THE
EASTERN AFRICA
ASSOCIATION

GLOBAL TRADE

Recent trends

There has been much media coverage of global trade trends recently and the implications of certain key political events. Much of the discussion about the UK's Brexit has been dominated by the issue of "access to the EU single market"; President Trump is threatening to tear up existing trade deals like NAFTA and has effectively called a halt to other pending negotiations, such as the Trans-Pacific Partnership (TPP) with Asia and the Transatlantic Trade and Investment Partnership (TTIP) with the EU; there has also been a great deal of debate about "free trade deals" and "the impact of globalisation" and the supposed benefits (or disadvantages) these bring to the global economy. As a consequence, protectionist tendencies are rising, as are the threats of increased tariffs and duties between various countries.

President Trump's rhetoric on global trade is certainly alarming but there is no support for a trade war in the Congress and hopefully some of his more senior Cabinet members will persuade him to tone things down and be more realistic in his demands. Positioning the US as a protectionist aggressor could see widespread economic stagnation and a far less stable world order.

At the Davos World Economic Forum recently, President Xi Jinping beat the drum for capitalism and globalisation, a risible and hypocritical presentation from the leader of a still-communist country that is centrally planned and remains substantially a closed economy. China can never lead when it comes to open markets and trade liberalisation, especially as it does not play by the rules itself. Market reform in the country has stalled and it continues to run a huge, globally destabilising trade surplus; rule of law and contract is entirely lacking; Chinese industry is routinely subsidised and foreign imports are discriminated against; state-sanctioned theft of intellectual property remains rife; and perhaps most importantly of all, the government does not allow the sort of individual freedoms which are the very bedrock of any genuine, market-based system.

Mr. Trump's pick as Commerce Secretary, Wilbur Ross, is right when he says that China is one of the most protectionist countries in the world. The idea that such a serial offender against the basic tenets of free-market capitalism is going to lead the world into a further round of trade liberalisation is frankly laughable. Hopefully he will be able to persuade his President not to vacate the role of cheerleader in chief for the established, rules-based international trading system and all the talk of imposing huge tariffs on imports will be seen as purely negotiating tactics and soon die down. This would be in both countries' interests.

KENYA

Challenges to economic growth

The impending drought, previously mentioned, is a serious challenge, with its inevitable effect upon food prices and hence inflation. Coupled to this issue is the reduced flow in the Tana River and the water level drop in the whole Tana River Basin — this, and the issue of water in general is a whole topic in itself. Suffice it to say that many of Kenya's other rivers, including the Athi, Mara, and Uaso Nyiro are all reflecting diminished flows, for a variety of reasons — tree felling in the mountainous sources, excessive off-take by the increasing population of riverside dwellers and soil erosion among them.

The pending reversion to thermal generation of power by the Kenya Power & Lighting Company (KPLC) will inevitably add to costs which without doubt will be passed on to the consumer —undoing much of the benefit over the past year or two of expanding the number of rural household connections.

Whilst on power, the cost of imported oil, be it crude or refined is generally on the rise, albeit modestly — but again this will add to the inflationary trend.

In a different form, the shrinking access to credit, following the interest capping contained in the 2016 Banking Act, is also a challenge. Banks are quite evidently rationing their loans, as mentioned earlier; in truth annual credit growth, formerly around 19% dropped to 4.8% in December last year; its slowest for 8 years.

A further issue giving rise to economic challenges is that of Kenya's exports to the East African region which have been dropping over the last 3 years. As a matter of record exports to Uganda dropped 30% in the 3 months to September 2016, compared to the previous year's equivalent. Tanzania exports have dropped to around $67 million from $78 million over the past 2 years; and those to Rwanda are down to $43 million from $56 million. In asking "Why?" one finds that the ever-increasing direct imports from China are some part of the answer; new competing industries within each of the neighbouring countries is another; the import vacuum in South Sudan following its political turmoil, has a part to play too. In this overall context, Kenya relies on the prospect of exporting 40% of its locally manufactured goods to African countries — essentially its neighbours. Having said all this, the downward trend looks set to continue.

And then there is the whole issue of US aid to Africa — not just Kenya — which is predicted to fall during the "Trump" presidency. As a matter of record, US aid to Kenya has been running at some US$2.5 billion a year; a little behind only Ethiopia in the Eastern Africa region. This and the unanswered question as to whether the current tariff concessions offered by AGOA (African Growth and Opportunities Act) to East African countries will continue under the unpredictable moods of the new US President, is in the balance too.

Last but not least, Kenya is on a knife-edge, happily a blunt one, over the extension of tariff concessions into the European Union under the Economic Partnership Agreement, on all flower and horticultural exports. Whilst a stop-gap formula is currently in place, it does not conform to the World Trade Organisation's (WTO) insistence that tariff concessions on imports/exports should apply only to trade-bloc to trade-bloc arrangements.

UGANDA

Oil

Tullow Oil has announced that they have sold nearly two thirds of their interest in the Lake Albert oil exploration project to Total Oil for US$900 million. They will receive US$100million up front but will have to wait for the rest until oil production starts, which is not expected until 2020 at the earliest. The deal leaves Total as the dominant oil company in Uganda. The trigger for this move appears to have been the Ugandan Government's decision to build an oil export pipeline through Tanzania, rather than Kenya, the route favoured by Tullow because of their Kenyan oil exploration interests. The pipeline agreement was signed last December and a US company was appointed to carry out a front-end engineering and design study.

Despite the many concerns about the future of the sector in the country, the government remains optimistic as the pressure mounts to put in place the critical infrastructure for oil production in four years' time. It has announced that "they should have a key player for the refinery in February" and that "the legal and institutional frameworks are in place for building this infrastructure". This includes a 60,000 barrels per day refinery (in two 30,000 phases), a crude export pipeline and a products pipeline, all facilities that are required at roughly the same time. This is critical if production is actually going to commence as planned by 2020. It is estimated that the total investment required will hit the US$20 billion mark and this could mean new players entering the market once negotiations for a new Production Sharing Agreement is concluded.

Experts have said that "the two-year slump in the oil and gas industry could finally be coming to an end" following the rise in global prices during the past year and this "could lead to increasing capital expenditure in the sector". Hopefully such optimistic sentiment will not be misplaced.

TANZANIA

Industrialisation

The growing influence of China is becoming increasingly apparent and the country has pledged "to back Tanzania's industrialisation" by providing "more development support" to enable the country to meet targets set in the 2015/20 National Development Plan and to build an industrial economy. This will involve improving roads, railways and the construction of ports in Bagamoyo and Zanzibar as cooperation between the two countries gets closer and deeper. Chinese companies are being encouraged to invest in the country as it becomes increasingly clear Tanzania, much like Ethiopia, is turning eastwards for its development model.

The requirements remain daunting. The railways continue to offer a very poor service, the power sector is no longer the investment opportunity it used to be as the parastatal, TANESCO, which is effectively bankrupt, is required to own all the generating equipment and transmission lines. Increases in generating capacity are under way but many private sector companies in the sector are owed huge sums of money by the government and it will be a long time before supplies become reliable — a key requirement for any industrialisation plan. Gas does of course offer enormous long term potential following the recent offshore discoveries but this is progressing very slowly.

In the mining sector, there are signs that there is progress — graphite in the south east Lindi district and Helium in the south west are set for exploitation within a couple of years. Acacia gold mining has increased production by over 10% in the past year, despite huge tax demands and increasing, largely unwarranted, local government complaints. It is however closing down its most recent mine, Buzwagi, because reserves there are now considered "minimal".

Numerous foreign small-scale mining investors who obtained exploration licenses have ceased operations because of similar disputes and local conflicts. Coal mining, however, is being developed reasonably well, after fifteen years of stagnation.

In the agricultural sector, the current drought covering over half the country has reduced food production at the local level and the short term future remains uncertain. There is an attempt by government to divert public attention away from the problem but large reserves in warehouses do little to provide food for rural villagers. Irrigation and better water management systems to combat possible climate change in the country — mostly caused by cutting down trees — is still being touted, but with little actual implementation. There are some success stories — expanding sunflower cultivation, increasing Cassava production and exportation, for example — but with much routed through government there will inevitably be regulatory obstructions to contend with. The sector is attracting local low-level investment but this is being inhibited by the drought and government interference, so more larger commercial projects are unlikely to be forthcoming under current circumstances.

Telecommunications continue to flourish and Tanzania is now considered to be "just behind" Kenya in terms of usage. A number of foreign firms are operating in the cyber security sector and the four major telecoms companies are amongst the largest investors in the country. They have enhanced business and cash flow, even though they charge high interest rates on small loans, but further investment in the sector is still required, including skills-training centers.

Safety and security remains an issue in the country, although there are signs that robberies have declined slightly. Religious conflict, however, remains very limited.

Conclusion

In summary, the country is going backwards politically and the future prospects for foreign investment remain bleak indeed.

ETHIOPIA

Business

The Government has been reviewing liberalising the country's logistics sector for some time now as this is often cited as a major obstacle to the development of the private sector. There have been plans announced to sell off 40% of the shares in Ethiopian Shipping and Logistics Enterprise Services (ESL), the state-owned company that currently enjoys a monopoly. A Chinese consulting firm is evaluating the company's assets and several (mostly Chinese, but one Danish and one French) maritime freight organisations have been pre-selected as potential acquirers. The aim is to decrease ESL's debts and raise foreign exchange from the sale, in addition to improving the company's efficiency, which currently provides a poor service to customers. A possible management contract is also under review as an alternative to the sale of shares.

The Government is developing various industrial parks, aiming to become a light-manufacturing hub, and to create employment opportunities for the country's growing, and young, population. Hawassa Industrial Zone is already open for business and four others are currently under construction outside the capital. These will be for agro-processing as well as light manufacturing. Many more such industrial parks are planned for the future across the country.

Tourism is another sector being promoted by the government (perhaps "talked about" is a more apt description) as last year it contributed over US $3.4 billion in revenue to the economy from over 900,000 foreign tourists who visited the country.

International and business conferences contributed to an increase in arrival numbers. Many observers believe the potential is far higher if the sector was better promoted and managed, as the country has many unique attractions, and the recent civil unrest has of course had an impact but it is hoped that the upward trend will soon be revived following government efforts to stabilise the situation.

One of the more intriguing developments in this still socialist country has been the growing wine industry. In 2007, the now late Prime Minister Meles Zenawi invited Pierre Castel, founder of French beverage giant Castel, to assess the opportunities for vineyards in the country. It was not an entirely new idea as Awash Winery, which was privatised in 2013 with around 100 ha under cultivation, has been in existence for many years, producing poor quality wines.

Castel bought into the idea, already operating a brewery in the country, by importing various different grape varieties and setting up its own vineyard in Ziway, some 163 km from Addis Ababa. The first bottle was produced in January 2014 and sales began a few months afterwards. Today, Castel manages a 162 ha vineyard and produces around 1.4 million bottles a year — Merlot, Cabernet Sauvignon, Syrah and Chardonnay — under two brands, Rift Valley and Acacia. Around 15% is exported, mainly to China and the US, and these surprisingly good quality wines compete with imports from South Africa and France in the domestic market (in part helped by very high import taxes). The market is increasing as Ethiopians become more accustomed to drinking wine with meals and more restaurants open up in the country.

(Well worth a try, if you can get your hands on a bottle).