energy. The measures are intended to promote growth of the sector and more importantly, stimulate both upstream and downstream linkages, thus increasing the economic contribution of the FDI flowing into the sector.

On the revenue side, the government intends to carry out a comprehensive review of Tanzania’s tax regime to ensure its adequate cover of the gas sector; and embark on the development of staff expertise in the Tanzania Revenue Authority (TRA) on tax issues associated with the development and exploitation of gas. Meanwhile, the government has revealed that it plans to establish a sovereign wealth fund to ring-fence earnings from the gas sector resources, with the ultimate objective of translating the natural capital in the form of non-renewable resources into lasting development outcomes.
Future Prospects and Opportunities

Tanzania, with its oil seeps, seismic and other data, shows strong hydrocarbon potential in its upstream oil industry sector. However, with only less than 50 wildcat explorations and under 10 development wells that have been drilled in a 222,000 sq km area, Tanzania can still be classified as underexplored. Apart from the already proven natural gas reserves, there are still good prospects for further discoveries in the future. According to U.S. Geological Survey, the East Africa’s coastal region, stretching out to Seychelles is estimated to hold about 441.1 trillion cubic feet of natural gas. Currently, at least 18 companies have been licenced to carry out oil and gas prospecting in Tanzania (see Box 1).

The proven recoverable natural gas resources in Tanzania have now exceeded the minimum threshold volumes (at least 10 tcf) required for economically viable investment in the LNG. This prospect is boosted further by the proximity of the country to the fast growing Asian economies, particularly India and in the Far East, which could be potential destinations for export of LNG. And, with discoveries in Tanzania happening close to good harbours, this will allow beneficiated products to be readily traded internationally. However, substantial earnings from the sector will not be realized any time soon, because, based on similar projects in other countries, the foreseeable time frame for a full operation of the LNG plant is a horizon of 10-15 years.

Natural Gas: A Potential Solution to the Energy Crisis in Tanzania

While investment in LNG will largely target export markets, natural gas will contribute significantly in addressing the power crisis in the country through the increased use of gas-fired power plants to generate electricity. The government is working closely with several partners to further develop the Songo Songo gas fields off the Southern Tanzanian coast and in the Mnazi Bay area, with a view to substituting expensive imported petroleum fuels. Currently, off-shore gas production is being carried out at Songo-Songo by Songas (part of Globeleq) and at Mnazi Bay, Mtwara by Wentworth Energy. Songas in involved in both gas processing, transportation and power generation. Gas from Songo Songo gas field is transported through a 225 kilometer pipeline to Dar es Salaam for electricity generation at Songas’ Ubungo power plant, the largest gas-fired power station in East Africa, and for industrial use. The Songas gas-to-electricity facility generates 180 megawatts (MW) of electricity or approximately 30% of Tanzania’s electricity needs.

As part of the efforts to expand Gas-to-Electricity generation, the Government has signed agreement with China to build a 532-kilometre natural gas pipeline from Mnazi Bay and Songo Songo Island in southern Tanzania to Dar es
Salaam. The completion of the project will enable the 36-inch gas cylinder to produce 784 million standard cubic feet of gas per day, capable of powering up to 3,900 megawatts. The project will cost about US $1.2 billion, and China Exim Bank will provide a soft loan to cover 90% of the project cost, and the Tanzanian government will finance the remaining cost. The project will be jointly implemented by the China Petroleum and Technology Development Company (CPTDC), a unit of China National Petroleum Corp (CNPC), and state-run Tanzania Petroleum Development Corporation (TPDC).

**Challenges in harnessing Tanzania’s Natural Gas Resources**

The gas sector is relatively new area, and there are concerns that, just like it happened with the minerals, Tanzania could be caught completely off-guard by its gas wealth, especially as it lacks the skilled workforce for the industry. And given the nature of the gas sector, the government will be facing a major challenge to avoid signing opaque contracts for capital-intensive mega-projects that don’t create many local jobs. Further, the legal and regulatory environment for the sector is still weak, and the government is now working to put in place oil and gas legislation to guide the activities in the industry. Until the passage of new legislation, the hydrocarbon industry is regulated by the Ministry for Energy and Minerals, with upstream activities governed by the Petroleum (Exploration and Production) Act 1980 and the downstream activities by the National Investment (Promotion and Protection) Act 1990. Both pieces of legislation need urgent revisions. Also, there is a gap in terms of negotiation capacity and regulatory capacity along with skill mix to manage complex contractual and pricing arrangements associated with the gas projects.

Further, given the nature and scale of the investments needed in the natural gas sector, the new projects – especially leading to the production of LNG - will have significant major macro-fiscal impact on the Tanzanian economy over the next decade. In view of the potential macroeconomic destabilizing effects due to multi-billion dollar investments in the gas sector, the International Monetary Fund, agreed with the Government, as one of the structural benchmarks of the Policy Support Instrument Review, that “The Ministry of Finance, Planning Commission, and Tanzania Revenue Authority (TRA) will prepare a report identifying steps to be taken to prepare Tanzania’s macroeconomic management for the new gas economy, and identifying the nature of any corresponding technical assistance needs.”

**Opportunities for collaboration and support**

In conclusion, harnessing Tanzania’s natural gas resources will require reforms in various facets ranging from institutional and regulatory reforms to capacity and local content development. The following six areas are therefore identified as key opportunities for collaboration between the Tanzanian authorities and other stakeholders including the African Development Bank in designing and implementing the necessary reforms.

1. **Capacity Building** with specific focus on gas and oil sector especially to provide and strengthen technical expertise both at Ministry of Energy and Minerals, TPDC, Planning Commission and Tanzania Revenue Authority in certain critical aspects of the gas sector – including legal, technical, domestic revenue
management, and skills. For the Bank, a good start could be via dedicated legal assistance through the African Legal Facility, with aim to help the government get good deals during the negotiations with the powerful multinationals.

2. **Analytical Work**: Dedicated analytical work is needed to shed light on among other things, the ways for Tanzania to mitigate some of the potential risks associated with large gas extraction projects, and most significantly, how to manage some of the opportunities that would arise for sustainable and inclusive growth. This would help in bridging the existing knowledge gap on the linkages with the other sectors of the economy, and ultimate benefits of the gas sector to the majority of the population.

3. **Managing the natural resource discovery process**: Tanzania still remains underexplored, and there is need to invest more on public geological survey to generate the necessary geological information. This will reduce the information asymmetry between resource extraction companies and the government, and enable the government to negotiate the right deals with the companies.

4. **Investment in transport infrastructure**: There will be increased transport needs to support the coming resource extraction activities. And in managing the physical process of extraction, the infrastructure – railways in particular, could be made to be multi-user and multi-function, which will help open up whole areas of land.

5. **Knowledge Sharing about Best Practices**: Tanzania is currently weighing up options to get the right take of the resource rent, and it would benefit from the experience of other countries on the right mix between equity participation, taxation of profits and royalties. Also, knowledge about the right balance between consumption and the future, and the ultimate long term target to use the savings from the non-renewable resources to build up the capital stock in Tanzania.

6. **Building domestic capacity to invest**: The government has expressed its intention to create a sovereign wealth fund. For those savings to be properly invested in the future it is important to build the capacity for productive investment in the country. The key areas in this respect include strengthening the public investment management process, especially project selection and project implementation procedures; and improving the private investment climate.
IV | STATISTICAL ANNEX
A- SELECTED LONGER TERM STATISTICS

Table 1 - Basic Indicators, 2009

<table>
<thead>
<tr>
<th></th>
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<td>(thousands)</td>
<td>(thousands of km²)</td>
<td>(pop / km²)</td>
<td>(US $ Million)</td>
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Note: * Fiscal year July (n-1)/June (n)
Sources: ADB Statistics Department, Various domestic authorities; IMF World Economic Outlook 2009.

Table 2 - Real GDP Growth Rates, 2001-2011

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<th>2011 (p)</th>
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<td>4.5</td>
<td>5.2</td>
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</table>

Note: * Fiscal year July (n-1)/June (n)
Sources: ADB Statistics Department, Various domestic authorities; IMF World Economic Outlook 2009.

Table 3 - Demand Composition and Growth Rates, 2009-2011

<table>
<thead>
<tr>
<th></th>
<th>2009 (e)</th>
<th>2010 (p)</th>
<th>2011 (p)</th>
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<td></td>
<td>Total Final Consumption</td>
<td>Gross Capital Formation - Total</td>
<td>Exports</td>
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<td>Real Percentage Growth</td>
<td>Real Percentage Growth</td>
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<td>4.3</td>
</tr>
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<td>5.4</td>
<td>-1.7</td>
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<tr>
<td>Uganda</td>
<td>6.3</td>
<td>8.4</td>
<td>0.9</td>
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</tbody>
</table>

Note: * Fiscal year July (n-1)/June (n)
Sources: ADB Statistics Department, Various domestic authorities and IMF World Economic Outlook 2009.
### Table 4 – Public Finances and Fiscal Indicators, 2008-2011 (percentage of GDP)

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<thead>
<tr>
<th></th>
<th>Total revenue and grants</th>
<th>Total expenditure and net lending</th>
<th>Overall balance</th>
<th>Total revenue and grants</th>
<th>Total expenditure and net lending</th>
<th>Overall balance</th>
<th>Total revenue and grants</th>
<th>Total expenditure and net lending</th>
<th>Overall balance</th>
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<td>-6.8</td>
</tr>
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<td>23.4</td>
<td>-1.9</td>
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<td>-1.7</td>
<td>21.1</td>
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<tr>
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<td>33.3</td>
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<td>3.1</td>
<td>33.4</td>
<td>31.6</td>
<td>1.8</td>
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<tr>
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<td>24.2</td>
<td>-2.7</td>
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<td>-3.8</td>
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<tr>
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<td>-1.7</td>
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<td>15.8</td>
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<td>29.7</td>
<td>31.6</td>
<td>-1.9</td>
</tr>
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</table>

**Notes:** * Fiscal year July
(n-1)/June (n)
² = 2007 data
¹ = 2006 data

**Sources:** ADB Statistics Department, Various domestic authorities, OECD/DAC, OECD Development Centre calculations and IMF *World Economic Outlook.*

### Table 5 – Select Monetary Indicators

<table>
<thead>
<tr>
<th></th>
<th>Inflation (%)</th>
<th>Exchange Rate (LCU / $)</th>
<th>Reserves, excluding gold, ($ million)</th>
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<tbody>
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<td></td>
<td>2008</td>
<td>2009 (e)</td>
<td>2010 (p)</td>
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<td>8.53</td>
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<td>12.04</td>
<td>11.14</td>
<td>8.90</td>
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<td>Africa</td>
<td>10.60</td>
<td>9.90</td>
<td>7.73</td>
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</table>

**Sources:** ADB Statistics Department, Various domestic authorities, IMF *World Economic Outlook* & *International Financial Statistics* and authors’ estimates and forecasts.
### Table 6 - Balance of Payments Indicators, 2008-2011

<table>
<thead>
<tr>
<th>Country</th>
<th>2008 (million)</th>
<th>2009 (million)</th>
<th>2010 (million)</th>
<th>2011 (million)</th>
<th>2008 (as % of GDP)</th>
<th>2009 (as % of GDP)</th>
<th>2010 (as % of GDP)</th>
<th>2011 (as % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
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<td>262.85</td>
<td>277.37</td>
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<td>155.63</td>
<td>179.55</td>
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<td>5,979.22</td>
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<td>7,715.66</td>
<td>3,009.24</td>
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<td>3,463.94</td>
<td>2,591.68</td>
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<td>456.81</td>
<td>531.45</td>
<td>578.13</td>
<td>285.62</td>
<td>295.10</td>
<td>293.63</td>
<td>274.39</td>
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<td>516.00</td>
<td>249.90</td>
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<td>169.15</td>
<td>335.90</td>
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<td>3,739.98</td>
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<td>2,084.49</td>
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<td>2,873.53</td>
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**Note:** Fiscal year July (n-1)/June (n)

**Source:** ADB Statistics Department; IMF WEO

October 2009

### Table 7 - Diversification and Competitiveness

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**Source:** ADB Statistics Department; COMTRADE Database (Harmonized system, Rev.1) - UN Statistics Division

### Table 8 - External Debt Indicators

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<tr>
<th>Country</th>
<th>Total debt outstanding (as % of total)</th>
<th>Total debt outstanding (as % of exports of goods and services)</th>
<th>Debt Service (as % of exports of goods and services)</th>
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<tr>
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<td>95.5</td>
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**Source:** ADB Statistics Department; IMF, World Economic Outlook Database, October 2009; GDF Online Database, Worldbank
B - SELECTED SEASONAL STATISTICS

Table 9 - Comparative Prices: Major Food Crops (April—June 2012)
-(USD per metric Ton)

<table>
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<tr>
<th>Country</th>
<th>Maize</th>
<th>Rice</th>
<th>Beans</th>
<th>Wheat</th>
<th>Sorghum</th>
<th>Millet</th>
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<td>756</td>
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<td>1284</td>
<td>855</td>
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<td>701</td>
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<tr>
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<td>1159</td>
<td>668</td>
<td>1099</td>
<td>758</td>
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<tr>
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<td>1469</td>
<td>970</td>
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<td>518</td>
<td>724</td>
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<td>546</td>
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<td>627</td>
<td>569</td>
<td>814</td>
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</tr>
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<td>1323</td>
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<tr>
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<td>1331</td>
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<td>910</td>
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<td>976</td>
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Sources: Regional Agriculture Intelligence Network, except for Burundi whose data is from Burundi Institute of Statistics (ISTEEBU).

Table 10: Regional Inflation Developments (April—June 2012)

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Sources: National Statistics Bureaus (various countries)
About the African Development Bank Group

The African Development Bank Group – which comprises the African Development (ADB), the African Development Fund (ADF) and the Nigeria Trust Fund (NTF) – aims is to promote the economic development and social progress of its regional member countries. It contributes to improving the living conditions of the populations, as well as creating, expanding and rehabilitating productive and social investments. It finances development and structural adjustment projects and programs, provides advisory services and stimulates investments from other sources of finance. Although the ADF and NTF are legally and financially distinct from the ADB, they share the same staff, and their projects are subject to the same standards.