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Business Monitor International's monthly regional report on political risk and macroeconomic prospects

KENYA

Political Risk Threatens Balance Of Payments

BMI View: We expect a widening current account deficit in 2012 will be adequately covered by portfolio inflows, foreign direct investment and multilateral support and this should forestall a balance of payments crisis. However, a major elevation in political risk in the lead up to election in March 2012 could result in capital flight and pose real risks to Kenya's balance of payments position.

Kenya's current account deficit ballooned to an estimated US$3.8bn (10.1% of GDP) in 2011 from US$2.5bn (7.8%) a year earlier. We believe that a combination of subdued demand from Europe (an important export partner) and strong demand for consumer imports will see the shortfall grow further to US$3.9bn (8.4% of GDP). However, we believe that the growing attraction of Kenyan financial assets combined with increased multilateral support will forestall a balance of payments crisis. The major risk to this view comes from political risk. Although not our core scenario, a repeat of the violence after the 2008 poll at elections scheduled for August could result in capital flight and pose real risks to Kenya's balance of payments position.

In sum we are forecasting total goods and services exports to grow by 9.2% to US$11.0bn in 2012, although we note a divergent outlook for different export sectors depending on the destination market. On one hand, subdued growth in Europe bodes ill for the tourism and horticulture sec-

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SUDAN

Pressure Mounting On Government

BMI View: A cabinet reshuffle and the killing of an influential rebel leader in are being held up by the government as evidence it is broadening its base and winning the battle against insurgents, but its popular support remains limited and armed opposition is more united than it has been for years.

On the surface, several domestic developments appear to have bolstered the powerbase of President Omar al-Bashir's regime over the last few weeks, most notably a cabinet reshuffle and the death of a prominent rebel leader, Khalil Ibrahim. However, the positive effect of these developments on al-Bashir's regime should not be overstated; moreover, they are not without their caveats. First, while the cabinet reshuffle fol-

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THIS MONTH'S TOP STORIES

South Sudan: Security Woes Dampen Independence Excitement

BMI View: Ongoing security concerns – resulting from tension with Sudan both among tribal groups in South Sudan - have demonstrated that post-independent South Sudan has still struggled to achieve the peace and stability it needs to thrive as the world's newest nation. We believe the underlying points of contention will remain volatile flashpoints well into the future, posing a long-term challenge to policymakers.

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Uganda: Unrest Brewing As Cost Of Living And Borrowing Rises

BMI View: The public unrest seen in 2011 is set to continue, and perhaps intensify, in 2012. Although inflation has begun to come down, there is still widespread discontent over the rising cost of living and doing business.

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Tanzania: Disinflation In Spite Of Electricity Hikes

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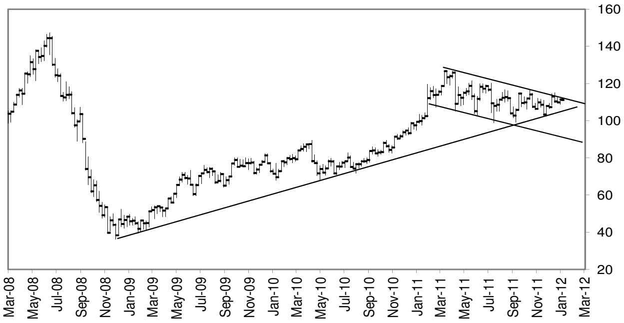
OIL MARKET OUTLOOK



Source: BMI

Front-month Brent crude remained resilient in January and we expect oil to be one of the outperformers in the commodity complex in 2012. Q112 prospects for oil are relatively positive, as supply remains tight, political risks high and investor sentiment towards equities and commodities warming. However, we continue to forecast slightly lower prices in the medium term, with Brent pencilled in at US$102/bbl in 2012 and US$100/bbl in 2013. Our core view is that Iran will not force a closure of the Strait of Hormuz, but supply risks will remain elevated in the coming months.

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RISK SUMMARY

POLITICAL RISK

Election Date Ruling

Kenya's High Court ruled on January 13 that elections will take place in March 2013 instead of August 2012 unless the coalition government collapses before then. The court had been asked to decide on the date after different interpretations of the constitution led to confusion about when the poll should take place. The ruling leaves open the possibility that elections will take place before March 2013 if the government collapses as a result of one of the parties withdrawing from the coalition. In such a case, an election would be called within 60 days.

Our short-term political risk rating is 55.6.

ECONOMIC RISK

Commercial Vehicle Growth

BMI's Autos team believes that Kenya's commercial vehicle segment will continue to perform strongly over the coming years, as construction projects in the region will fuel sales in the heavier segments. In 2011, it was smaller dealers who cashed in on the trend, as bigger brands such as Nissan Diesel (represented by DT Dobie) and Mitsubishi Motors (Simba Colt) struggled with supply issues relating to the tsunami which hit Japan in early 2011. General Motors East Africaoffset some of the negative impact of restricted supplies for its Isuzu truck brand, however, through its domestic production.

Our short-term economic risk rating is 40.4.

BUSINESS ENVIRONMENT

No Dividends From Telecoms Strategy

The Communications Commission of Kenya has published market data for the three months ended September 2011. The regulator's figures show Safaricom still accounts for the majority of mobile subscriptions and traffic. However, the operator's financial data, which BMI believes reflects general market trends, is less impressive. This implies that Kenya's promotion-driven mobile subscriber and traffic growth has not delivered the expected financial returns for the operators and our telecoms team believes there could be a change of market strategy in 2012 and beyond.

Our business environment rating is 39.2.

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tors, which together make up about 17% of total Kenyan exports. According to the latest available data from the Central Bank of Kenya, 46% of visitors to Kenya in the January to July period in 2011 were European, while close to 20% of Kenya's goods exports were sold to Europe in the 12 months to July 2011. The bulk of the goods exports comprised cut flowers to the Netherlands (which are then sent around the continent) and vegetables to the UK. With our Europe team forecasting real GDP growth of -0.3% in the eurozone and 0.6% in the UK in 2012, the outlook for tourism and horticulture receipts does not look too bright.

However, this gloomy picture is offset to some extent by more promising economic growth stories in African countries, which cumulatively purchase a shade under half of Kenya's total exports. Regional peers in the East Africa Community account for about half of this or a quarter of the total exports. The Ugandan economy (which accounted for 14.7% of total Kenyan exports in 2010) is forecast to expand by 7.1% in 2012 and Tanzania (8.0% of total 2010 exports) is expected to grow by 5.9%. Strong economic outlooks for these economies should help to support export growth, particularly manufactured products and tea.

Imports: Strong Consumer Goods Demand

Overall, we believe total imports will grow by 7.2% to US$17.2bn in 2012 from US$16.0bn in 2011, although once again we believe that the outlook is mixed for capital and consumer goods. We have written about the fact that gross fixed capital formation is expected to be a weak spot for Kenyan growth in 2012 as both the public and private sector grapple with high borrowing costs (*see our online service, December 30 2012, 'Economy To Remain Resilient Amid The Risks'*). This should help contain demand for capital goods such as machinery and transport equipment, which together made up about a third of total goods imports in 2010.

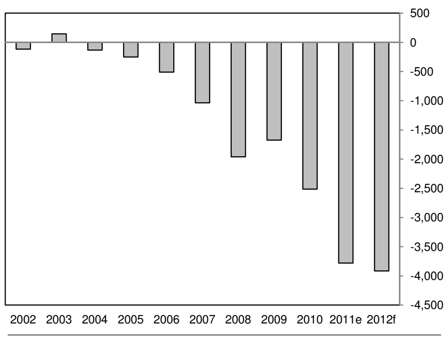
On the other hand, we are expecting consumer goods to grow strongly in 2012. The government is likely to boost current expenditure in the lead up to the election scheduled for March 2013 (the date has been pushed back following a high court ruling in January 2012). Private consumption, meanwhile, should receive a fillip as the incomes of the many Kenyans who rely on agriculture for their livelihood are boosted by improving rains in 2012. Given the Kenyan shilling's 20% surge of recent months and our expectation that it will hold onto the majority of these gains, a lot of the demand for consumer products resulting from the positive consumption outlook will be met by imports.

No Balance Of Paymets Crisis For Now

Taking an expected surplus of US$2.7bn in the transfer account (the majority of which will be accounted for by remittances) and a small deficit in the income account, we believe that Kenya's current account deficit will come in at US$3.9bn (8.5% of GDP) in 2012, up from an estimated US$3.8bn (10.0% of GDP) in 2011. Inflows to the financial account will go some way towards offsetting this. We have written about the fact that Kenyan local debt is starting to look very attractive to foreign investors, with nominal yields of close to 20% and the shilling expected to remain stable. This should help to attract portfolio flows into the local debt market. We also believe shilling stability could lure some foreign investors back into the equity market. Indeed, data from the Nairobi Stock Exchange showed foreigners were major buyers towards the end of 2011 after the shilling had recovered from its historic lows reached at the end of the third quarter.

Deficit To Grow Further, But No BOP Crisis

Kenya – Current Deficit, US$mn



Source: Central Bank of Kenya, BMI

Furthermore, we believe that the overdue shift into aggressive monetary tightening mode in September 2011 will please multilateral funders and will increase Kenya's access to funds from these organisations. The IMF approved additional balance of payments support funding in December. Taking all of these together, we believe that Kenya should be able to cover its current account shortfall and therefore do not believe a balance of payments crisis is in the offing.

POLITICAL OUTLOOK

Implications Of The ICC Decision

BMI View: The decision by the International Criminal Court to proceed with trials against four Kenyans accused of fomenting post-election violence in early 2008 raises a great deal of uncertainty and several risks.

A panel of judges from the International Criminal Court (ICC) has confirmed charges relating to the post-election violence of 2007-2008 against four prominent Kenyans. After considering evidence from pre-trial proceedings, the judges decided that Deputy Prime Minister and Finance Minister Uhuru Kenyatta, former higher education minister William Ruto, Head of Civil Service Francis Muthaura and media executive Joshua arap Sang all have cases to answer and that trials should go ahead. The panel ruled there was insufficient evidence for cases against former police commissioner Mohammed Hussein Ali and former industrialisation minister Henry Kosgey, and charges against both men have been dropped. While the accused have reiterated their innocence and political leaders have called for calm, the decision to proceed with trials a potentially has significant ramifications for Kenya's political landscape:

Ethnic Tension: In broad terms the post-election violence pitted Kalenjin supporters of the Orange Democratic Movement against Kikuyu supporters of the Party of National Unity. Kenyatta and Ruto are widely viewed as leaders of the Kikuyu and Kalenjin communities respectively and the trials could re-ignite the tensions which led to the post election violence.

Elections: Although there is a risk of ethnic tensions heightening during the trials, the biggest risk will come when the country goes to the polls (likely in March 2013) to vote for a new president. Both Ruto and Kenyatta have announced their intentions to run for the presidency and their participation in the trials could galvanise ethnic animosity at the election.

Government Credibility: The caveat to the end-of-impunity argument is that the attorney general (AG) announced that neither Kenyatta nor Muthaura would be asked to resign their respective posts. This was in spite of an agreement signed between President Mwai Kibaki and Prime Minister Raila Odinga in December 2008 which stated that 'any person holding public office or any public servant charged with a criminal offence related to 2008 post-election violence shall be suspended from duty until the matter is fully adjudicated upon.' Although Kenyatta and Muthaura subsequently voluntarily resigned, the fact that there seemed little pressure from within the government for them to do so raises questions about its credibility. The AG has established a panel to advise the government on how to respond to the court's decision. It will, among other things, revisit government reservations over the jurisdiction of the court.

Presidentail Candidates: Apart from potentially raising tensions at the elections, the ICC's decision could have a bearing on who ends up participating in it. Guilty verdicts could preclude Ruto and Kenyatta from running given that Odinga and Kibaki's December 2008 agreement added: 'any person convicted of a post-election violence offence is barred from holding any public office or contesting any electoral position.' Even if they are able to run, the strain on the resources and popularity of Ruto and Kenyatta exerted by the ICC trials might harm their ability to successfully campaign. On the other hand, the trials may actually improve their chances at the poll if they are able portray themselves as 'martyrs'. This could prove to be a successful strategy if Odinga, the arguable front-runner for the presidency, is perceived to exploit the trials for his own political advantage.

DATA & FORECASTS

BMI View: A combination of higher debt service costs, elevated inflation, tight domestic liquidity and spending commitments will put pressure on Kenya's fiscal accounts in 2012. Although we believe these issues will lead to a widening of the fiscal deficit, we expect lower government spending will see the shortfall come in below the government's expectations. Our forecast for the 2011/12 fiscal year budget deficit is KES204.3bn (US$2.3bn), lower than the government's estimate of KES238.1bn (US$2.6bn).

	2009	2010	2011e	2012f	2013f
Population, mn [4]	39.5	40.5	41.6	42.7	43.9
Nominal GDP, US$bn [5]	30.6	32.2	37.9	46.1	50.8
GDP per capita, US$ [5]	776	795	910	1,079	1,157
Real GDP growth, % change y-o-y [6]	2.6	5.6	4.1	5.0	6.1
Budget balance, % of GDP [5]	-3.8	-4.2	-3.7	-5.1	-5.1
Consumer prices, % y-o-y, ave [7]	9.4	3.9	12.5	14.5	9.5
Real lending rate, %, eop [2,8]	6.5	-0.5	-0.9	8.0	7.4
Exchange rate KES/US$, ave [9]	77.20	79.24	88.80	87.58	91.50
Goods exports, US$bn [5]	4.5	5.2	6.0	6.7	7.5
Goods imports, US$bn [5]	9.5	11.5	13.8	14.8	15.7
Balance of trade in goods, US$bn [5]	-5.0	-6.3	-7.8	-8.1	-8.2
Current account, % of GDP [5]	-5.5	-7.8	-10.0	-8.5	-7.1
Foreign reserves ex gold, US$bn [10]	3.8	3.5	3.6	3.8	4.0
Import cover, months g&s [3,11]	4.1	3.1	2.7	2.7	2.6
Total external debt stock, % of GDP [13]	26.2	27.0	24.7	22.0	21.5
Short term debt as a % of International reserves [13]	13.4	19.9	21.8	23.9	26.3
Short term foreign debt, % of total [13]	6.4	8.0	8.5	9.0	9.7

Notes: e BMI estimates. f BMI forecasts. 1 Basket Reweighted In 2009; 2 Real rate strips out the effects of inflation; 3 Cover for goods and services; Sources: 4 World Bank/UN/BMI. 5 Central Bank of Kenya/BMI calculation; 6 Central Bank of Kenya; 7 Kenya National Bureau of Statistics; 8 Central Bank of Kenya/BMI; 9 BMI; 10 IMF IFS; 11 IMF IFS and Central Bank of Kenya/BMI calculation; 12 World Bank GDF; 13 World Bank GDF/BMI calculation.

RISK SUMMARY

POLITICAL RISK

Ex-Rebels Rewarded For Backing Kabila

The UN has claimed that former rebels were promoted to senior positions in the Congolese army in return for supporting President Joseph Kabila's re-election effort in November 2011. It highlighted the case of Bosco Ntaganda, a former rebel who is now a general in the national army and wanted by the International Criminal Court for war crimes. The UN claimed he used troops to pressure local populations into voting for Kabila in return for posts for his men in the army.

Our short-term political risk rating is 27.5.

ECONOMIC RISK

Government Aims For 6.0% 2012 Growth

The Democratic Reupublic of the Congo (DRC)'s government is aiming for 6.0% real GDP growth in 2012, according to Finance Minister Matata Ponyo Mapon. Ponyo said that the government hopes to bring inflation down from an average of 15.4% in 2011 to 9% in 2012 and boost reserves from US$1.2bn to US$2.1bn. He is also confident that a dispute with the IMF over publishing mining contracts will be resolved, unblocking the latest US$90mn tranche of a US$560mn loan facility with the organisation.

Our short-term economic risk rating is 38.5.

BUSINESS ENVIRONMENT

Crackdown On Conflict Minerals Backfiring

According to a UN report released on December 30, a US crackdown on 'conflict minerals' from eastern DRC has been counter-productive. The 2010 Dodd-Frank law forces companies to prove minerals from the DRC are 'conflict free' but the Securities and Exchange Commission has yet to finalise specific rules. Uncertainty surrounding the provisions has led to international companies stopping virtually all purchases from the DRC. The report claims that the collapse in demand has led to increased criminality and smuggling into neighbouring Rwanda. The Congolese army has also been implicated in the smuggling, although the government denies this.

Our business environment rating is 17.8.

POLITICAL OUTLOOK

Deep Problems In East

BMI View: The massacre of 45 civilians in eastern Democratic Republic of Congo in January highlights the continued instability in the region. Although there are signs that the main rebel group may be weakening, BMI is sceptical of significant security improvements in 2012.

According to the Congolese army, 45 civilians were killed in villages in South Kivu province in the east of the Democratic Republic of Congo (DRC) on January 1-2 2012. The massacre highlights the instability in the east of the country, where land disputes, ethnic tensions and natural resources sustain violent militias. The army is already pointing the finger at the Forces Démocratique pour la Libération du Rwanda (FDLR), a Hutu rebel group operating in the region. Given the nature of the organisation and its history, **BMI** believes the accusation is credible. The government may use the massacre as a pretext for a renewed offensive against the FDLR. The region had been an important source of electoral support for President Joseph Kabila, but fears about insecurity eroded his share of the vote in the 2011 presidential election. The government will be under pressure to improve security in the run-up to local elections in early 2012.

There are signs that the FDLR is weakening. The loss of its Rwandan backer in 2008 was a serious blow and there are reports that the Congolese army is forcing the FDLR off the mines that currently sustain it financially. However, **BMI** is sceptical the government can significantly improve security in 2012 The International Crisis Group has written that armed conflict in the east is sustained by inter-communal tensions and land disputes that are exacerbated by repeated cycles of displacement. Unresolved inconsistencies between customary and statutory law put traditional chiefs in conflict with administrative authorities. The army is poorly trained and equipped, as it is the product of an over-hasty integration of the previously Rwanda-backed rebels, and includes several alleged war criminals. Although the FDLR may be in decline, a much diminished organisation can still be difficult to wipe out completely in the unruly jungles of Central Africa.

DATA & FORECASTS

BMI View: We are forecasting real GDP growth of 6.1% in the DRC in 2012, a slight fall from the 6.4% growth we estimate for 2011. Economic activity should be driven by an expanding mining sector – BMI's Mining team forecasts copper and cobalt output to nearly double and gold production to triple between 2010 and 2015.

	2009	2010	2011e	2012f	2013f
Population, mn [1]	64.2	66.0	67.8	69.6	71.4
Nominal GDP, US$bn [2]	11.3	13.1	15.6	16.6	17.1
GDP per capita, US$ [2]	176	199	230	239	240
Real GDP growth, % change y-o-y [2]	3.1	6.5	6.4	6.1	7.0
CDF nominal growth, % change y-o-y [2]	39.0	31.0	20.5	19.5	17.8
Budget balance, CDFbn [3]	-381.0	282.0	-508.9	-595.4	-696.6
Budget balance, % of GDP [3]	-4.2	2.4	-3.6	-3.5	-3.5
Consumer prices, % y-o-y, ave [4]	42.9	24.6	15.6	14.4	11.5
Consumer prices, % y-o-y, eop [4]	53.4	9.8	16.7	12.0	11.0
Exchange rate CDF/US$, ave [5]	804.56	905.82	919.26	1,030.21	1,175.87
Exchange rate CDF/US$, eop [5]	907.19	915.13	910.82	1,020.78	1,164.98
Exchange rate CDF/EUR, eop [5]	1,152.13	1,224.17	1,179.06	1,275.98	1,456.22
Goods exports, US$bn [6]	4.4	8.3	10.0	12.2	14.1
Goods exports, % change y-o-y [6]	-33.6	91.1	20.0	22.0	15.0
Goods imports, US$bn [6]	4.9	7.8	9.4	11.3	13.0
Goods imports, % change y-o-y [6]	-26.3	58.2	20.0	20.0	15.0
Balance of trade in goods, US$bn [6]	0.6	-0.5	-0.6	-1.0	-1.1
Current account, US$bn [6]	-1.2	-0.9	-0.5	-0.2	-0.0
Current account, % of GDP [6]	-10.3	-6.8	-3.5	-1.5	-0.3
Foreign reserves ex gold, US$bn [7]	0.8	1.0	1.1	1.1	1.2
Import cover, months g&s [7]	1.4	1.2	1.2	1.0	1.0
Total external debt stock, % of GDP [8]	121.5	30.6	29.7	32.0	34.1
Total external debt stock % of XGS [8]	273.0	44.7	43.7	41.4	39.8

Notes: e BMI estimates. f BMI forecasts. Sources: 1 World Bank/UN/BMI. 2 AfDB/IMF/BMI; 3 BCC/IMF/BMI; 4 Banque Centrale du Congo/BMI; 5 BMI; 6 IMF/BMI; 7 BCC/BMI; 8 IMF, BMI.

POLITICAL OUTLOOK

Security Woes Dampen Independence Excitement

BMI View: Ongoing security concerns – resulting from tension with Sudan and among tribal groups in South Sudan – have demonstrated that post-independent South Sudan has still struggled to achieve the peace and stability it needs to thrive as the world's newest nation. We believe the underlying points of contention will remain volatile flashpoints well into the future, posing a long-term challenge to policymakers.

The people of South Sudan have endured hostility for decades, with the most recent Sudanese civil war finally ending in 2005 after more than 20 years of fighting, paving the way for the country's independence in July 2011. Many South Sudanese people – and many from around the world – hoped that with a new country, a new government, and a new beginning, that the violence would stop.

While we are optimistic that this will eventually be the case, the end of 2011 and early 2012 have been characterised by heightened tensions both domestically and abroad, and resolution to these problems will remain difficult to overcome in the medium term.

Sudanese Relations Hanging By A Thread

Despite the fact that fighting officially ended years ago, there remain violent clashes between South Sudan and its northern neighbour, which seems to have been little helped by the country's formal independence.

Skirmishes along the border region have disrupted trade and have led to very high inflation (which was approaching 80% in November 2011) in South Sudan. While both sides blame the other for using proxy militants along their shared border, a rare direct confrontation between the two country's armed forces occurred in early December 2011.

The clash took place in Jau, a disputed area between the Sudanese state of South Kordofan and the South Sudanese Unity state. Both sides claimed the territory as rightfully theirs, and promised to issue complaints with the UN over the incident. A South Sudanese army spokesperson said that the two countries were 'on the brink of conflagration', and in the subsequent days the UN helped 20,000 refugees flee from the area.

Against this backdrop of heightened tension, Sudan accused South Sudan of violating its obligations to pay transit fees for using Sudanese pipelines and other infrastructure. Sudanese President Omar al-Bashir told members of Sudan's parliament early in January that since South Sudan was not serious about reaching an agreement, Sudan would have to take a 'unilateral decision' to impose transit fees on crude oil every month.

As a result, on January 15 it began confiscating oil to use in its refineries as a sort of coercive collection of arrears. The US Embassy in Khartoum issued a statement saying that the US was 'greatly concerned by recent Sudanese public threats and unilateral actions that impede the flow of oil from South Sudan, jeopardise the viability of the oil sector and increase tensions'. South Sudan denies that it has not paid the appropriate fees, with top negotiator Pagan Amum saying Sudanese demands had 'no basis'.

There is no question that relations between Sudan and South Sudan have deteriorated in recent months, and a return to overt military conflict is not completely out of the question. However, we believe that for now neither party wants this, and we expect that the two countries' rocky and defiant diplomatic discourse will continue for the time being.

Trouble On The Home Front

Apart from conflict with its northern neighbour, one of the most serious sources of violence in South Sudan in recent months has been based around ethnic feuds within its own borders.

At the beginning of January, an armed group made up of about 6,000 people of the Lou Nuer tribe attacked the town of Pibor in Jonglei state, targeting a bitter rival, the Murle tribe. At least 20 people were killed, with another 160 wounded, although the final tally was unclear since authorities could not reach all the affected areas. Around a third of the settlements in Pibor were torched, according to reports. The army was deployed to secure the area, but around 60,000 people have fled the violence and become refugees, according to the UN.

Some Murle members retaliated several days later, when they attacked two Lou Nuer settlements, also in Jonglei state, killing at least 24 people and wounding 23. The assailants also stole an unspecified number of cattle.

Following these attacks, the government in Juba declared Jonglei a disaster area, but the violence has worsened. On January 11, 57 people were killed when Murle fighters attacked three more villages. Another 47 were killed several days later in what was called a revenge killing.

A local leader and MP, Philip Thon Leek Deng, said in the latest violence, the raiders 'did not take cattle. They were only coming for annihilation'. Deng further pleaded with the government to 'take forces to protect the old men and women who are there'.

There are concerns among some that the government will not be able to reverse the escalation, and the cycle of violence could see hundreds killed. Indeed, some local officials claim that the death toll is already in the many hundreds.

While aid agencies have consistently been more conservative in their estimates of the casualties, there is little doubt that the problem is getting worse and requires urgent attention.

The Way Forward

Political strife and security challenges affect every aspect of life in South Sudan, exacerbating an already dire food harvest by displacing hundreds of thousands of people.

Apart from food security, these issues also harm economic output both in the short term (due to the gross underutilisation of human and natural resources, and general inefficiencies in times of conflict) and the long term (due to adverse effects on investor sentiment).

The government in Juba undoubtedly recognises this, and is working with donor nations to set the ship aright. However, we believe that given the evidence on the ground over the past several months, this is likely to be a very slow and rather painful transition.

RISK SUMMARY

POLITICAL RISK

Oil Seizure Allegations

South Sudan has claimed that US$815mn worth of crude was seized while being transported through its Sudan's pipeline. South Sudan seceded from the north in July 2011, but the two countries have failed to agree on how to share revenues from oil that is produced in the south. The oil needs to travel through northern pipelines to be exported. Sudan has reportedly seized oil being transported from the south as compensation for not having received a fee. South Sudan has responded by starting to shut down oil production.

Our short-term political risk rating is 30.0.

ECONOMIC RISK

Ambitious Oil Production Increases Planned

The head of Sudan's Oil Exploration and Production Administration, Azhari Abdalla, has declared that the country plans to increase oil production to 180,000 barrels per day (bpd) by the end of 2012 from 115,000bpd in January. The increase will be driven by new discoveries and by more efficient recovery from existing production facilities as superior technology is adopted. All 115,000 barrels of current production is consumed domestically. While 180,000 barrels per day would leave the country with a small surplus, Sudan would not resume exporting until 2017 when Abdalla said he expects production to rise to 320,000bpd.

Our short-term economic risk rating is 26.5.

BUSINESS ENVIRONMENT

Dam Funding

Sudan's Finance and Economy Minister Ali Mahmoud and the Arab Fund for Economic and Social Development (AFESD)'s Director General Abdullatif Al-Hamad have signed a loan agreement for the Upper Atbara and Stait dams' hydropower project in Eastern Sudan. Under the terms of the agreement signed on December 28 2011, the AFESD will provide financial assistance of US$111mn adding to US$400mn already provided for the Merwoe Dam on the Atbara River. Hydropower currently accounts for almost 60% of Sudan's total power generation output, with the remaining output largely comprising oil-fired facilities.

Our business environment rating is 25.4.

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lowed a four-month consultation and entailed providing opposition parties with portfolios, there has not been a significant dilution of the ruling National Congress Party (NCP)'s powerbase. Overall, the reshuffle reflects only a very partial rapprochement with opposition forces in the country. Both the main National Umma Party (NUP) led by Saddiq al-Mahdi and Hassan al-Turabi's Popular Congress Party (PCP) – two key unarmed opposition forces – are notable by their absence from the freshly reshuffled government. In early January, al-Mahdi and al-Turabi, who had earlier been at loggerheads, agreed to unite behind the common purpose of bringing down the regime through orchestrating popular protests.

This is potentially significant, since while al-Turabi and the PCP have long been calling for popular pressure modelled on the successful regime-changing movements in Tunisia and Egypt, al-Mahdi's NUP had previously been reluctant to endorse this radical agenda. The agreement does not necessarily suddenly mean that Sudan is ripe for popular revolution; compared with other countries in the region, protests in Sudan over the last year have been limited. They have generally been characterised by low volumes of protestors and have been easily dispersed. Such protests have also been infrequent, with little street activity outside January and December last year. However, cooperation between the PCP and NUP could be a factor that contributes to a potential eventual 'critical mass' required to catalyse mass protests.

Meanwhile, with regard to armed opposition, the death of Justice & Equality Movement (JEM) leader Khalil is being flagged by the regime as an indicator that it is winning its battles against insurgents. On the flipside, however, Khalil had built a reputation as being a notoriously difficult character to work with and his behaviour arguably contributed to a collapse of cooperation between the various rebel groups in Darfur over the years. More recently, cooperation between rebel groups has been revived, with the formal creation of the Sudanese Revolutionary Front (SRF) in November. This alliance comprises three Darfur rebel groups- JEM and two factions of the Sudan Liberation Army (SLA) – together with the Sudan People's Liberation Movement North (SPLM-N), which began fighting a rebellion in Southern Kordofan and Blue Nile last year. Khalil's death does not necessarily have a negative effect on the durability of this fresh alliance of rebel forces.

DATA & FORECASTS

BMI View: We expect that Sudanese real GDP growth will remain subdued in 2012 at 2.4% as the economy struggles to adjust to life without oil reserves which were lost to South Sudan following secession in July 2011. High inflation, security concerns and international economic sanctions will preclude a more robust recovery following a 10% economic contraction in 2011. Growth is expected to gradually pick up to over 5% by 2014, although we note that possibility of a return to full military conflict with South Sudan poses downside risk.

	2009	2010	2011e	2012f	2013f
Population, mn [1,2]	42.5	43.6	35.7	36.5	37.4
Nominal GDP, US$bn [1,3]	54.2	63.2	70.0	76.4	91.4
GDP per capita, US$ [1,3]	1,277	1,452	1,961	2,093	2,445
Real GDP growth, % change y-o-y [1,4]	4.5	5.7	-10.9	2.4	4.8
SDG nominal growth, % change y-o-y [1,3]	3.7	16.1	26.9	21.7	25.7
Budget balance, SDGbn [1,5]	-2.3	-24.0	-11.4	-13.0	-15.9
Budget balance, % of GDP [1,3]	-1.8	-16.5	-6.1	-5.8	-5.6
Consumer prices, % y-o-y, eop [1,3]	13.4	15.4	18.9	20.0	20.0
Exchange rate SDG/US$, eop [6]	2.31	2.50	2.80	3.10	3.10
Exchange rate SDG/EUR, eop [6]	2.94	3.34	3.62	3.88	3.88
Goods exports, US$bn [5]	5.9	0.6	7.6	5.5	5.7
Goods imports, US$bn [5]	6.6	7.1	6.6	6.8	7.1
Balance of trade in goods, US$bn [5]	-0.7	-6.6	1.0	-1.3	-1.4
Current account, US$bn [5]	-6.0	-12.0	-4.2	-6.6	-6.9
Current account, % of GDP [3]	-11.1	-19.0	-5.9	-8.7	-7.6
Foreign reserves ex gold, US$bn [5]	1.1	1.2	1.1	1.1	1.2
Import cover, months g&s [3]	1.5	1.5	1.4	1.4	1.4
Total external debt stock, US$mn [7]	35,700.0	35,700.0	36,000.0	24,127.5	23,886.3
Total external debt stock, % of GDP [8]	65.8	56.5	51.5	31.6	26.1
Short term debt as a % of International reserves [8]	1,773.0	1,589.3	1,751.1	729.7	688.0
Short term foreign debt, % of total [8]	54.3	53.6	52.7	34.4	34.4

Notes: e BMI estimates. f BMI forecasts. 1 Forecasts from 2011 onwards assume secession of South Sudan and hence, exclude the South Sudanese portion of the economy; Sources: 2 World Bank/UN/BMI. 3 IMF/BMI calculation; 4 African Development Bank; 5 IMF; 6 BMI; 7 World Bank GDF; 8 World Bank GDF/BMI calculation.

ECONOMIC OUTLOOK

Disinflation In Spite Of Electricity Hikes

BMI View: An electricity tariff hike does not alter our view that inflation will decline in early 2012. However, we believe it will fall slower than we previously anticipated.

On January 14, Tanzania's Energy and Water Regulatory Authority gave state-run **Tanzania Electricity Supply Company** (TANESCO) the go-ahead to increase electricity tariffs 40.3%. The move does not alter our view that disinflation will be the dominant trend in 2012 as a combination of base effects, improved rains and tight monetary policy feed through. However, we believe that the rate of decline will be slower as a result of the electricity price increase. We now see headline inflation falling to 11.1% y-o-y by end-2012 (compared with December 2011 inflation of 19.8%) and averaging 14.9% for the year. Our pre-tariff hike forecasts were for inflation to fall to 9.1% by the end of 2012 with an annual average of 12.1%.

Even in spite of the tariff hike, we maintain our view that the inflationary trend of the last 15 months, which has seen the rate of price growth increase from a low of 4.2% in October 2010, is close to an end. We are expecting that improved rains will help to increase food supplies, which should see food prices ease, while a stabilisation of the shilling militates against imported inflation. On the latter point, currency weakness and high oil prices in 2011 meant that average oil prices in shilling terms were over 50% higher than in 2010. Using our oil price forecasts (of US$102 for a barrel of Brent crude) and our exchange rate expectations (TZS1,615/US$ average for the year), we expect that average shilling-denominated oil prices will be about 6% lower in 2012 relative to 2011 and this should help to ease inflationary pressures.

All of that said, the electricity tariff increase will impact headline price growth in the form of slower disinflation and we have adjusted our forecasts to reflect a more gradual decline in the rate of price growth. With only 13.9% of people estimated to have electricity access, consumers will be impacted as producers pass on higher costs of production rather than as a direct result of higher household energy costs.

DATA & FORECASTS

BMI View: Tanzania's ballooning current account deficit will persist in 2012, reaching US$3.9bn (12.7% of GDP) as demand for capital goods takes the place of the high demand for oil in 2011. We expect the shortfall to narrow slightly in 2013 as import demand from the power sector cools. Thereafter, while we expect the shortfall to grow in absolute terms for the foreseeable future, we expect it will decline as a proportion of GDP and will become less of a structural weakness.

	2009	2010e	2011f	2012f	2013f
Population, mn [4]	43.5	44.8	46.2	47.7	49.2
Nominal GDP, US$bn [5]	22.6	23.8	26.5	30.8	34.9
GDP per capita, US$ [6]	526	532	574	646	709
Real GDP growth, % change y-o-y [5]	6.0	6.4	6.2	5.9	7.0
TZS nominal growth, % change y-o-y [6]	18.9	14.1	19.6	21.7	16.7
Unemployment, % of labour force, eop [1,7]	5.0	5.5	5.3	5.1	5.0
Budget balance, % of GDP [2,9]	-2.2	-2.0	-2.4	-2.3	-1.8
Consumer prices, % y-o-y, eop [7]	12.2	5.6	19.8	11.1	7.0
Lending rate, %, eop [11]	14.8	15.1	15.2	14.5	13.0
Real lending rate, %, eop [3,12]	2.6	9.4	-4.5	3.4	6.0
Exchange rate TZS/US$, eop [13]	1,339.50	1,505.00	1,582.00	1,650.00	1,700.00
Goods exports, US$bn [5]	3.3	4.3	5.4	6.2	7.4
Goods imports, US$bn [5]	5.8	7.1	9.5	11.0	12.1
Current account, % of GDP [6]	-7.8	-7.8	-12.6	-12.7	-10.3
Foreign reserves ex gold, US$bn [14]	3.6	3.4	3.6	3.9	4.2
Import cover, months g&s [15]	5.6	4.5	3.8	3.6	3.6
Total external debt stock, % of GDP [17]	24.2	24.1	24.4	24.9	24.9
Short term foreign debt, % of total [17]	13.7	13.9	14.7	13.7	12.7

Notes: e BMI estimates. f BMI forecasts. 1 Surveys conducted in 1990/91, 2000/01 and 2006; 2 Fiscal year (x-1)/(x), so 2008 figure is for FY 07/08. Includes grants.; 3 Real rate strips out the effects of inflation; Sources: 4 World Bank/UN/BMI. 5 Bank of Tanzania; 6 Bank of Tanzania/BMI; 7 Tanzania Bureau of Statistics; 8 Bank of Tanzania, Tanzania Ministry of Finance; 9 Bank of Tanzania, Tanzania Ministry of Finance, BMI; 10 Tanzania Bureau of Statistics/BMI; 11 IMF; 12 IMF/BMI; 13 BMI; 14 IMF IFS; 15 IMF IFS/BMI; 16 World Bank; 17 World Bank/BMI.

RISK SUMMARY

POLITICAL RISK

Constitutional Progress

Following meetings with leaders of opposition Chadema party, President Jakaya Kikwete announced that the government would submit a bill to the National Assembly that will amend the Constitutional Review Act. The National Assembly, which is dominated by Kikwete's Chama Cha Mapinduzi, approved the act, which will guide the country's constitution-making process, in late 2011, despite vehement opposition from Chadema. The main source of Chadema's concern was that the act gave Kikwete complete power to appoint members of the Constitutional Review Commission. The amendment bill will reportedly see the president elect the members of the committee from a list put together by a cross-section of stakeholders.

Our short-term political risk rating is 66.7.

ECONOMIC RISK

Economy Growing Strongly

The Tanzanian economy grew by 6.4% y-o-y in real terms in Q311, compared with 6.7% in 2010, according to the National Statistics Bureau. The growth has been attributed to improved performances in the mining, agriculture, transport and communications sectors. The country's mining sector expanded 1.5% in Q311, compared with a contraction of 12.3% in Q310. Economic growth is expected to have slowed in the fourth quarter as rising inflation and chronic electricity shortages impacted production efficiency.

Our short-term economic risk rating is 46.7.

BUSINESS ENVIRONMENT

M-Pesa Upgrade

The Tanzanian subsidiary of South Africa-based mobile telecoms company Vodacom has upgraded its M-Pesa mobile payments system to ensure it copes with the speed and growing demand for the service. The upgrade took place in December 2011. According to Vodacom Tanzania's managing director, Rene Meza, the quality and speed of M-Pesa services have improved and the company intends to continue coming up with innovations to enhance the service. M-Pesa, which has 9mn subscribers, lets users carry out simple financial transactions through their mobile phones.

Our business environment rating is 33.5.

RISK SUMMARY

POLITICAL RISK

Besigye Detained, Released

Former presidential candidate Kizza Besigye was arrested late in January, as he and others opposing the rule of President Yoweri Museveni, were accused of planned to stage anti-government demonstrations in Kampala. Police were also said to have surrounded other opposition leaders' homes in an effort to keep them from leaving, and used tear gas to disperse gathering crowds. The government has accused several of the organisers of treason, while the opposition has complained of the high cost of living, corruption in government, and Museveni's 'failed economic policies'.

Our short-term political risk rating is 56.7.

ECONOMIC RISK

Yields Attract Foreigners

Thanks to very high yields on domestic debt, foreigners have poured into Uganda's bond market. According Stephen Kaboyo, director of financial markets at the Bank of Uganda, foreign holdings which now make up nearly 20% of outstanding domestic debt and are 'creeping up to pre-2008-crisis levels', when foreigners held about a quarter of all debt. Kaboyo added that foreign holdings could exceed pre-crisis levels if yields remain in the high double-digits, as this is far higher than most other Sub-Saharan African countries, offering an attractive opportunity for investors.

Our short-term economic risk rating is 47.7.

BUSINESS ENVIRONMENT

Tullow Seeks Stability Clause

Tullow Oil announced it was on track to complete the long-awaited sale of some of its stakes to France's Total and China's CNOOC, although it remains unclear whether the company can reach an agreement with the Ugandan government over the issue of a stability clause. Such a clause would protect the company from adverse policy shifts in the future, affording it and its partners added confidence to make major investments. Tullow previously negotiated with the Ugandan government for over a year, as it tried to resolve a tax dispute.

Our business environment rating is 37.0.

POLITICAL OUTLOOK

Unrest Brewing As Living And Borrowing Costs Rise

BMI View: The public unrest seen in 2011 is set to continue, and perhaps intensify, in 2012. Although inflation has begun to come down, there is still widespread discontent over the rising cost of living and doing business.

The stage is set for a return to public unrest in Uganda, as the cost of living and doing business continues to rise at very rapid rates. Headline inflation rose nearly 30% over the course of 2011, with year-end inflation coming in at 27.0%. Core inflation, which strips out the effects of food crops, fuel, electricity and metered water, was even higher, at 29.2%. Opposition and organised labour have both promised to take to the streets and demand major changes.

Opposition leader Kizza Besigye, who led the charge against rising inflation early in 2011 in the hugely controversial 'Walk to Work' protests, has announced that he is resigning his position as head of the Forum for Democratic Change political party, in order to devote himself more fully to ousting President Yoweri Museveni through popular uprising. He told reporters, 'What's urgent now is for the country to really organise a broad and strong social movement that will challenge the dictatorship and remove the dictatorship. That's what I would like to be involved in.' Besigye unsuccessfully ran against Museveni in the 2011 general elections, which he claimed were rigged and unfair. International observers concurred that there were irregularities and condemned what were described as acts of intimidation by the incumbent, although most stopped short of challenging the poll's outcome.

Rising inflation has various origins outside policymakers' control. For example, fuel costs rose owing to global supply uncertainty while a regional drought affected the price of food. However, the government has stoked tensions by announcing early in January that power subsidies have been removed, resulting in an estimated 42% rise in electricity tariffs, along with expected knock-on effects throughout the whole economy. Business leaders called the move a 'provocation' at a time of already-heightened distress, and a leader for the Kampala City Traders Association promised that 'street action' would result from the move.

DATA & FORECASTS

BMI View: Uganda's current account deficit is expected to narrow in 2012, but still remain quite large, at just under 10% of GDP. The trade account deficit makes up most of the shortfall, as we believe that steady growth in the country's exports will be outpaced by an even faster rate of import growth.

	2009	2010	2011e	2012f	2013f
Population, mn [3]	32.4	33.4	34.5	35.6	36.8
Nominal GDP, US$bn [4]	16.6	17.1	17.6	23.7	29.4
GDP per capita, US$ [5]	565	562	561	733	879
Real GDP growth, % change y-o-y [4]	3.9	5.6	6.2	7.1	7.3
Budget balance, % of GDP [1,5]	-1.5	-2.7	-7.4	-5.4	-5.0
Consumer prices, % y-o-y, eop [7]	10.9	3.1	27.0	10.2	7.9
Lending rate, %, eop [4]	20.0	19.7	33.8	26.8	19.0
Real lending rate, %, eop [2,8]	9.1	16.6	6.8	16.6	11.1
Exchange rate UGX/US$, eop [5]	1,895.00	2,337.00	2,446.45	2,300.00	2,200.00
Goods exports, US$bn [4]	2.3	2.2	2.3	2.5	3.1
Goods imports, US$bn [4]	3.8	4.3	4.8	5.3	5.8
Balance of trade in goods, US$bn [1,4]	-1.5	-2.1	-2.5	-2.8	-2.7
Current account, % of GDP [5]	-6.7	-9.2	-11.1	-9.6	-7.4
Foreign reserves ex gold, US$bn [4]	3.0	3.0	3.3	3.6	4.4
Total external debt stock, % of GDP [5]	13.9	16.1	18.0	14.6	12.9
Short term debt as a % of International reserves [5]	4.3	4.4	4.6	4.1	3.4
Short term foreign debt, % of total [5]	5.6	4.7	4.8	4.3	4.0

Notes: e BMI estimates. f BMI forecasts. 1 fiscal year, July-June; 2 Real rate strips out the effects of inflation; Sources: 3 World Bank/UN/BMI. 4 BOU, BMI; 5 BMI; 6 Ministry of Finance, BoU, BMI; 7 UBOS, BMI; 8 IMF/BMI; 9 World Bank, BMI.

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