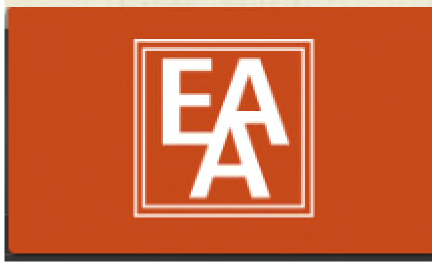

THE EASTERN AFRICA ASSOCIATION

EAST AFRICAN TRADE

The EU Economic Partnership Agreement (EPA)

The long road towards securing a trade agreement between the EU and EAC has been a tortuous one, driven by vested national interests that have meant Kenya's significant export trade with Europe has been placed in jeopardy. As the only "non-LDC" in the EA Community – all the others enjoy duty and quota-free access to the EU single market – Kenya has been struggling to conclude an agreement that will enable its exports, for horticultural products in particular, to this market to continue on the same terms as before. The negotiations have been bogged down by reluctant neighbours unwilling to sign a deal, for various spurious and unrelated reasons.

The Agreement was supposed to be signed by October 1st to extend the existing pact but, so far, only Kenya and Rwanda have actually put pen to paper, whilst the rest have shown little interest in doing so. Discussions have been pushed back four months to see if the EAC countries can come to some form of agreement but Tanzania in particular has said the agreement, as it currently stands, is "negatively skewed against the country's economic interests" as "it was bound to result in its markets being flooded with imported industrial products from Europe". The new government there has also sought to use the recent Brexit vote as an excuse for further delay.

Technically and legally, the EU is only meant to sign trade agreements with groups comprising several countries, like the EAC, but a recent announcement by its Ambassador to Kenya that it was willing to sign a deal with Kenya alone if its neighbours continue to refuse, is welcome news. However, there is some doubt that this will be possible and a more likely scenario will be to delay and continue "kicking the can down the road" in usual EU style. In principle, it should make sense to sign as a bloc but the tortuous process over many years demonstrates how difficult this is if some countries decide not to cooperate. Securing the European market for its exports, which contribute nearly 2% of Kenya's GDP and employs more than two million people, is crucial for the country, so the next few months will be very important. If a deal is concluded then it will in theory be much easier to have a transition to a similar deal with the UK after "Brexit".

KENYA

Interest rate capping

The Central Bank's ill-conceived cap on interest rates from mid-September is already beginning to have an impact. The positive aspect is that there has been a substantial jump in requests for bank loans – no surprise; but the fact is that the smaller banks do not have the money to lend, and the larger ones are not interested with the margins as narrow as they are now.

Indeed, the reality is that the small and medium-sized banks are the "big losers", and that the CBK may well have sealed the fate of some by putting them out of business.

Despite this, the CBK has since opted to drop its base rate by a further 0.5% to 10% flat, which simply aggravates an already tenuous future for smaller banks.

Indeed, all banks, large and small, will face tough times in this last quarter of the year, and certainly in the year ahead. The Revenue Authority can forget looking to the banking sector for every-increasing corporate tax, because they will simply be whistling in the wind.

The demand for Treasury Bills has risen sharply as banks seek to house their funds relatively risk-free, rather than lend it out – cynics will say that this was always the CBK's intention; a gateway to ever cheaper funding from commercial banks for a Treasury desperately in need of the means to meet its rising debt service demands.

The private sector will certainly be crowded out, as the availability of commercial bank loan funds dries up.

To sum up, a disaster in the making; one which, sensibly, no other Central Bank in the EAC has bought in to.

UGANDA

Oil

The Government announced recently that it had issued eight petroleum licences to two major oil companies to enable them to commence production. Five went to a consortium led by Tullow Uganda whilst the other three were issued to total Uganda, all for a period of 25 years, renewable if required for a further 5 years.

The companies are expected to make final investment decisions within the next eighteen months and "to begin production of oil by 2020". Most observers believe 2022 is more realistic as little or no actual work has commenced on the key infrastructure requirements for oil production. Whatever the likely date, the issuing of these licences is seen as a step forward in what has been a lengthy negotiating period, paving the way for possible joint ventures and other potential stakeholders to review long-term capital investments – estimated at over US$10 billion.

The Ministry of Energy has said that the oil refinery to be built in Uganda will be the first option for the oil companies, with 200-230,000 barrels of oil produced with 30,000 being refined in the country. The remainder "will be exported as the refinery is expanded". The granting of the production licences follows the agreement between Uganda and Tanzania to construct a pipeline to transport crude to the port of Tanga.

A statement that oil would be produced "by 2018" raises expectations and adds to the string of political promises made by President Museveni ahead of elections scheduled for that year that are unlikely to be met. The government is banking on revenues from the sector to fund other infrastructure projects and appears to assume that the global price for the commodity will recover in time to make their plans viable.

TANZANIA

The Economy

The IMF remains optimistic about the country's economic well-being, essentially sticking to the government's forecast of GDP growth of 6.7% in 2016, although they have expressed "growing concern" about the deteriorating business environment and the future prospects that will inevitably ensue from this. Private sector analysts are forecasting economic growth is likely to be down to 5.5% for this year, given the declining business sentiment and activity.

The exchange rate has remained broadly stable, possibly helped by Bank of Tanzania intervention, but there is talk of a possible devaluation. Inflation, according to official figures, remains below the government target of 5%, currently 4.9% year on year. A key concern is rising sovereign debt, currently at nearly 50% of GDP, "sustainable and not yet critical" according to both the IMF and World Bank. As usual with Tanzania, and this applies to most countries in Africa and the region, "there is some economic progress, but at a pace far short of capability" which is required to have a meaningful impact on per capita poverty levels.

ETHIOPIA

Business

Ethiopia's manufacturing sector is expanding as cheap electricity, tax holidays and land availability attract investors into the country. One such company is Dangote, which has set up a cement plant in the country, with an estimated 40% of its output expected to be exported. The extremely low discounted electricity price of three cents per kilowatt hour was perhaps the major attraction, cutting the costs of producing cement very considerably. This will represent serious competition to Kenya's producers and is likely to shake up the regional cement market. One of India's largest paint manufacturers, Asian Paints, has also entered the market in the country through the acquisition of a local manufacturer.

Following the privatisation of the country's three breweries some five years ago, thanks to significant additional investment, production capacity has been increased threefold whilst sales and tax revenues from beer have doubled. A clear success story for the industry, even if this has not been shared between the three companies. A Japanese company, JT Group, has acquired a 40% stake in the state-owned monopoly tobacco company, for an estimated half a billion US dollars. Studies in 2012 showed only 9% of Ethiopian men smoked, the lowest ratio in the world, compared with 49% in China and 26% in neighbouring Kenya.

The emergence of Ethiopia to become Africa's second largest flower exporter in just ten years is another indicator of tremendous growth. In the process threatening Kenya's traditional role as the region's economic powerhouse. The advantages of a more favourable climate for flowers, better-skilled workers, access to capital and private land ownership in Kenya remain very significant but there is growing dissatisfaction about excessive taxes and frequent bribe demands which make Ethiopia an increasingly attractive location. The economy, in particular the financial services sector, need to be opened up for this attractiveness to accelerate but there is no doubt that there is massive potential for growth in this and other agricultural sectors in Ethiopia.