January 2010
IMF Country Report No. 10/1

Uganda: Sixth Review Under the Policy Support Instrument and Request for an Extension of the Policy Support Instrument—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uganda.

In the context of the sixth review under the policy support instrument, the following documents have been released and are included in this package:

- The staff report for the Sixth Review Under the Policy Support Instrument and Request for an Extension of the Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on October 27, 2009, with the officials of Uganda on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 1, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Press Release summarizing the views of the Executive Board as expressed during its December 22, 2009 discussion of the staff report that completed the request and/or review.

- A statement by the Executive Director for Uganda.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Uganda*
Memorandum of Economic and Financial Policies by the authorities of Uganda*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UGANDA

Sixth Review Under the Policy Support Instrument and Request for an Extension of the Policy Support Instrument

Prepared by the African Department
(In consultation with other departments)

Approved by Saul Lizondo and Dominique Desruelle

December 1, 2009

- **Fund relations.** The Executive Board approved a three-year Policy Support Instrument (PSI) on December 15, 2006. Outstanding Fund credit amounts to SDR6 million (3.32 percent of quota).

- **The authorities request an extension of the current PSI** to December 14, 2010 to align a possible successor PSI with their budget cycle and the National Development Plan currently under preparation.

- **Uganda received an allocation of Special Drawing Rights** of SDR 133.8 million in the context of the general allocation on August 28, 2009, and a special one-time allocation of SDR 9.9 million on September 9, 2009.

- **Staff team**. Martine Guerguil (head), Nabil Ben Ltaifa, Stella Kaendera (all AFR), Amina Lahreche (SPR), Jack Grigg (FAD), and Thomas Richardson (Senior Resident Representative).

- **Mission.** Discussions for the sixth review under the PSI took place in Kampala during October 14-27, 2009. The mission met with the Minister of Finance, Planning and Economic Development, Ms. Bbumba; Bank of Uganda Governor Tumusiime Mutebile; and other senior officials. The staff in the resident representative office provided valuable support to the mission.

- **Outreach activity**. The mission met with the press, representatives of the civil society, the parliament budget office, members of the business community, and representatives of the donor community.

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Executive Summary

The Ugandan economy is weathering the impact of the global financial crisis better than anticipated. Despite a slowdown in economic activity, real GDP growth (at 7 percent) has remained strong by regional and international standards. Core inflation has been easing in spite of an increase in headline inflation due to higher food prices. The external current account performed better than expected, buoyed by strong cross-border exports. The shilling has regained strength as investor confidence has reversed the sudden portfolio outflows and the decline in FDI observed earlier in 2008/09. Gross international reserves remain strong.

Structural rigidities continue to pose challenges to macroeconomic management. Persistent weaknesses in project implementation coupled with rigidities in domestic financial markets limited the scope for fiscal and monetary stimulus in 2008/09. Progress with structural reforms has been uneven and may not have kept pace with the needs raised by the public investment drive. A renewed, more comprehensive structural reform agenda is needed to increase absorptive capacity as well as policy effectiveness.

Macroeconomic policies will continue to aim at overcoming infrastructure bottlenecks while mitigating the impact of external shocks on domestic activity. Full execution of the 2009/10 budget would provide a healthy stimulus to the economy but is contingent upon successful efforts to alleviate technical and administrative capacity constraints. The new, more flexible liquidity management framework should allow the central bank to support private demand while continuing to bring down inflation, although a tightening of the monetary stance may be required if food price pressures were to spill over to core inflation.

Preliminary plans to further step up public investment over the coming years seem justified in view of Uganda's large infrastructure deficit. However, considerable caution will be required to preserve fiscal and debt sustainability and leave space for private sector growth. The commercial exploitation of oil, although still distant in time, will raise additional challenges. The authorities are committed to manage oil revenue carefully and transparently through the budget process. A full assessment of the macroeconomic impact of oil production is planned for 2010.

The PSI-supported program remains on track and staff recommends completion of the 6th review. Staff support the authorities' request to extend the PSI to December 14, 2010 to align a possible successor PSI with the budget cycle and the new National Development Plan.

I. Recent Developments and Outlook

1. **The Ugandan economy is weathering the impact of the global crisis better than expected**. Despite a slowdown, economic growth (7.1 percent in FY 2008/09) has remained strong by regional and international standards. [1] The impact on the external current account has been limited, mainly on account of the strong performance of cross-border exports (Box 1). Declining foreign direct investment and a reversal of portfolio flows led to pressures on the capital account and the exchange rate in the first half of the fiscal year. More recently, the shilling has regained most of its strength as investor confidence rebounded. Gross international reserves (including the SDR allocation) stood at the equivalent of about 5 months of imports at end-September 2009.

2. **The recent surge in food prices has halted the downward trend in headline inflation but core inflation has continued to decline.** The prices of local food crops increased by a record 29 percent over August-September 2009, largely on account of the regional drought. Food inflation is expected to remain well above trend until year end, at the beginning of the new harvest season. However, core inflation (excluding food crops and fuel) has continued to inch down, to a 12-month rate of 9.1 percent in October, the lowest in 19 months.

3. **Structural rigidities have reduced the effectiveness of the intended loosening of the fiscal and monetary stances.**

- The 2008/09 budget aimed at a widening of the fiscal deficit (after grants) by 1.1 percent of GDP, on the heels of a similar increase in public investment. In the event, persistent weaknesses in project implementation and shortfalls in external project financing constrained fiscal execution and the end-June fiscal deficit (including grants) ended up 2 percentage points of GDP lower than projected.

- The unintended shortfall in budget execution complicated monetary management, resulting at times in a tighter-than-intended monetary stance and increasing interest rate volatility.

- Rigidities in domestic financial markets further reduced the impact of the cautious monetary easing on domestic demand. Although interbank interest rates declined in response to liquidity injections, lending rates remained stubbornly high and credit to the private sector was subdued in the latter part of the fiscal year. At the same time, banks accumulated deposits as local investors shifted out of securities thus leading to a rapid increase in broad money, contributing to the upward shift in the money multiplier.

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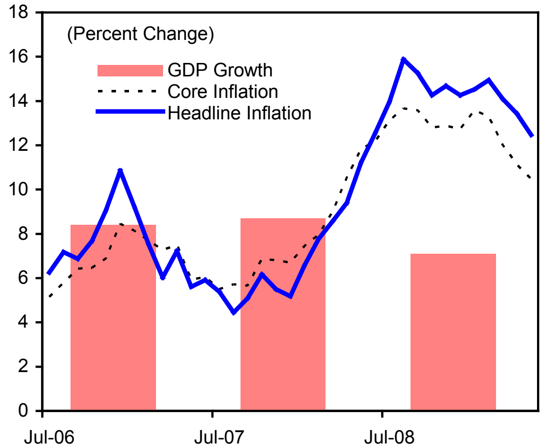
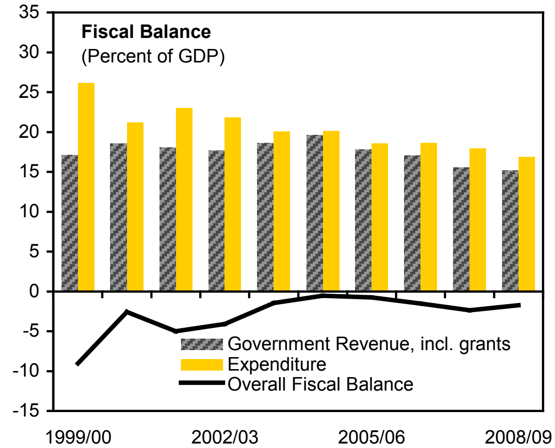
[1] The fiscal year starts on July 1.

Growth edged down but inflation remained higher than pre-2007 levels ...



the fiscal deficit narrowed somewhat owing mainly to lower project implementation ...



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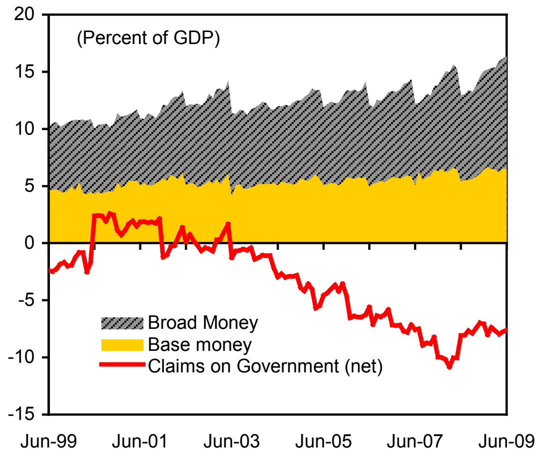
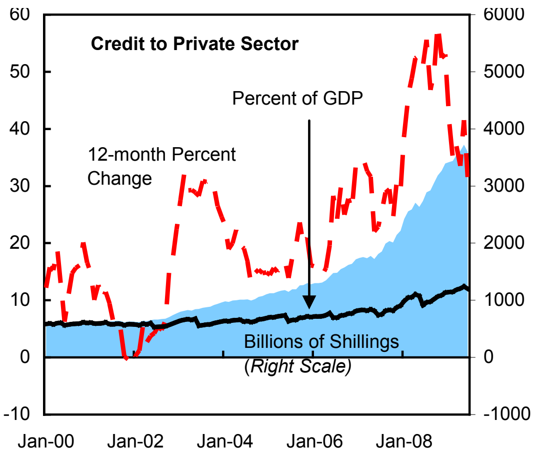
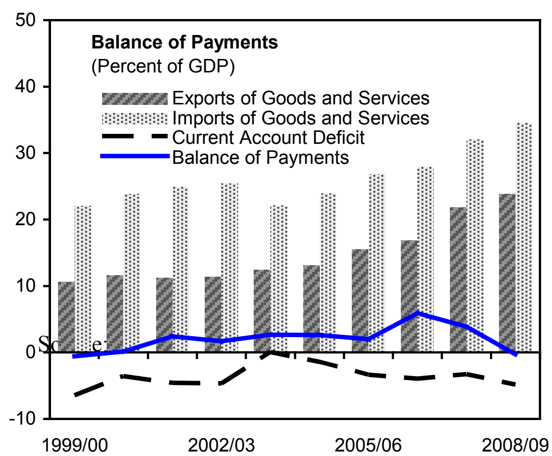


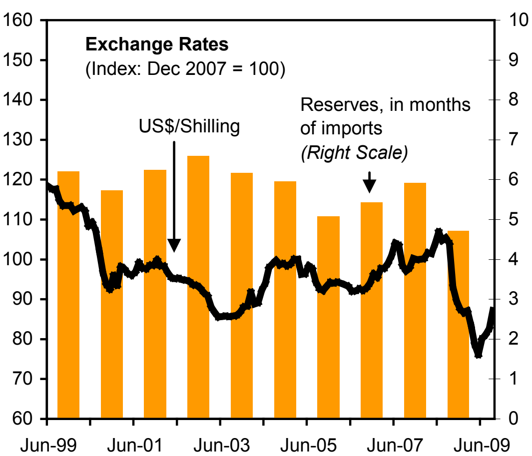
but private sector credit growth slowed down ...



Non-traditional export growth limited the increase in the current account deficit...



and gross international reserves declined, but still remained at a comfortable level...



Source: Ugandan authorities and Fund staff estimates

Box 1. The Spillovers of the Global Financial Crisis in the EAC [1]

The EAC countries, like the rest of the world, have been all affected by the global crisis. The impact, however, has varied from one country to the other. Differences in the countries' economic structures and their degree of openness and financial integration have played a role in shaping this impact. The regional drought has exacerbated these effects in most countries, but mitigated them in Uganda.

The impact of the crisis was transmitted to EAC countries through three primary channels. First, demand for their exports of goods and services declined significantly as growth in trading partners slowed down. Second, the sharp decline in terms of trade and workers' remittances reduced income and capital transfers, dampening domestic demand growth. Finally, the drying up of liquidity in global financial markets led to a sharp reversal of portfolio flows and lowered FDI; the resulting tighter financing conditions have constrained investment and dampened growth prospects.

Exports and remittances have slowed significantly in all countries except Uganda. The impact was stronger in Kenya and Tanzania, where both exports of goods and tourism have suffered significantly. In both cases, the negative impact of declining exports was exacerbated by the rise in food prices. The impact was somewhat milder in Rwanda. Total exports in Uganda have continued strong, buoyed by a large increase in non-traditional exports (notably agricultural exports) to neighboring countries. Remittances declined in all countries except Uganda. On average, EAC countries received remittances inflows of about 1.3 percent of GDP in 2008.

The impact on the capital account was felt strongest in Kenya and Uganda, and to a lesser degree in Tanzania. In Uganda and Kenya, a sharp reversal of portfolio capital inflows led to a rapid depreciation of the exchange rate starting mid-2008 and through May 2009. The tighter global liquidity conditions led also to a decline in foreign direct and domestic investment in Tanzania. In Rwanda, the impact was most reflected in lower foreign aid.

More recently, the EAC economies have suffered from the impact of a prolonged drought that dramatically curtailed food availability in some areas. The resulting sharp increase in food prices has raised headline inflation across East Africa. Lower agricultural output and hydro power generation have adversely affected growth in Kenya and to a lesser extent Tanzania. The impact of the drought was less severe in Uganda and may have contributed to boost agricultural output in some parts of the country, with the resulting growth in food exports to neighboring countries mitigating the crisis-induced deterioration of the external accounts.

Impact of the Gobal financial Crisis on EAC countries
Main channels of transmission

Channel	***Uganda***	***Kenya***	***Rwanda***	***Tanzania***
Trade channel		√√√		√√√
Income channel	√√	√√√	√√	√√√
Financial links				
Portfolio	√√√	√√√		
Aid			√√√	
FDI	√√	√√		√√√

Srong: √√√; Moderate: √√; Mild: √

[1] Paulo Drummond, and Gustavo Ramirez, *Spillover Effects and the East African Community: Explaining the Slowdown and Recovery*, Departmental Paper (DP/09/2), December 2009; http://www.imf.org/external/pubs/ft/dp/2009/afr0902.pdf.

4. **Performance under the PSI has continued to be strong, despite delays in structural reforms.**

- All end-June assessment criteria have been met. The indicative target on base money was missed only by a very small margin.

- The two structural benchmarks have been missed. The submission to Parliament of a draft regulatory framework for pension funds—a structural benchmark for end- September—was delayed because of needs for technical clarification and regional coordination (MEFP ¶24). The rolling-out of the Integrated Personnel and Payroll System—a structural benchmark for end-November—has been launched, but delays in procurement have further postponed its completion, which is now expected by September 2010. However, there has been good progress with parallel reforms aimed at strengthening the integrity of the public payment system, including through the introduction of Straight Through Payment for salaries and pensions (MEFP ¶25) and the strengthening of audit procedures (MEFP ¶29). The challenge now remains with sustaining the integrity of the payroll data as it is migrated to the IPPS data base in February 2010. A rigorous system is being designed to take care of this.

- The indicative target on minimum expenditures under the Poverty Action Fund (PAF) was met by a comfortable margin. Preliminary information (pending final audit results) suggest that the indicative target on clearance of past domestic arrears was missed. The government is taking extensive measures to reduce this stock in the future and prevent the accumulation of new arrears (MEFP ¶28).

5. **The near term outlook is largely shaped by the projected recovery in the global economy and the implementation of the authorities' ambitious public investment program.** Against that background, growth in 2009/10 is forecast to decline slightly to 6.3 percent, gradually rebounding to its potential of 7 percent over the next two years. Core inflation is expected to edge slightly lower, to about 8 percent, converging to its medium-term 5 percent target. Gross international reserves are projected to remain at a comfortable level, reflecting, inter alia, the positive impact of the SDR allocation, which provides an additional buffer against shocks and downside risks (Box 2). The above projections are however subject to a high degree of uncertainty, reflecting the uncertain path of global and regional growth, the unpredictability of weather-related shocks, and lingering weaknesses in domestic absorption capacity.

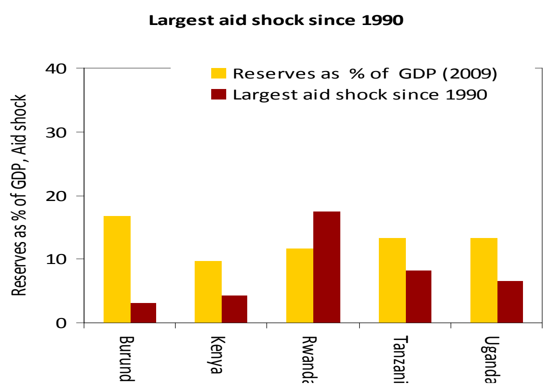
II. Policy Discussions

6. **Macroeconomic policy in 2009/10 will continue to aim at expanding public infrastructure while alleviating the impact of the recent external shocks on domestic activity.** Discussions focused on ways to enhance policy effectiveness and mitigate the potentially adverse impact of high price and exchange rate volatility on demand. A renewed, more comprehensive effort at fiscal and financial structural reforms would help increase absorptive capacity while also enhancing policy flexibility, raising the capacity to respond quickly to future shocks.

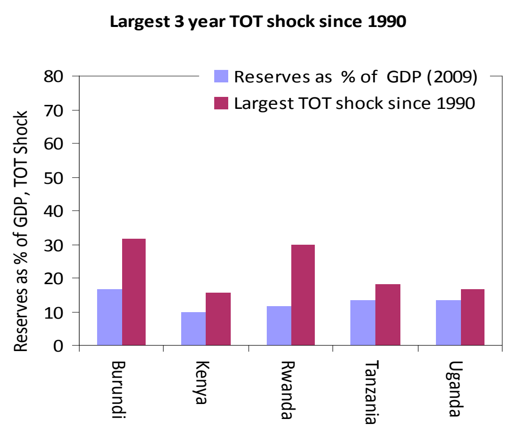
Box 2. Reserve Adequacy in the East African Community [1]

Sustaining an adequate level of reserves is a key policy consideration. Low-income countries like Uganda face risks arising from abrupt changes in the terms of trade and aid flows, which contribute to a higher volatility in aggregate output and, in extreme cases, to economic crisis. In this setting, maintaining an adequate level of foreign reserves can help reduce macroeconomic volatility, particularly when there are no alternative sources of short-term financing. Foreign exchange reserves have thus largely been viewed as an inventory held against an uncertain future in the balance of payments accounts.

Recent research by Fund staff suggests that all East African Community countries, including Uganda, carry some buffer compared to standard and model-based reserve metrics. Reserve holdings are generally consistent with the levels required to accommodate large annual trade or aid shocks. However, the same levels of reserves may not be sufficient to cover a persistent terms of trade or aid shock.



Current holdings of reserves would also seem to be above the levels suggested by optimal reserve models. These models weigh the benefits of consumption smoothing against the opportunity cost of holding reserves. However, such exercises do not take into account more qualitative factors that may affect the choice of a reserve level, including the degree of and prospects for international and regional integration. Higher reliance on volatile international capital flows would increase the vulnerability to their reversal and thus the optimal level of reserves, while regional integration—to the extent that it involves some pooling of risk—may reduce the optimal reserve level.



[1] Paulo Drummond, Aristides Mrema, Stéphane Roudet, and Mika Saito, *Foreign Exchange Reserve Adequacy in East African Community Countries*, Departmental Paper (DP/09/1), December 2009; http://www.imf.org/external/pubs/ft/dp/2009/afr0901.pdf.

A. Fiscal policy

7. **The 2009/10 program aims at imparting a healthy stimulus (about 0.5 percent of GDP) to the economy**. Nonetheless real GDP growth will remain below potential, even after assuming full execution of programmed spending. Investment spending is slated to increase by 1.7 percent of GDP, on the back of an expansion of about 1½ percent of GDP in donor-financed projects. The approved budget includes measures to support the agricultural sector, including through a limited credit guarantee scheme (at an estimated cost of Ush 30 billion or

less than 0.1 percent of GDP).[2] The authorities have maintained an unwavering commitment to trade openness and resisted pressures to restrict agricultural trade during the drought. Staff observed that the maintenance of market-based incentives will help boost sustainable agricultural growth, export diversification and the reduction of poverty. Staff also noted that the emphasis on infrastructure development should not come at the expense of a continued expansion of social programs, including in health and education, particularly in the context of the current slowdown.

8. **Large, rapid increases in implementation and absorption capacity are necessary for the intended fiscal stimulus to materialize.** Underexecution of the investment budget made the fiscal stance slightly contractionary in 2008/09, although the initial budget was predicated on an expansionary impulse (Text Table). Delays in adjusting the monetary stance to the shortfall in public spending, largely because of weaknesses in predicting aid flows, exacerbated the adverse impact on private demand. In 2009/10, under-execution of investment spending is likely to limit the size of the cyclically-adjusted fiscal impulse to 0.5 percentage point of GDP. Staff encouraged the authorities to strengthen their capacity to refine and adjust their fiscal forecasts as the year unfolds. This would facilitate the coordination of near term fiscal and monetary management and deliver a more consistent signal to the private sector regarding the actual fiscal stance. The authorities pointed out that all of last year's underexecution had fallen on externally-financed projects, reflecting not only implementation challenges but also shortfalls in donor disbursements. Staff agreed that more accurate and timely reporting from donors would help ground investment forecasts on a more solid basis.

Uganda: Fiscal Impulse of the Central Government, FY2007/08–2010/11

	2007/08	2008/09	2009/10	2010/11
	Actual	Est.	Proj.	Proj.
Overall fiscal balance (including grants)	-2.4	-1.7	-2.5	-3.8
Primary balance	-1.1	-0.9	-1.5	-2.8
Fiscal impulse (unadjusted for cyclical position) 1/	0.7	-0.3	0.6	-1.3
Cyclical adjustment	0.3	0.0	-0.1	-0.1
Fiscal impulse adjusted for cyclical position 2/	***1.0***	***-0.2***	***0.5***	***-1.4***
GDP growth	8.7	7.1	6.3	6.6
Potential GDP growth	7.0	7.0	7.0	7.0
gap	1.7	0.1	-0.7	-0.4
cyclical elasticity of primary balance	0.2	0.2	0.2	0.2

1/ The impulse is calculated as the change in the primary fiscal balance with respect to the preceding year; (-) = fiscal withdrawal
2/ The adjusted impulse is equal to the fiscal impulse, adjusted for the fiscal impact of the deviation of growth from potential; the calculation assumes an elasticity of 0.2 and a potential GDP growth of 7 percent.

9. **A renewed, more comprehensive effort to address structural weaknesses in public financial management would raise spending capacity and efficiency**. The authorities are taking valuable steps to strengthen the technical and administrative capacity of

[2] Humanitarian assistance is being provided to the poor population in the regions affected by the drought by both the government and international organizations. The drought has also increased food prices and created new income-generating opportunities for poor farmers in the less affected regions.

spending agencies and institute more frequent, systematic monitoring of the use of budget allocations (MEFP ¶11). However, these measures are often discrete in nature; they may leave important gaps unaddressed. A thorough review of account management procedures and Treasury operations, for instance, seems to be warranted. An expansion of the coverage of the Integrated Financial Management System to all spending agencies could also facilitate monitoring and reduce leakages. Staff advised the authorities to design a new, more all-encompassing strategy of public financial management reform, taking stock of past achievements and shortcomings to define a new set of priorities that are more closely in line with the drive to step up public investment. The authorities proposed to further discuss the review of the PFM strategy in the context of the forthcoming mission, scheduled for March 2010.

10. **A range of measures are being introduced to tighten payment controls and strengthen auditing procedures in order to prevent the further accumulation of arrears (MEFP ¶25, 28).** Staff expressed the hope that these measures will be fully and strictly enforced. Some reclassification of government expenditure could also strengthen budget integrity and ensure better value for money. A substantial share of recurrent expenses (including staff compensation and maintenance) are now classified under development spending. This hampers accurate forecasting and auditing of total current costs and may contribute to cost inflation.

11. **Staff urged the authorities to step up efforts to increase the efficiency of tax administration**. After a period of steady increases in tax collections, the tax revenue-to-GDP ratio declined in 2008/09 in the face of the economic slowdown. Uganda's tax ratio is low by international standards, suggesting there is scope to raise tax revenue without an adverse impact on activity. The authorities expect that the rolling-out of the medium taxpayer office, tighter controls over smuggling, and the automation of tax processes could increase tax collections by more than 0.2 percent of GDP (Ush 90 billion) with respect to their initial estimates (an increase of 0.3 percent with respect to the previous year's outcome). It will be important to ensure that appropriate financial, technical and political support is provided to the Uganda Revenue authority (URA) to achieve this objective.

12. **The authorities agreed to undertake a comprehensive review of existing tax exemptions—**most of which have been granted in an *ad hoc* fashion over the past years. A register of all existing incentives and exemptions will be compiled and their cost—in terms of lost revenue—and net economic impact quantified, with an eye to eliminating unproductive tax expenditures in the FY 2010/11 budget (MEFP ¶22).

B. Monetary and financial policies

13. **The monetary targets for the remainder of FY2009/10 aim at facilitating a further decline in core inflation to about 8 percent by end-June.** The authorities adjusted moderately the path of base money in the first half of 2009/10 to accommodate the first round effects of food price increases. They intend to revert to a base money path consistent with the disinflation program in the second half of the year (as pressures from food inflation ease). They emphasized their readiness to tighten the monetary stance should core inflation fail to decline as expected (MEFP ¶13).

14. **The Bank of Uganda (BOU) has introduced a new, more flexible monetary and liquidity management framework to be able to react in a more timely manner to unanticipated changes in public and private demand.** The new framework (designed with assistance from MCM) allowed the de-linking of structural liquidity management (based on regular primary securities auctions and regular daily foreign exchange sales) from daily liquidity management, which is implemented through repos and reverse repos operations. Preliminary evidence suggests that these more flexible modalities have helped reduce the volatility of interest rates. An assessment of their impact will be undertaken once the pilot implementation program concludes at end-November.

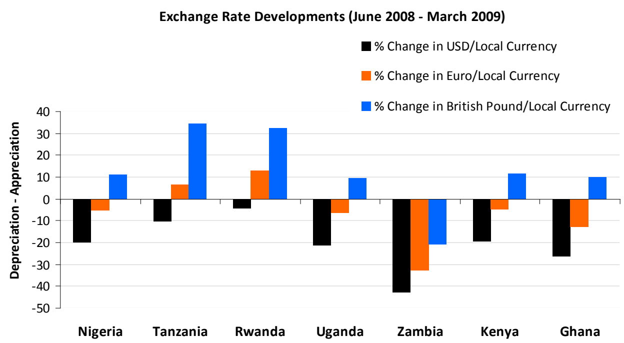
15. **The BOU's flexible exchange rate policy has helped the Ugandan economy navigate volatility in trade and capital flows relatively smoothly (Box 3).** The authorities are committed to maintain a market-determined exchange rate, limiting their interventions to smoothing excessive volatility. Staff observed that reforms aimed at supporting the development of hedging instruments could help mitigate exchange rate volatility going forward. As the overall balance of payments is projected to remain in surplus over the coming years, the authorities do not intend to draw down their SDR allocation in the near future (MEFP ¶15).

16. **The authorities have continued to fine-tune their monitoring and oversight of the banking system, including in a regional context (MEFP ¶16)**. Uganda's banking sector has been largely shielded from the effects of the global financial crisis because of its relatively limited integration with international financial markets, underpinned by a strong regulatory and supervisory environment and strong capital adequacy. While spillover effects from the banking system problems in Nigeria have been limited, some indirect effects of the global crisis have been felt through an increase in funding costs and a small increase in non performing assets, as well as intermittent liquidity pressures. The establishment of a financial stability department in the BOU, coupled with the close monitoring of early warning indicators, will help sharpen the authorities' capacity to identify early potential financial pressures and strengthen crisis resolution measures. Increased information sharing across regulators in East Africa and beyond will also lessen the risks of uncontrolled regional spillovers.

17. **Reforms aimed at addressing structural rigidities in domestic financial markets would increase both policy and productive efficiency.** Although fully liberalized and free of entry barriers, domestic financial markets remain segmented and weakly responsive to policy signals. Staff welcomed the BOU's efforts to further upgrade the relevant legal framework and develop the financial infrastructure. Additional reforms related to, for example, land titling (enabling collateral for agricultural credit) and the establishment of a pension sector regulator could help unlock remaining bottlenecks. The publication of official high-frequency data (including the quarterly GDP series now produced by the Uganda Bureau of Statistics) would also help better guide both private and public policy decisions.

Box 3. The impact of the Global Financial Crisis on Exchange Rate Developments and Policies in Uganda [1]

Subsequent to a long period of strength and appreciation, the Ugandan shilling (Ush), akin to most currencies in sub-Saharan Africa, has been hit hard by the crisis. Between June 2008 and March 2009, it depreciated by 22 and 7 percent with respect to the US dollar and the Euro, respectively, and appreciated slightly vis-à-vis the Pound Sterling. The loss in value of the Ush was relatively high by regional standards—including the EAC countries—and reflected the relative flexibility of the Ush and the sharp reversal of private capital flows with the onset of the global financial crisis.



Source: IMF, *World Economic Outllook (WEO)*

The volatility of the shilling has increased significantly. This was triggered by the decline in confidence and flight to safety of private investors and the higher volatility of the US dollar as a reserve currency. Lately, the Ush has been recouping some of its losses with the reversal of private outflows and better-than-expected export earnings. Overall, the volatility of Ush has been higher on the down trend.

All along the BOU has let the exchange rate largely reflect market forces. During the initial stages of the crisis, the BOU intervened in the foreign exchange market to smooth the exchange rate movement. At the same time, it stepped up its provision of short term liquidity to banks to mitigate the impact of the shortfall in external financing, temporarily loosening the monetary stance while allowing a modest drawdown in international reserves.

As a result, the currency depreciated in both the nominal and real effective terms. Prior to the crisis, the real effective exchange rate (REER) appreciated somewhat buoyed by improved fundamentals, including productivity gains and growth, remarkable increase in private capital inflows, and lower debt service. Beginning in mid-2008, this trend was reversed with the precipitous decline of the nominal effective exchange rate (NEER). Above trend inflation, however, has dampened the effects on the REER.

The flexibility of the exchange rate seems to have helped the economy adjust quickly to the crisis:

- The current account seems to have held well by regional standards, reflecting the response of aggregate demand to the income and expenditure-switching effects of the exchange rate depreciation. Uganda's terms of trade improved slightly thanks to a more diversified export base and the booming regional trade.
- The draw down of gross official reserves has been relatively marginal as most of the adjustment has been borne by the exchange rate.
- Inflation has, however, remained high relative to the pre-crisis level and the region, reflecting a combination of the high exchange rate pass-though effects and the impact of exogenous factors–including the recent rise in food prices, supply rigidities, and the increase in regional demand for food.

[1] Nabil Ben Ltaifa, Stella Kaendera, and Shiv Dixit, *Impact of the Global Financial Crisis on Exchange Rates and Policies in Sub-Saharan Africa,* Departmental Paper (DP/09/3), December, 2009; http://www.imf.org/external/pubs/ft/dp/2009/afr0903/pdf.

III. MEDIUM-TERM ISSUES

18. **The medium term is shaped by both the authorities' desire to overcome infrastructure bottlenecks through large investment projects and the prospect of commercial oil exploitation**. Staff held preliminary discussions with the authorities pending the completion of the National Development Plan (NDP). The latter is expected to be finalized in early 2010 and will form the basis of future policy discussions. Staff stressed the importance of ensuring consistency between the macro-economic goals embedded in the medium-term budget framework (MTBF) and the one underlying the forthcoming NDP. Staffs' assessment of the NDP will be presented to the IMF and World Bank's Executive Boards shortly after the plan is finalized.

A. Infrastructure investment and challenges

19. **Efforts to reduce Uganda's large infrastructure deficit must be consistent with external and fiscal medium-term sustainability as well as the country's absorptive capacity**. The authorities' desire to ramp up public investment to address Uganda's pressing infrastructure and energy needs is well justified (Box 4). Preliminary medium-term projections show however that a sizeable increase in public investment could entail risks that should be carefully weighted:

- Without decisive enhancements in fiscal and financial management capacity, implementation will continue to be hampered by absorptive capacity constraints. To be effective, an increase in public investment of 3 percent of GDP, as envisaged, would require immediate, sizeable efforts to strengthen the public sector's technical and administrative resources.

- Sustainable financing of large infrastructure projects could represent a considerable challenge, as grants and concessional resources would likely need to be supplemented by nonconcessional borrowing. Preliminary calculations suggest that debt vulnerabilities could remain manageable and the risk of debt distress low if access is limited to semi-concessional resources (on terms equivalent to those provided by multilateral banks). However, the projected external debt stock would still rise quickly, reaching 20 percent of GDP by 2013/14 (an increase of 1 percent of GDP every year).

- Higher public investment would also boost imports and could put pressure on the exchange rate and the reserve cover, raising external vulnerabilities and crowding out private sector growth. In that context, maintaining internal and external balances would require limiting private sector credit growth much below the high levels of recent years (above 30 percent year-on-year growth) though it would still grow somewhat faster than nominal GDP. At the same time however, infrastructure investment would be expected to have a positive impact on competitiveness and growth. Given data limitations, the net impact of these influences is difficult to assess at this stage.

Box 4. Uganda's Infrastructure Needs

Uganda currently suffers from large infrastructure shortages in the transport, energy and telecommunications sectors when compared to other Sub Saharan African and low-income countries. Electricity coverage at 8 percent of the population fares poorly with respect to averages for low income countries. The development of affordable and reliable power supply will be important to allow industrial development. Road transport provides vital access to international markets for land-locked Uganda. While road density appears adequate by Sub-Saharan African standards, the low proportion of paved roads increases transport costs and restrict market access for agricultural producers in rural areas.

		Low-income Countries	Sub-Saharan Africa	Uganda
Energy	Households reporting access to electricity (% of households)	34.7	27.2	**8.6**
	Households reporting access to modern cooking fuels (% of households)	11.7	13.0	**3.2**
Water	Improved water source (% of popn. With access)	63.8	64.1	**56.0**
	Households using piped water as a major source of drinking water, total (% households)	30.1	31.9	**10.8**
Sanitation	Improved sanitation facilities (% of population with access)	37.5	36.5	**41.0**
	Households reporting access to a flush toilet (% of popn.)	8.6	8.7	**1.7**
Roads	Road density, land (road-m/sq-km)	125.9	195.3	**190.0**
	Paved roads (% of total roads)	27.2	23.1	**7.0**
Telecom	Telephone (cell+fixed) subscribers (per 1,000 inhabitants)	49.2	98.9	**32.7**
	Households with own telephone (% of households)	8.4	4.5	**2.7**

Source: "Uganda Moving Beyond Recovery", World Bank, 2007. Data from World Bank Database, based on the latest observation available for the period 2000-04.

These infrastructure shortages will increasingly act as binding constraints for further economic activity, suggesting high social rates of return to investment in these sectors. The Ugandan authorities have recognized the importance of addressing these infrastructure bottlenecks. The 2008/09 budget proposed an increase in development spending from 3 to 5.5 per cent of GDP in years until 2010/11. In particular, the government doubled – to 4 percent of GDP – the allocation of resources to the road sector. The 2009/10 budget has retained this focus on infrastructure investment.

20. **The authorities reiterated that their plans are still at the design stage.** Their intent is for a temporary, time-bound expansion in public investment explicitly designed to unlock the private sector's longer-term growth potential. They expressed their continued interest in

public-private partnerships (PPPs) to develop infrastructure investment while avoiding excessive public debt accumulation. Staff underscored the need for a well-crafted legal and institutional framework as PPPs have in cases given rise to significant contingent liabilities. Also, investment projects should be carefully prioritized and screened in order to avoid a worsening in debt indicators. A fully-fledged debt sustainability analysis will be undertaken at the time of the 7th review, once the authorities have finalized the public investment program that will underpin the NDP ((MEFP ¶19-21).

21. **Regional integration could also enhance Uganda's medium-term growth.** Further headways in trade openness are expected as Uganda comes close to completing tariff reductions in the context of the EAC customs union in 2010. Cross-border financial and capital movements are also slated to continue to grow across the EAC. The authorities expressed their intention to continue participating actively in regional policy discussions and coordination (MEFP ¶18).

B. Oil prospects

22. **Recent estimates suggest that Uganda's commercially-exploitable oil reserves may be as large as 2 billion barrels.** While small by global standards (around 2 percent of proven oil reserves in Africa), they would still be comparable to those of Equatorial Guinea, the Republic of Congo, or Gabon. The precise volume and timing of oil production in Uganda remain highly uncertain and commercial extraction is unlikely to commence before 2012 at the earliest. Nevertheless, government oil revenues will likely be significant. Simple calculations under different hypothetical scenarios suggest that they may account for one third to one half of total government revenue at its peak. There is no doubt that their efficient and effective management and use will be challenging.

23. **The authorities are focused on setting up a sound legal and institutional framework and strengthening domestic management capacity before oil revenue materializes.** The Fund and other development partners continue to provide technical assistance in these areas. Different benchmarks or rules could be used to guarantee that oil revenue are used in a productive manner. The authorities are committed to ensure that all such revenues are fully and transparently incorporated into the budget, thereby preserving the integrity of the budget. All revenue will be collected by the URA, and all spending will take place through the budget process. The authorities agreed that a fuller assessment of the macroeconomic impact and possible policy implications of oil production in Uganda will be a priority for the discussion of a successor PSI.

IV. Program Monitoring

24. **The quantitative assessment criteria and structural benchmarks for end-December 2009 and end-June 2010 (the seventh and eighth reviews of the PSI) are presented in the authorities' Memorandum of Economic and Financial Policies (MEFP)** (Attachment I to the Letter of Intent). The assessment criteria were derived from the indicative targets for end-December 2009 established at the time of the fifth review, adjusted for the changes in economic conditions. Specifically, the NFA target has been set to reflect an increase in gross reserves, including the recent SDR allocation; the NDA has

been changed accordingly; and NCG has been revised on the basis of the new fiscal projections. Table 2 of the MEFP presents the structural measures that are being proposed to be monitored under the PSI.

25. **The authorities request a non-zero ceiling on nonconcessional borrowing, for an amount of EUR 75 million**, in order to provide a guarantee to a new harbor project on Lake Victoria (MEFP ¶20). The project would facilitate access to the port of Dar es Salaam and help lower transportation costs, thereby supporting export growth over the medium term. The available export credit would have a grant element of about 4 percent, well below the required threshold of 35 percent. However, the project meets two of the conditions for nonconcessional borrowing: (i) concessional resources are not available from development partners for such commercial infrastructure development; and (ii) the financing of the project does not endanger debt sustainability over the near or medium term, as it would only increase the NPV of external debt by 0.38 percent of GDP. The authorities have requested an assessment of the economic viability of the project. Staff supports the authorities' request of using nonconcessional financing for this project contingent upon confirmation of its viability through an independent feasibility study.

V. Staff Appraisal

26. **Sound macroeconomic policies have supported external and domestic confidence in the Ugandan economy.** The economy has performed better than expected and activity looks headed for a steady rebound after a relatively modest dip in growth. Barring an unexpected internal or external shock, the external financing position seems set to remain strong.

27. **Monetary management will need to balance the need to accommodate the first-round impact of higher food prices against risks of fueling broader, lasting inflationary pressures.** The authorities have been successful in gradually reducing core inflation in the context of fast exchange rate depreciation in the first half of 2009. The recent, drought-related surge in food inflation may stall further declines in the near term. The authorities should stand ready to tighten their stance if second-round price pressures were to emerge.

28. **A strengthening of fiscal monitoring capacities would allow for a closer coordination of fiscal and monetary policies and increase the near term effectiveness of macroeconomic management.** Unforeseen budget under execution has at times resulted in a tighter-than-expected monetary stance last year. The introduction of more flexible modalities for the management of short-term liquidity has given the monetary authorities more latitude to react to such unexpected shortfalls in public or private money demand. Higher-frequency and more accurate monitoring on the fiscal side would help enhance the transmission of macroeconomic policy decisions.

29. **A renewed emphasis on comprehensive, well-coordinated structural reforms could help raise both implementation capacity and the economy's absorptive capacity.** The authorities have introduced several reforms over recent years to strengthen public financial management and deepen financial markets but these efforts have been scattered and

not always well synchronized. There would be benefits in taking stock of past achievements and resetting priorities, in line with the new focus on stepped-up investment in infrastructure.

30. **Large financial resources will have to be mobilized to reduce Uganda's infrastructure deficit over the medium term**. It will be important to ensure that the terms and the sequencing of this borrowing do not compromise external nor fiscal sustainability. To that end, the selection and prioritization of public investment projects should be submitted to rigorous and transparent procedures.

31. **The PSI-supported program is on track and staff recommend completion of the review.** All assessment criteria for the sixth review have been met and the authorities remain strongly committed to maintaining macroeconomic stability. Although this review's two structural benchmarks have been missed, there has been good progress in advancing parallel reforms in the PFM and financial areas and the authorities strongly intend to implement the measures included in the benchmarks in this fiscal year.

32. **Staff support the authorities' request for an extension of the current PSI to align a possible successor PSI with their budget cycle and the National Development Plan currently under preparation.**

Table 1. Uganda: Selected Economic and Financial Indicators, FY2007/08–2013/14 [1]

	2007/08	2008/09		2009/10	2010/11	2011/12	2012/13	2013/14
	Act.	Fifth Rev.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
GDP and prices (percent change)								
Real GDP	8.7	6.2	7.1	6.3	6.6	7.0	7.0	7.0
Headline inflation (end of period)	12.5	10.3	12.3	12.2	5.9	5.5	5.0	5.0
Core inflation (end of period)	12.1	10.3	11.1	7.9	5.0	5.0	5.0	5.0
External sector (percent change)								
Terms of trade (deterioration –)	-1.1	…	3.9	-2.7	-6.5	-4.1	-2.6	0.1
Real effective exchange rate (depreciation –)	-1.3	…	…	…	…	…	…	…
Money and credit (percent change)								
Broad money (M2)	30.1	20.9	26.3	21.2	17.1	17.7	17.4	17.1
Domestic credit	19.1	17.8	24.1	13.7	11.7	12.5	12.2	11.9
Credit to the central government [2]	-4.8	1.3	6.8	1.4	2.1	2.9	2.4	2.1
Private sector credit	50.9	29.6	31.6	21.4	16.7	16.8	17.4	17.2
Savings and investment (percent of GDP)								
Domestic investment	23.7	25.3	23.1	24.9	26.4	27.1	27.5	28.0
Public	5.5	7.7	5.4	7.2	8.4	8.6	8.5	8.5
Private	18.2	17.6	17.7	17.7	18.0	18.5	19.0	19.5
National savings (excluding grants)	17.5	14.6	15.7	15.7	18.2	19.2	19.9	20.7
Public	0.4	0.7	1.1	2.2	2.4	3.0	3.4	3.9
Private	17.1	13.9	14.7	13.5	15.8	16.2	16.5	16.7
External sector (percent of GDP)								
Current account balance (including grants)	-3.2	-6.2	-4.8	-6.7	-6.0	-5.9	-5.6	-5.4
Current account balance (excluding grants)	-6.2	-10.7	-7.4	-9.2	-8.3	-7.9	-7.5	-7.3
Net donor inflows	4.9	7.3	4.2	6.1	5.0	4.3	3.9	3.5
External debt (including Fund)	--	17.3	15.9	14.3	16.3	17.9	18.7	19.2
External debt-service ratio [3, 4]	1.4	1.8	1.6	1.0	1.0	1.7	2.1	2.5
Government budget and debt (percent of GDP)								
Revenue	12.8	12.4	12.5	12.8	13.2	13.7	14.2	14.7
Grants	2.7	3.2	2.6	2.6	2.2	2.0	2.0	2.0
Total expenditure and net lending	-17.9	-19.4	-16.9	-17.8	-19.2	-19.2	-19.2	-19.3
Overall balance (including grants)	-2.4	-3.7	-1.7	-2.5	-3.8	-3.6	-3.1	-2.6
Overall balance (excluding grants)	-5.1	-7.0	-4.4	-5.0	-6.0	-5.5	-5.0	-4.6
Stock of domestic debt	10.7	8.6	8.4	6.7	6.0	6.0	5.7	5.5
Memorandum items:								
Nominal GDP (U Sh billions)	24,497	30,496	29,972	36,330	41,479	46,388	53,093	60,010
Average exchange rate (U Sh per US$)	1,696	…	1,905	…	…	…	…	…
Treasury bill yield (percent)	8.3	…	6.0	…	…	…	…	…
Overall balance of payments (US$ millions)	563	-100	-46	291	75	175	202	225
Gross foreign exchange reserves								
(months of next year's imports of goods and services)	5.9	5.2	4.7	4.9	4.7	4.7	4.8	4.7

Sources: Ugandan authorities; and IMF staff estimates and projections.

[1] Fiscal year begins in July.
[2] Percent of M3 at start of the period.
[3] Percent of exports of goods and nonfactor services.
[4] Including Fund obligations; reflects actual debt service paid, including debt relief.

Table 2. Uganda: Fiscal Operations of the Central Government, FY2007/08–2013/14 [1]

	2007/08	2008/09		2009/10		2010/11	2011/12	2012/13	2013/14
	Actual	Fifth Review	Est.	Fifth Review	Proj.	Proj.	Proj.	Proj.	Proj.
				(U Sh Billions)					
Total revenue and grants	3,800	4,779	4,546	5,260	5,577	6,383	7,253	8,586	10,021
Revenue	3,145	3,791	3,758	4,231	4,642	5,460	6,345	7,546	8,837
Tax	3,024	3,625	3,560	4,115	4,439	5,258	6,105	7,254	8,505
International trade taxes	308	502	361	589	431	501	608	751	925
Income taxes	862	1,043	1,094	1,172	1,372	1,634	1,867	2,198	2,573
Excises	815	898	921	998	1,083	1,266	1,480	1,766	2,067
Value-added tax	1,039	1,091	1,184	1,253	1,464	1,657	1,901	2,248	2,611
Additional revenue effort	0	91	0	103	90	200	250	290	330
Nontax	121	166	198	115	203	202	239	292	331
Grants	656	988	787	1,030	936	923	909	1,040	1,184
Budget support	470	528	531	483	519	518	547	576	602
Project grants	185	459	257	546	417	406	362	464	582
Expenditures and net lending	4,384	5,913	5,065	6,600	6,472	7,955	8,905	10,214	11,567
Current expenditures	2,881	3,249	3,198	3,522	3,737	4,347	4,844	5,633	6,412
Wages and salaries	1,106	1,198	1,184	1,331	1,307	1,584	1,752	2,030	2,300
Interest payments	309	365	264	379	358	400	401	449	476
Other current	1,466	1,686	1,750	1,812	2,072	2,363	2,692	3,155	3,636
Development expenditures	1,362	2,335	1,641	2,968	2,599	3,486	3,959	4,490	5,090
Donor-supported projects	644	1,177	434	1,295	1,077	1,589	1,627	1,698	1,733
Domestic-financed	718	1,158	1,207	1,674	1,522	1,897	2,332	2,792	3,357
Net lending and investment	-163	-27	-57	-40	-40	-39	-39	-34	-34
Other spending [2]	304	355	283	150	176	125	120	100	100
Overall balance									
Including grants	-583	-1,134	-519	-1,340	-895	-1,571	-1,651	-1,628	-1,546
Excluding grants	-1,239	-2,122	-1,307	-2,369	-1,830	-2,495	-2,560	-2,667	-2,731
Financing	541	1,134	478	1,340	895	1,571	1,651	1,628	1,546
External financing (net)	618	899	544	825	863	1,242	1,221	1,209	1,114
Disbursement	706	1,058	699	910	1,044	1,354	1,358	1,370	1,329
Budget support	211	340	233	162	383	300	273	241	252
Project loans	495	718	466	748	661	1,054	1,085	1,129	1,077
Amortization (–)	-87	-108	-126	-48	-119	-116	-130	-153	-216
Exceptional financing [2]	-13	-50	-29	-27	-61	1	-10	-11	0
Domestic financing (net)	-78	235	-66	514	32	329	430	418	433
Bank financing	-177	65	343	364	88	159	260	248	263
Nonbank financing	99	170	-409	150	-57	170	170	170	170
Errors and omissions/financing gap	43	0	-41	0	0	0	0	0	0

Sources: Ugandan authorities; and IMF staff estimates and projections.

[1] Fiscal year begins in July.

[2] Includes arrears.

Table 2. Uganda: Fiscal Operations of the Central Government, FY2007/08–2013/14 [1] (concluded)

	2007/08	2008/09		2009/10		2010/11	2011/12	2012/13	2013/14
	Actual	Fifth Review	Est.	Fifth Review	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent of GDP)								
Total revenue and grants	15.5	15.7	15.2	15.3	15.4	15.4	15.6	16.2	16.7
Revenue	12.8	12.4	12.5	12.3	12.8	13.2	13.7	14.2	14.7
Tax	12.3	11.9	11.9	11.9	12.2	12.7	13.2	13.7	14.2
International trade taxes	1.3	1.6	1.2	1.7	1.2	1.2	1.3	1.4	1.5
Income taxes	3.5	3.4	3.6	3.4	3.8	3.9	4.0	4.1	4.3
Excises	3.3	2.9	3.1	2.9	3.0	3.1	3.2	3.3	3.4
Value-added tax	4.2	3.6	4.0	3.6	4.0	4.0	4.1	4.2	4.4
Additional revenue effort	0.0	0.3	0.0	0.3	0.2	0.5	0.5	0.5	0.5
Nontax	0.5	0.5	0.7	0.3	0.6	0.5	0.5	0.6	0.6
Grants	2.7	3.2	2.6	3.0	2.6	2.2	2.0	2.0	2.0
Budget support	1.9	1.7	1.8	1.4	1.4	1.2	1.2	1.1	1.0
Project grants	0.8	1.5	0.9	1.6	1.1	1.0	0.8	0.9	1.0
Expenditures and net lending	17.9	19.4	16.9	19.1	17.8	19.2	19.2	19.2	19.3
Current expenditures	11.8	10.7	10.7	10.2	10.3	10.5	10.4	10.6	10.7
Wages and salaries	4.5	3.9	3.9	3.9	3.6	3.8	3.8	3.8	3.8
Interest payments	1.3	1.2	0.9	1.1	1.0	1.0	0.9	0.8	0.8
Other current	6.0	5.5	5.8	5.3	5.7	5.7	5.8	5.9	6.1
Development expenditures	5.6	7.7	5.5	8.6	7.2	8.4	8.5	8.5	8.5
Donor-supported projects	2.6	3.9	1.4	3.8	3.0	3.8	3.5	3.2	2.9
Domestic-financed	2.9	3.8	4.0	4.9	4.2	4.6	5.0	5.3	5.6
Net lending and investment	-0.7	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other spending [2]	1.2	1.2	0.9	0.4	0.5	0.3	0.3	0.2	0.2
Overall balance									
Including grants	-2.4	-3.7	-1.7	-3.9	-2.5	-3.8	-3.6	-3.1	-2.6
Excluding grants	-5.1	-7.0	-4.4	-6.9	-5.0	-6.0	-5.5	-5.0	-4.6
Financing	2.2	3.7	1.6	3.9	2.5	3.8	3.6	3.1	2.6
External financing (net)	2.5	2.9	1.8	2.4	2.4	3.0	2.6	2.3	1.9
Disbursement	2.9	3.5	2.3	2.6	2.9	3.3	2.9	2.6	2.2
Budget support	0.9	1.1	0.8	0.5	1.1	0.7	0.6	0.5	0.4
Project loans	2.0	2.4	1.6	2.2	1.8	2.5	2.3	2.1	1.8
Amortization (–)	-0.4	-0.4	-0.4	-0.1	-0.3	-0.3	-0.3	-0.3	-0.4
Exceptional financing [2]	-0.1	-0.2	-0.1	-0.1	-0.2	0.0	0.0	0.0	0.0
Domestic financing (net)	-0.3	0.8	-0.2	1.5	0.1	0.8	0.9	0.8	0.7
Bank financing	-0.7	0.2	1.1	1.1	0.2	0.4	0.6	0.5	0.4
Nonbank financing	0.4	0.6	-1.4	0.4	-0.2	0.4	0.4	0.3	0.3
Errors and omissions/financing gap	0.2	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Ugandan authorities; and IMF staff estimates and projections.

[1] Fiscal year begins in July.

[2] Includes arrears.

Table 3. Uganda: Monetary Accounts, FY2007/08–2013/14[1]
(U Sh billions; end of period, unless otherwise indicated)

	2007/08	2008/09		2009/10	2010/11	2011/12	2012/13	2013/14
	Act.	Fifth Review.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
			Monetary survey					
Net foreign assets	5,087	5,521	5,711	5,508	6,161	6,851	7,687	8,644
Net domestic assets	-49	578	586	2,122	2,773	3,667	4,659	5,818
Claims on public sector (net)[2]	-1,026	-944	-677	-589	-430	-169	79	342
Claims on private sector	2,736	3,669	3,599	4,371	5,103	5,962	6,997	8,201
Other items (net)[3]	-1,759	-2,147	-2,336	-1,661	-1,900	-2,126	-2,417	-2,725
Money and quasi-money (M3)	5,038	6,099	6,298	7,630	8,934	10,518	12,347	14,461
Broad money (M2)	3,895	4,715	4,921	5,961	6,981	8,218	9,647	11,299
Foreign exchange deposits	1,142	1,384	1,377	1,668	1,953	2,300	2,699	3,162
			Bank of Uganda (BOU)					
Net foreign assets	4,351	4,690	5,119	4,737	5,157	5,715	6,410	7,207
Net domestic assets	-2,737	-2,745	-3,169	-2,377	-2,354	-2,415	-2,536	-2,670
Claims on public sector (net)[2]	-2,418	-2,173	-2,277	-2,154	-1,900	-1,744	-1,583	-1,415
Of which: MDRI	…							
Claims on commercial banks	131	105	124	124	124	124	124	122
Other items (net)[3]	-449	-677	-1,016	-348	-578	-795	-1,077	-1,377
Base money	1,614	1,945	1,950	2,360	2,803	3,300	3,874	4,537
Currency outside banks plus cash in vaults	1,230	1,483	1,469	1,779	2,128	2,505	2,940	3,444
Commercial bank deposits with BOU	384	462	482	581	676	796	934	1,094
Memorandum items:			(12-month change, percent)					
Base money	29.9	20.5	20.8	21.0	18.8	17.7	17.4	17.1
M3	31.1	20.5	25.0	21.2	17.1	17.7	17.4	17.1
Credit to the private sector	50.9 [4]	29.6	31.6	21.4	16.7	16.8	17.4	17.2
			(Units indicated)					
M0-to-GDP ratio (percent)	6.6	6.4	6.5	6.5	6.8	7.1	7.3	7.6
M3-to-GDP ratio (percent)	20.6	20.0	21.0	21.0	21.5	22.7	23.3	24.1
Base money multiplier (M2/base money)	2.41	2.42	2.52	2.53	2.49	2.49	2.49	2.49
Credit to the private sector (percent of GDP)	11.2	12.0	12.0	12.0	12.3	12.9	13.2	13.7
Gross reserves of BOU (US$ millions)	2,684	2,244	2,442	2,730	2,803	2,971	3,166	3,391

Sources: Ugandan authorities; and IMF staff estimates and projections.

[1] Fiscal year begins in July.
[2] The public sector includes the central government, the public enterprises, and the local government.
[3] Including valuation effects and the BOU's claims on the private sector.
[4] Reclassification of non-bank institutions added approximately Ush 250 bn to the stock of private sector credit. Excluding this amount, credit to the private sector grew by about 40 percent.

Table 4. Uganda: Balance of Payments, FY2006/07-2013/14 [1]
(US$ millions)

	2006/07	2007/08	2008/09		2009/10	2010/11	2011/12	2012/13	2013/14
	Act.	Act.	Fifth Rev.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-470	-469	-990	-761	-1,247	-1,307	-1,363	-1,408	-1,462
Percent of GDP	*-3.9*	*-3.2*	*-6.2*	*-4.8*	*-6.7*	*-6.0*	*-5.9*	*-5.6*	*-5.4*
Trade balance	-995	-913	-1,384	-1,046	-1,329	-1,318	-1,340	-1,374	-1,501
Percent of GDP	*-8.4*	*-6.3*	*-8.6*	*-6.6*	*-7.1*	*-6.1*	*-5.8*	*-5.4*	*-5.5*
Exports, f.o.b.	1,500	2,597	2,606	3,085	3,388	3,764	4,053	4,376	4,520
Of which: coffee	229	349	325	336	314	326	335	350	367
Imports, f.o.b.	-2,495	-3,509	-3,989	-4,131	-4,716	-5,082	-5,393	-5,750	-6,021
Services (net)	-321	-555	-603	-644	-743	-800	-836	-879	-934
Income (net)	-229	-280	-375	-329	-485	-560	-562	-639	-657
Of which: interest on public debt	-22	-22	-24	-24	-25	-35	-63	-88	-96
Transfers	1,075	1,278	1,372	1,258	1,309	1,371	1,375	1,484	1,630
Private transfers	639	852	655	857	825	889	923	989	1,090
Of which: nongovernmental organizations	460	547	420	454	440	449	460	473	486
Official transfers	436	427	717	401	484	482	452	495	539
Of which: budget support	359	232	229	224	219	219	219	219	219
project support	0	109	402	135	215	212	180	221	265
HIPC grants	77	48	49	44	50	51	53	55	55
Capital and financial account	1,041	1,139	906	1,197	1,538	1,381	1,538	1,610	1,687
Capital account	3,428	0	0	0	0	0	0	0	0
Of which: MDRI debt relief	3,428	0	0	0	0	0	0	0	0
Financial account	-2,387	1,139	906	1,197	1,538	1,381	1,538	1,610	1,687
Foreign direct and portfolio investment	779	817	638	631	812	896	972	1,052	1,139
Other investment	-3,166	322	268	566	726	485	566	559	548
Medium- and long-term	-3,043	516	545	549	966	885	640	591	495
Of which:									
Public sector (net)	-3,097	318	499	294	694	646	611	580	507
SDR allocation					224				
Disbursements	389	369	556	360	756	707	676	653	605
Project support	200	292	377	242	341	550	540	538	490
Budget support	264	2	179	118	191	157	136	115	115
Amortization due	-3,487	-51	-57	-65	-62	-61	-65	-73	-98
Private sector (net)	54	198	46	255	271	239	29	11	-12
Short-term	-123	-193	-277	17	-239	-400	-74	-32	53
Errors and omissions	132	-143	0	-482	0	0	0	0	0
Overall balance	704	563	-100	-46	291	75	175	202	225
Financing	-704	-563	100	46	-291	-75	-175	-202	-225
Central bank net reserves (increase = –)	-682	-545	126	62	-289	-75	-170	-197	-227
Of which: gross reserve change	-682	-545	126	61	-288	-73	-168	-195	-225
Memorandum items:									
Coffee export volume (millions of 60-kg. bags)	2.5	3.0	3.1	3.2	3.3	3.4	3.6	3.7	3.8
Coffee price (U.S. cents per kg.)	105	192	173	178	160	160	159	160	162
Net donor support	722	708	1,175	656	1,137	1,089	996	983	952
Of which: budget support	623	235	408	342	410	376	355	334	334
project support	200	401	780	376	556	762	720	759	755
total HIPC debt relief	49	51	48	48	68	67	68	69	68
Residual inflows (after trade and official flows)	1,275	1,309	696	973	1,210	1,099	1,350	1,468	1,709

Sources: Ugandan authorities; and IMF staff estimates and projections.

[1] Fiscal year begins on July 1.

Table 5. Uganda: Quantitative Assessment Criteria and Indicative Targets for June, 2009 [1]
(Cumulative change from the beginning of the fiscal year, unless otherwise stated) [2]

	June 30 2009			
	Prog.	Revised	Adj. Prog.	Actual
Assessment criteria				
Ceiling on the increase in net domestic assets of the Bank of Uganda [3]	478	577	679	513 ✓
Ceiling on the increase in net claims on the central government by the banking system [3]	71	65	727	613 ✓
Ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda [5]	0	0	0	0 ✓
Ceiling on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda [4,5]				
Karuma hydropower plant	400	400	400	0 ✓
JBIC loan guarantee to Phenix textile factory	6	6	6	3 ✓
Other	0	0	0	0 ✓
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the government or the Bank of Uganda [4,6]	0	0	0	0 ✓
Minimum increase in net international reserves of the Bank of Uganda (US$ mn)	-117	-126	-178.4	-93.1 ✓
Indicative target				
Ceiling on the increase in base money liabilities of the Bank of Uganda [3]	290	330	330	331 x
Stock of domestic budgetary arrears under the Commitment Control System (CCS) [7/ 8/]	81	81	81	94 x
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	662	662	662	696 ✓

[1] The assessment criteria and indicative targets under the program, and their adjusters, are defined in the TMU.
[2] Fiscal year begins on July 1.
[3] Cumulative changes are from average of June 2008 as defined in the TMU.
[4] Continuous performance criterion.
[5] Cumulative change from December 1, 2006.
[6] Excluding normal import-related credits.
[7] Arrears incurred after end-June 2004. Excludes new arrears accumulated during the current fiscal year.
[8] The end-June 2009 outturn is preliminary, pending confirmation by the Auditor General.

Table 6. Uganda: Structural Benchmarks[1]

Policy Measure	Date of Implementation	Macro Criticality	*Implementation Status*
Implement pilot Integrated Personnel and Payroll System in three Commissions (Public Service Commission, Health Service Commission, Education Service Commission), Ministries (Ministry of Finance, Ministry of Health, Ministry of Public Service, Ministry of Education), and Local Governments (Lira and Jinja Districts).	End-November 2009	To improve fiscal control and increase efficiency in fiscal spending	Not met. Proposed as an end September 2010 structural benchmark.
Submit to Parliament draft regulatory framework for pension funds.	End-September 2009	To encourage the development of the financial sector and promote private savings.	Not met. Proposed as an end June 2010 structural benchmark.

[1] Assessment criteria also apply on a continuous basis to the standard provisions on the exchange and trade issues that apply to programs supported by the Fund's financial resources.

Table 7. Uganda: Financial Soundness Indicators, 2006–2009
(In percent, unless otherwise indicated)

	2006		2007		2008		2009
	Jun	Dec	Jun	Dec	Jun	Dec	Jun
Commercial Banks							
Regulatory capital to risk weighted assets	18.3	18.0	20.1	19.5	20.5	20.7	21.1
Regulatory Tier I capital to risk-weighted assets	16.7	16.5	18.7	17.8	19.1	18.7	19.3
Nonperforming loans net of loan-loss provision to capital	0.6	2.6	3.6	4.4	4.0	-1.5	3.7
Nonperforming loans to total gross loans	2.8	2.9	3.4	4.1	4.1	2.2	4.0
Return on assets	3.5	3.4	3.9	3.9	3.4	3.5	3.2
Return on equity	30.4	28.3	31.5	31.4	26.6	25.0	20.3
Interest margin to gross income	56.9	82.2	53.6	52.1	50.3	48.8	51.6
Noninterest expenses to gross income	49.3	51.5	47.8	46.3	49.0	49.5	51.9
Liquid asset to total assets	30.7	33.9	31.5	30.4	31.2	29.9	26.7
Liquid asset to short-term liabilities	41.0	47.1	44.4	42.4	44.6	45.9	41.3
Net open position in foreign exchange to capital	-8.7	-7.4	-2.5	-8.4	-7.9	-1.4	-2.9
Sectoral distribution of loans							
Manufacturing	16.6	15.9	14.6	16.7	12.3	14.2	14.0
Trade and Services	16.4	15.6	16.1	13.5	12.2	18.2	18.3
Mining and Quarrying	0.1	0.3	2.5	0.6	0.4	0.8	0.3
Agriculture	9.3	6.8	6.9	9.1	6.0	6.9	7.1
Construction	5.7	5.6	6.4	5.6	9.7	10.9	11.0
Government	0.0	0.1	0.0	0.0	0.6	0.1	0.1
Other	45.3	48.0	46.9	54.5	51.2	42.0	42.5

Source: Ugandan authorities

APPENDIX I. LETTER OF INTENT

Kampala, Uganda
December 1, 2009

Mr. Dominique Strauss Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss Kahn:

On behalf of the Government of Uganda, I wish to provide you with an update on the progress we have made under our program backed by the IMF's Policy Support Instrument (PSI). I would also like to transmit the attached Memorandum of Economic and Financial Policies (MEFP), which sets out the Government's objectives and policies for the period ahead.

The policies outlined in the MEFP derive from the Government's own program aimed at promoting employment, poverty reduction and sustainable economic growth in Uganda. The Government intends to request to begin discussions on a successor PSI during the first half of calendar year 2010, upon completion of the National Development Plan, and thus better align the new PSI with the new government strategy. In the meantime, we hereby request extension of the current PSI through December 14, 2010, which will permit two additional reviews covering test dates at December 31, 2009, and June 30, 2010.

Performance under the PSI through the 6th review has been strong. We have weathered the difficult storm caused by the international financial crisis better than originally expected, and we are addressing issues arising from regional drought conditions. Growth has remained robust, albeit slower than in recent years, and core inflation has been kept under control. Although there has been some delays in implementing two structural benchmarks, we have made advances in carrying out related reforms. Our commitment to strengthen the structural reform agenda remains strong and our policy stance has remained fully aligned with the objectives of the PSI. For reasons explained in the MEFP, we ask that these two structural benchmarks be reprofiled for 2010. We stand ready to work with the Fund and other development partners in the implementation of our program and will consult in advance should revisions be contemplated to the policies contained in the PSI.

The Government of Uganda authorizes publication and distribution of this letter, the attachments to it, and all reports prepared by IMF staff for the 6^{th} review under the PSI.

Sincerely,

/s/

Ms. Syda Bbumba
Minister, Ministry of Finance, Planning, and Economic Development

cc: The Governor, Bank of Uganda

Attachment 1. Uganda: Memorandum of Economic and Financial Policies

December 1, 2009

I. INTRODUCTION

1. Purpose of MEFP

The Government of Uganda (GoU) is requesting the Fund to extend test dates under the current PSI until June 30, 2010 to allow the finalization of the National Development Plan (NDP) and alignment of the successor PSI with the fiscal year of GoU. This memorandum outlines the performance of the economy in the fiscal year 2008/09 and sets out the policy objectives and the macroeconomic projections for the fiscal year 2009/10 and establishes specific targets through June 30, 2010.

2. Performance under the PSI.

The six assessment criteria under the PSI for June 2009 were all met and the indicative target on the minimum expenditures under the poverty action fund (PAF) was comfortably achieved. The indicative target on the ceiling on base money was missed albeit by a very small margin. Preliminary estimates show that the indicative target on the stock of domestic budgetary arrears has been missed. Regarding structural measures, both of the structural benchmarks—submission to Parliament of a draft regulatory framework for pension funds and introduction of pilots for the Integrated Personnel and Payroll System—were missed. We ask that they be rephased as explained below.

II. ECONOMIC AND POLICY DEVELOPMENTS

3. Macroeconomic outturn in FY08/09

The Ugandan economy was hit by an external shock which began in the second quarter of the fiscal year, arising from the global economic crisis. Despite this, the economy registered a growth rate of 7.1 percent at market prices (6.2 percent at basic prices) during fiscal year 2008/09, which was lower than the outturn for 2007/08 8.7 percent, indicating a slowdown in the economy because of the global economic crisis. The global crisis affected growth mainly by reducing aggregate demand in markets for Uganda's traditional exports, tightening of liquidity conditions, and a slowdown in the construction sector.

Inflation rose rapidly in the first 8 months of calendar year 2008, driven by the rise in regional demand for food and international fuel prices. By June 2009, headline and core inflation had fallen by 3.6 and 2.6 percentage points respectively, relative to their peaks in August 2008, reflecting lower fuel prices. Core inflation ended the fiscal year approximately 0.8 percentage points higher than had been initially programmed largely because of the pass through to domestic prices of the sharp nominal depreciation of the exchange rate.

4. Fiscal outturn

Both revenues and overall expenditures underperformed in 2008/09 by 0.3 percent and 4.3 percent of GDP compared to the original budget, respectively, hence the fiscal deficit was smaller than budgeted. The fiscal deficit excluding grants was 4.4.percent of GDP compared to 7.7 percent of GDP in the budget. Tax revenues in Ush fell short of budgeted amounts by 5 percent, with most of this shortfall attributable to the weak performance of indirect taxes due to low aggregate demand. Total expenditures fell short of the budgeted amount by 20 percent, because of a 43 percent shortfall in development expenditures in domestically financed and donor funded projects. The underperformance of donor projects was a result of lower-than-expected disbursement by donors, coupled with challenges in absorption by implementing agencies.

5. Monetary and exchange rate policy stance

The BOU's monetary policy framework continued to utilize reserve money as the operating target and broad money as the intermediate target. The BOU initially set a target of 18 percent for base money growth. Early in the second half of the fiscal year, the target was raised to 20.5 percent to take account of increased demand for liquidity, partly arising from the disruptions to money markets that were related to the global financial crisis. The Bank of Uganda continued to maintain a flexible exchange rate regime.

6. Balance of payments and exchange rate.

The BOP was hit by a major external shock beginning in the second quarter of 2008/09. This was a result of a weakening of both the current and capital accounts. The global economic crisis affected formal sector exports, tourism and remittances, all of which fell in the second half of 2008/09 compared to the first half of the year. Preliminary data shows a rebound in workers' remittances in the first two months of fiscal year 2009/10.

Although import growth also slowed down, partly as a result of the exchange rate depreciation, the trade deficit was larger in 2008/09 than in the previous year by USD 130 million. The surplus of the capital and financial account was reduced as a result of the reversal of portfolio capital flows mainly related to offshore investors in the Government securities market, who drew back from emerging and frontier markets across the globe. These flows were negative in most months of the last three quarters of the fiscal year. Compared to a build up of international reserves (net of valuation effects) of USD 545 million in 2007/08, there was a decline of reserves of USD 62 million in 2008/09.

The deterioration in the BOP triggered a depreciation of the exchange rate of 37 percent in nominal terms against the US dollar between the end of September 2008 and mid May 2009. The exchange rate subsequently rebounded by 10 percent between mid May and the end of June 2009. The rebound in the exchange rate was stimulated initially by an improved trade balance and then, at the end of the year, by a recovery of remittances and net portfolio flows, as well as by the weakening of the dollar against other international currencies.

III. Outlook and Key Economic Objectives

7. Key goals.

The key macroeconomic goals in 2009/10 are to increase production, improve productivity, and reduce poverty by making investments in infrastructure for sustainable growth, to continue reducing core inflation back towards the target of 5 percent and to ensure that external stability is not undermined.

8. Macroeconomic outlook

Real GDP growth is projected at 6.3 percent in fiscal year 2009/10, and core inflation is expected to decline to 7.9 percent by end of this fiscal year. Developments in the BOP in recent months indicate that the negative effects of the global economic shock have begun to subside. However, food prices have risen sharply, by 30 percent in the first three months of 2009/10, partly due to the high regional demand for food and reduced food production which is linked to the drought affecting large parts of East Africa.

Government is giving priority to increasing food production in order to increase supply in response to the high food demand. In this regard, a number of initiatives are being implemented. These include (i) reforming and refocusing National Agricultural and Advisory Delivery Services (NAADS) and ensuring value addition; (ii) working with commercial farmers to increase production by increasing availability of seed and other planting materials; (iii) establishing a credit guarantee scheme to encourage commercial banks to provide credit to agriculture and agro-processing at subsidized interest rates, with the Government providing initial seed money of Ushs 30 billion, (iv) providing equipment for irrigation and (iv) upgrading rural infrastructure including rural electrification and feeder roads.

The BOP is expected to improve in 2009/10 with the more favorable external environment, which should allow some recovery of remittances and capital flows. Aggregate demand is expected to remain relatively subdued during the first half of the fiscal year, but to pick up in the second half, boosted by higher government spending, as well as the recovery in the global and regional demand.

A. Fiscal Policy

9. The primary objective of the 2009/10 budget is to provide a fiscal stimulus to the economy and to continue the re-orientation of the budget towards development expenditures. Government will continue its strong efforts to enhance revenue administration, including by rolling out the medium taxpayer office and stepping up enforcement. Expenditures and net lending are programmed to rise by 0.9 percent of GDP from the 2008/09 outturn, largely on account of higher development expenditures. The fiscal deficit before grants is programmed at 5 percent of GDP while the fiscal deficit after grants is budged at 2.5 percent of GDP. The Government's financing requirement will be met primarily through external sources, projected at 2.4 percent of GDP on a net basis.

10. The Government is continuing to shift expenditure allocations towards capital formation. While government does not intend to cut on-going programs, additional allocations of resources will favor capital formation, except in education and health where the bulk of the expenditures are of a recurrent nature.

11. In view of the low absorptive capacity observed in implementation of infrastructure projects and ensuring value for money, Government is strengthening the output-based budgeting reforms which commenced in FY2008/09 through the following measures: (i) ensuring that expenditure releases to spending agencies are based on concrete work plans and evidence of outputs of previous releases, (ii) advance planning of implementation of programs and projects including preparation of procurement and recruitment plans; (iii) establishment of the Budget Monitoring and Analysis Unit (BMAU) within the Ministry of Finance, Planning and Economic Development (MFPED), which undertakes sample expenditure tracking in relation to outputs on the ground in the implementation of projects and programs; instituting ministerial quarterly reviews on implementation of Government projects and programs; and (iv) strengthening the audit function in the Treasury.

12. Nevertheless, in light of the potential delay in increasing absorptive capacity, and in order to avoid complicating the conduct of monetary policy, we envisage expenditure outturns—particularly for donor-financed project infrastructure spending—that are somewhat less ambitious than the available financing in the budget would afford. We are confident that our spending profile will accelerate as implementation capacity picks up.

B. Monetary and Exchange Rate Policies

13. Monetary policy objective for 2009/10.

The primary objective of monetary policy in 2009/10 is to continue reducing core inflation towards the long term goal of 5 percent while ensuring that real money balances and credit growth are sufficient to support activity at a level consistent with potential output. The BOU aims to reduce core inflation to 7.9 percent by June 2010 and to achieve this goal, it will restrict broad money growth to 21.2 percent and reserve money growth to 21 percent. The BOU will tighten the monetary targets for June 2010 if the shock to food prices feeds through to core inflation to the extent that the target of 7.9 percent for June 2009 might not be met.

14. Monetary policy

Although the monetary policy framework will continue to comprise a quantitative target for reserve money and an intermediate target for broad money, the BOU has revised the operating procedures for monetary policy. The revisions, which were supported by Fund Technical Assistance, include the de-linking of structural liquidity management (based on regular primary securities auctions and regular daily foreign exchange sales) from daily liquidity management (which is implemented through repos and reverse repos). The aim of these changes was to dampen the volatility (e.g. in interbank interest rates) which has frequently characterized the money market and to allow the targets for reserve money to be adjusted to accommodate any unanticipated shocks to money demand. The introduction of the flexible reserve money program is intended to be a step towards the eventual adoption of inflation targeting. In the long-run Uganda is committed to participating in the East African Monetary Union (EAMU).

15. Exchange rate policy

BOU will continue to implement a flexible exchange rate policy, intervening only to dampen excessive volatility in the exchange rate. Gross foreign exchange reserves are projected to increase by USD 288 million, including the recent SDR allocation. We do not intend to draw down the SDR allocation in the near future.

C. Financial Sector Policies

16. Supervision and regulation

The banking system was not adversely affected by the global financial crisis, mainly because its exposure to toxic assets and distressed financial institutions abroad was minimal. In aggregate, it remains very well capitalized with an average regulatory capital to risk-weighted assets ratio of over [20] percent. The banks are liquid and their loan quality is relatively good; the average ratio of non-performing loans to total loans was 4 percent in June 2009. Nevertheless, the non-performing loans ratio has crept up during the year and may rise further if the economic slowdown affects the capacity of businesses and households to service debts. The BOU will closely supervise the regulated financial institutions to ensure that appropriate remedial measures are implemented in the event of any weakening in their financial condition.

To strengthen the regulatory framework for financial institutions, the BOU intends to update the Financial Institutions Act of 2004 and Microfinance Deposit-taking Institutions Act of 2003. This will include an upward revision of minimum capital requirements, provisions to cover Islamic banking products, and regulations to cover insurance products offered by banks and regulated non-banks. Furthermore, the BOU will review the regulatory restrictions on lending with maturity of over three years with a view to encouraging longer term lending by banks. At the regional level, the East African central banks are implementing measures to strengthen information sharing and regulation of financial institutions which operate across borders in the region.

17. Creation of financial stability department.

The BOU has set up a Financial Stability Department within its Supervision Function. The department will monitor threats to systemic stability in the financial system, analyze issues related to this and will produce a bi-annual financial stability report. The Supervision Function is receiving TA from the Fund to support this activity.

D. Medium-term Outlook

18. The macroeconomic strategy for the medium term will continue to focus on maintaining sound fiscal policy that allows Government investment in the critical areas to address the binding constraints on economic growth while at the same time ensuring macroeconomic stability and creating room for strong growth in private sector credit and

investment, thus helping to reduce poverty. Government is committed to participating in the East African Monetary Union and its fiscal and monetary policy objectives will be consistent with the macroeconomic convergence criteria for the East African Community member countries.

19. Medium term budget policy aims to address critical constraints to growth and to reduce the costs of doing business. To achieve this Government will increase spending on infrastructure in roads, railways, energy and water for irrigation. It will create fiscal space for this through implementation of measures to improve efficiency. Beyond expenditure efficiency gains, Government will mobilize external resources where available and consistent with the Debt Strategy, and will also seek private sector participation in infrastructure projects.

20. Government requests a €75 million increase in the ceiling on nonconcessional loans to accommodate a strategic project to establish a new port facility on Lake Victoria. This project is of strategic importance as we seek to diversify our access to regional and international markets. As a landlocked country, we currently rely mostly on the road to Mombasa, which implies both high transaction costs (as the cost of road transportation is high) and limited access to regional markets. The project would facilitate access to the port of Dar es Salaam and help lower transportation costs, thereby supporting export growth over the medium term. The government will only contract the loan upon confirmation of the economic viability of the project based on the completion of a feasibility study by an independent reputable institution.

21. The Government recognizes that addressing the critical infrastructure gaps in the economy will require leveraging private financing to compliment both domestic resources and Official Development Assistance. The Government is preparing a Public Private Partnership (PPP) Policy Framework to facilitate private involvement in the provision of public goods. Government intends to undertake a Debt Sustainability Analysis in March 2010, which will be used to inform its borrowing strategy over the medium term.

22. In view of the need to increase domestic revenue mobilization, Government will continue to strengthen tax administration, including with the support of IMF technical assistance. Moreover, Government intends to conduct a review of all existing tax incentives and exemptions in the period prior to the next IMF review under the PSI. Our objective, with support from IMF staff, is to compile a register of all existing tax incentives and exemptions, including quantifying their cost in terms of their impact on government revenues. These costs will compared to their net economic benefits, with an eye toward eliminating those exemptions which are found not to deliver value for money in the FY2010/11 budget.

23. The National Development Plan currently under preparation will be consistent with the macroeconomic policy objectives of Government. It will provide the strategic guidance for the expenditure allocation in the MTEF to ensure optimal use of resources. It is, therefore, envisaged that the NDP will be periodically reviewed to ensure that emerging priorities are reflected in the expenditure planning.

E. Structural Reforms

24. Government has made a decision to liberalize the pension sector, allowing entry of private pension providers which will compete with the National Social Security Fund. A Bill to establish a regulatory framework for pension sector and other retirement benefits schemes is in Cabinet and a policy paper detailing the nature of the liberalization is currently being prepared. It is expected that the Bill and the policy paper on the regulatory framework will be submitted to parliament by end June 2010. This measure, which was a structural benchmark for September 2009, has been delayed to take into account the results of a study being conducted by the East African Community Secretariat on consolidated regulation of financial services in the East African Community, which is due by December 2009.

25. Government is implementing measures that will streamline the payment of pension obligations. These include implementation of the Straight Through Payment (STP) for both salaries and Pensions which will be completed this Fiscal year. It is envisaged that this will eliminate further accumulation of pension and salary arrears, which arose on account of under-provisioning especially of pension and gratuity payments. In addition, Government is undertaking forensic audit of the existing pension arrears to determine the actual stock with a view to prioritizing their settlement. The November 2009 structural benchmark for introduction of a pilot of the integrated Personnel Payroll System (IPPS) has been missed due to procurement capacity challenges within the Ministry of Public Service and delays in connecting the four service commissions to the IFMIS. It is now envisaged that a trial run will be implemented by end July 2010 and the full IPPS will roll out in September 2010.

26. The emergence of an oil and gas sector presents a unique opportunity for Uganda's growth and poverty reduction. To ensure prudent utilization, the oil revenues will be integrated into the medium term fiscal framework and budgetary process. Fiscal policy will incorporate a target for the non-oil structural fiscal balance which ensures sustainable use of oil revenues over the long term.

27. Public Financial Management (PFM) will continue to be strengthened through further rolling out of the Integrated Financial Management System to cover all spending agencies. PFM will be monitored in the context of the Joint Assessment Framework (JAF). which has specific performance indicators that relate to credibility of the budget and value for money.

28. To deal with the problem of domestic arrears arising from membership subscriptions to international organizations and as a result of Accounting Officers bypassing the established IFMS, Government will double up efforts to minimize arrears by implementing the following actions by January 2010: (i) submission to Cabinet of a priority list of those international organizations it will subscribe to in the next three years; (ii) verify the stock of arrears to international organizations and specification that membership fees be paid from the budgets of responsible line ministries for FY 2009/10; (iii) the Accountant General to implement a zero tolerance policy of issuance of expenditure and accounting warrants for those expenditure incurred outside the IFMS; and (iv) establish the CCS arrears accumulated since March 2008 to be paid by the responsible line ministries from their budget of FY 2009/10. With these measures, we are confident that the target that we have set for ourselves

under the program—a reduction of the stock of domestic arrears under the commitment control system (CCS) to Ush 51 billion by end-June 2010—will be achieved.

29. Government will ensure operational independence of Internal Audit, by reporting directly to the Permanent secretary/Secretary to the Treasury and the six sectoral audit committees. This reform will address the current weakness in financial management and compliance, and strengthen internal planning, execution and reporting on Audits. Starting in 2009/10, performance audits, risk management, IT audits and more effective quality assurance will be undertaken.

30. The Government is implementing a five year financial markets development plan, the objectives of which include deepening the financial markets and strengthening financial intermediation. The plan includes measures to establish a credit reference bureau, strengthen the payment system and revise the commercial laws to strengthen contract enforcement.

VI. Program Monitoring

31. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs) and indicative targets, and structural benchmarks. Quantitative targets, which are established for end-December 2009 and end-June 2010, are detailed in Tables 1 and 2. The attached Technical Memorandum of Understanding contains definitions and adjustors. Program performance will be assessed in the course of the seventh and eighth reviews that will take place before the end of May and November 2010 respectively.

Table 1. Uganda: Quantitative Assessment Criteria and Indicative Targets for December 2009 - June 2010 1/

(Cumulative change from the beginning of the fiscal year, unless otherwise stated) 2/

	Dec. 31 2009		Mar. 31 2010 3/	June 30 2010
	Prog.	Rev. prog.	Prog.	Prog.
Assessment criteria	(Billions of Uganda shillings)			
Ceiling on the increase in net domestic assets of the Bank of Uganda	486	187	237	289
Ceiling on the increase in net claims on the central government by the banking system	199	-59	-92	88
	(Millions of U.S. dollars unless otherwise specified)			
Ceiling on the stock of external payments arrears incurred by the government or the Bank of Uganda 5/	0	0	0	0
Ceiling on new nonconcessional external borrowing with maturities greater than one year contracted or guaranteed by the government or the Bank of Uganda 5/ 6/				
Karuma hydropower plant	400	400	400	400
JBIC loan guarantee to Phenix textile factory	6	6	6	6
Central Corridor (Lake Victoria port, in Euro millions)**	0	75	75	75
Other	0	0	0	0
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the government or the Bank of Uganda 5/ 7/	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda (US$mn)	-115	263	276	288
Indicative target	(Billions of Uganda shillings)			
Ceiling on the increase in base money liabilities of the Bank of Uganda 4/	260	261	335	410
Stock of domestic budgetary arrears under the Commitment Control System (CCS) 8/				51
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	160	536.5	817.6	1,097.0

1/ The assessment criteria and indicative targets under the program, and their adjusters, are defined in the technical memorandum of understanding (TMU).

2/ Fiscal year begins on July 1.

3/ Indicative targets.

4/ Cumulative changes from the average of June 2009, as defined in the TMU.

5/ Continuous performance criterion.

6/ Cumulative change from December 1, 2006.

7/ Excluding normal import-related credits.

8/ Arrears incurred after end-June 2004.

**Contingent upon the completion of a feasibility/viability study by an independent international reputable institution.

Table 2. Uganda: Proposed Structural Benchmarks[1]

Policy Measure	Date of Implementation
Structural Benchmarks	
Implement pilot Integrated Personnel and Payroll System in four Commissions (Public Service Commission, Health Service Commission, Education Service Commission and Judicial Service Commission), Ministries (Ministry of Finance, Ministry of Health, Ministry of Public Service, Ministry of Education, Judiciary (Courts and Judicature)), and Local Governments (Lira and Jinja Districts).	End-September 2010
Submit to Parliament draft regulatory framework for pension funds.	End-June 2010

[1] Benchmarks also apply on a continuous basis to the standard provisions on the exchange and trade issues that apply to programs supported by the Fund's financial resources.

Attachment II. Uganda: Technical Memorandum of Understanding

A. Introduction

1. This memorandum defines the targets described in the memorandum of economic and financial policies (MEFP) for the July 2006–June 2009 financial program supported by the IMF Policy Support Instrument (PSI), and sets forth the reporting requirements under the instrument.

B. Net Foreign Assets (NFA) and Net Domestic Assets (NDA) of the Bank of Uganda (BOU)

2. The net foreign assets of the BOU are defined as the monthly average (based on daily data) of foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank. The monthly average values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the average cross exchange rates for October 2009 for the various currencies and then converted into Uganda shillings using the average U.S. dollar-Uganda shilling exchange rate for October 2009.

Program Exchange Rates (US$ per currency unit, unless indicated otherwise)	
Euro	1.48164
British pound	1.61854
Japanese Yen	0.011066
Kenya shilling	0.01329
SDR	1.5896
Uganda shilling (per US$1)	1898.28

Net domestic assets (NDA) of the Bank of Uganda (BOU) are defined as the monthly average (based on daily data) of base money (defined below) less net foreign assets of the BOU (as defined in para. 2). Based on this definition, the NDA limits will be cumulative changes from the average of June 2009 to the average of December 2009 and March and June 2010.

	December 31, 2009	March 31, 2010	June 30, 2010
Cumulative change in base money	260.8	335	410
Cumulative change in NFA	73.7	98.4	121.4
Cumulative change in NDA	187.0	237	288.6

B. Base Money

3. Base money is defined as the sum of currency issued by Bank of Uganda (BOU) and the commercial banks' deposits in the BOU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BOU and are net of the deposits of closed banks at the BOU and Development Finance Funds (DFF) contributed by commercial banks held at the BOU. The base money limits will be cumulative changes from the daily average of June 2009 to the daily average of December 2009, and March and June 2010.

C. Net Claims on the Central Government by the Banking System

4. Net claims on the central government (NCG) by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding deposits in administered accounts and project accounts with the banking system, including the central bank. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. Central government's deposits with the banking system include the full amount of IMF MDRI. NCG will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey. The quarterly limits on the change in NCG by the banking system will be cumulative beginning end-June in the previous fiscal year.

D. Net International Reserves of the Bank of Uganda

5. Net international reserves (NIR) of the BOU are defined for program monitoring purpose as reserve assets of the BOU net of short-term external liabilities of the BOU. Reserve assets are defined as external assets readily available to, and controlled by, the BOU and exclude pledged or otherwise encumbered external assets, including, but not limited to, assets used as collateral or guarantees for third-party liabilities. Short-term external liabilities are defined as liabilities to nonresidents, of original maturities less than one year, contracted by the BOU and include outstanding IMF purchases and loans.

6. For program-monitoring purposes, reserve assets and short-term liabilities at the end of each test period will be calculated in U.S. dollars by converting them from their original currency denomination at program exchange rates (as specified in para 2).

E. Ceiling on Domestic Budgetary Arrears of the Central Government

7. The stock of domestic payment arrears under the Commitment Controls System (CCS) will be monitored on an annual basis. Domestic payments arrears under the CCS are defined as the sum of all bills that have been received by a central government spending unit or line ministry delivered prior to the beginning of the current fiscal year, and for which payment has not been made within 30 days under the recurrent expenditure budget (excluding court awards) or the development expenditure budget. For the purpose of program monitoring, the quarterly CCS reports, which will include arrears accumulated at IFMS and non-IFMS sites, prepared by the Internal Audit and Inspection Office will be used to monitor arrears. Arrears can be cleared in cash or through debt swaps.

8. The payments of pre-CCS, non-CCS, and CCS arrears accumulated up to end-June 2004 ("group A arrears") are covered by specific budget allocations for 2008/09 and 2009/10. The program ceiling on the stock of CCS arrears only covers accumulation of arrears after end-June 2004 ("group B arrears"). According to the verified report prepared by the Internal Audit and Inspection Office, this stock of arrears is estimated at USh 94 billion as of June 2009[1].

F. Expenditures under the Poverty Action Fund (PAF).

9. The compliance with the indicative target on minimum expenditures under the PAF will be verified on the basis of releases (PAF resources made available to spending agencies).

G. Adjusters

10. The NDA and NIR targets are based on program assumptions regarding budget support, assistance provided under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), and external debt-service payments.

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[1] Preliminary estimate.

11. The NCG target, in addition to being based on the aforementioned assumptions, is also based on assumptions regarding domestic nonbank financing of central government fiscal operations. In addition, the NDA target depends on the legal reserve requirements on deposits in commercial banks. Finally, the NDA and NIR targets are based on program assumptions regarding automatic access by commercial banks to the BOU's rediscount and discount window facilities.

12. The Uganda shilling equivalent of budget support (grants and loans) plus HIPC Initiative assistance in the form of grants on a cumulative basis from July 1 of the fiscal year is presented under Schedule A. The ceilings on the cumulative increase in NDA and NCG will be adjusted downward (upward), and the floor on the cumulative increase in NIR of the BOU will be adjusted upward (downward) by the amount by which budget support, grants and loans, plus HIPC Initiative and MDRI assistance, exceeds (falls short of) the projected amounts.

Quarter	December 31, 2009	March 31, 2010	June 30, 2010
Budget support, including HIPC Initiative grants	609.3	851.4	901.4

13. The ceiling on the increases in NDA and NCG will be adjusted downward (upward) and the floor on the increase in NIR will be adjusted upward (downward) by the amount by which debt service due[2] plus payments of external debt arrears less deferred payments (exceptional financing) falls short of (exceeds) the projections presented in Schedule B. Deferred payments are defined to be (i) all debt service rescheduled under the HIPC Initiative; and (ii) payments falling due to all non-HIPC Initiative creditors that are not currently being serviced by the authorities (that is, gross new arrears being incurred).

Quarter	December 31, 2009	March 31, 2010	June 30, 2010
Debt service due before HIPC, excluding exceptional financing	119	160.8	194.5

[2] Debt service due is defined as pre-HIPC Initiative debt service due, but from 2003/04 onwards, this excludes HIPC Initiative debt rescheduling.

14. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing[3] less payment of domestic group A arrears relative to the programmed cumulative amounts presented in Schedule C. For the purpose of this adjuster, payment of domestic group A arrears cannot exceed the programmed amount by more than U Sh 45.0 billion.

Quarter	December 31, 2009	March 31, 2010	June 30, 2010
(A) Nonbank financing	-74.4	-66.9	-54.7
(B) Domestic arrears repayment	-40.1	-65.8	-76.1
(C) Total = (A) –(B)	-34.3	-1.1	21.5

15. The ceiling on NDA of the BOU for every test date will be adjusted upward by the daily average amount of commercial bank automatic access to the BOU discount window and rediscounting of government securities by commercial banks.

16. The ceiling on NDA of the BOU for every test date will be adjusted downward/upward to reflect decreases/increases in the legal reserve requirements on deposits in commercial banks. The adjuster will be calculated as the percent change in the reserve requirement multiplied by the actual amount of required reserves (Uganda shillings and foreign-currency denominated) at the end of the previous calendar month.

H. External Borrowing Contracted or Guaranteed by the Central Government, Statutory Bodies, or the Bank of Uganda, and Arrears

17. The assessment criterion on short-term debt refers to contracting or guaranteeing external debt with original maturity of one year or less by the government or the Bank of Uganda. Excluded from this assessment criterion are normal import-related credits. The definition of "debt" is set out in paragraph 19.

18. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the government, statutory bodies, or the BOU.[4] Nonconcessional borrowing is defined as loans with a grant element of less than

[3] Comprising the check float and the change in government securities and government promissory notes held by the nonbank sector. The change in government securities held by the nonbank sector will be calculated from the data provided by the Central Depository System (CDS).

[4] Contraction is defined as approval by a resolution of Parliament as required in Section 20(3) of the Public Finance and Accountability Act, 2003

35 percent, calculated using average commercial interest rates references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing or guarantees is to be observed on a continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, contingent or otherwise, on nonconcessional terms. Excluded from the limits are changes in indebtedness resulting from refinancing credits and rescheduling operations, and credits extended by the IMF. For the purposes of the program, arrangements to pay over time obligations arising from judicial awards to external creditors that have not complied with the HIPC Initiative do not constitute nonconcessional external borrowing. Excluded from these limits are also nonconcessional borrowing for the Karuma hydroelectric project, the JBIC loan guarantee to Phoenix Textile factory and the Central Corridor (port facility at Lake Victoria) within the limits specified in Table 1 of the MEFP.[5]

19. The definition of debt, for the purposes of the limit, is set out in point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 12274-(00/85), August 24, 2000). It not only applies to the debt as defined in Point 9 of the Executive Board decision, but also to commitments contracted or guaranteed for which value has not been received. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

> (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e.,

[5] The nonconcessional borrowing for the port facility is contingent upon a confirmation on the viability of the project based on a study to be conducted by an independent reputable institution.

contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

20. The ceiling on the accumulation of new external payments arrears is zero. This limit, which is to be observed on a continuous basis, applies to the change in the stock of overdue payments on debt contracted or guaranteed by the government, the BOU, and statutory bodies[6] from their level at end-June 2006. It comprises those external arrears reported by the Trade and External Debt Department of the BOU, the Macro Department of the Ministry of Finance that cannot be rescheduled because they were disbursed after the Paris Club cutoff date.

I. Monitoring and Reporting Requirements

21. The authorities will inform the IMF staff in writing at least ten business days (excluding legal holidays in Uganda or in the United States) prior to making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include but are not limited to customs and tax laws (including tax rates, exemptions, allowances, and thresholds), wage policy, and financial support to public and private enterprises. The authorities will similarly inform the IMF staff of any nonconcessional external debt contracted or guaranteed by the government, the BOU, or any statutory bodies, and any accumulation of new external payments arrears on the debt contracted or guaranteed by these entities. The authorities will furnish an official communication to the IMF describing program performance of quantitative and structural assessment criteria and benchmarks within 8 weeks of a test date. The authorities will on a regular basis submit information to IMF staff with the frequency and submission time lag as indicated in Table 1. The information should be mailed electronically to AFRUGA@IMF.ORG .

[6] This definition is consistent with the coverage of public sector borrowing defined by the Fund (includes the debt of the general government, monetary authorities, and entities that are public corporations which are subject to the control by government units, defined as the ability to determine general corporate policy or by at least 50 percent government ownership).

Attachment II. Table 1. Summary of Reporting Requirements

Reporting institution	Report/Table	Frequency	Submission lag
I. Bank of Uganda	Issuance of government securities.	Weekly	5 working days
	Interest rates on government securities.	Weekly	5 working days
	Operations in the foreign exchange market and daily average exchange rates.	Weekly	5 working days
	Consumer price index.	Monthly	2 weeks
	Balance sheet of the BOU, consolidated accounts of the commercial banks, and monetary survey. The Internal Audit Department (IAD) of the BOU will review the reconciliations of monetary survey data with the financial records and the audited financial statements. Any revisions to monetary survey data, in line with the recommendations of the IMF safeguards mission, will be documented and reconciled with the previous presentation to ensure accurate reporting.	Monthly	4 weeks
	Composition of foreign assets and liabilities of the BOU by currency of denomination.	Monthly	4 weeks
	Statement of (i) cash balances held in project accounts at commercial banks; (ii) total value (measured at issue price) of outstanding government securities from the Central Depository System (CDS); and (iii) the stock of government securities (measured at issue price) held by commercial banks from the CDS.	Monthly	6 weeks
	Summary of (i) monthly commodity and direction of trade statistics; (ii) disbursements, principal and interest, flows of debt rescheduling and debt cancellation, arrears, and committed undisbursed balances—by creditor category; and (iii) composition of nominal HIPC Initiative assistance, disaggregated into grants, flow rescheduling, and stock-of-debt reduction by creditor.	Monthly	6 weeks
	Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	Quarterly	6 weeks
	Standard off-site bank supervision indicators for deposit money banks.	Quarterly	4 weeks
	Summary table of preliminary program performance comparing actual monthly outcome with adjusted program targets for (i) base money; (ii) net claims on central government by the banking system; (iii) stock of external arrears; (iv) new nonconcessional external borrowing; and (v) net international reserves	Quarterly	5 weeks
	Daily average amount of commercial bank automatic access to the BOU discount window and rediscounting of government securities by commercial banks.	Quarterly	4 weeks

Attachment II. Table 1. Summary of Reporting Requirements (concluded)

Reporting institution	Report/Table	Frequency	Submission lag
II. Ministry of Finance	Summary of central government accounts. Revenues shall be recorded on a cash basis. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due). Cash transfers to districts will be recorded as expenditures of the central government when the transfer is effected by the BOU. Expenditures on externally funded development programs will be recorded as the sum of estimated disbursements of project loans and grants by donors, less the change in the stock of government project accounts held at the BOU and domestic commercial banks.	Monthly	6 weeks
	Summary of outstanding stock of group (B) domestic arrears. Group (B) arrears comprise the stock of CCS/IFMS arrears incurred after end-June 2004.	Quarterly	6 weeks
	Summary of contingent liabilities of the central government. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, government guarantees, claims against the government in court cases that are pending, or court awards that the government has appealed.	Quarterly	6 weeks
	Detailed central government account of disbursed budget support grants and loans, HIPC support, and external debt service due and paid.	Monthly	4 weeks
	Detailed central government account of disbursed donor project support grants and loans.	Monthly	6 weeks
	Statement on new loans contracted during the period according to loan agreements.	Quarterly	6 weeks
	Updated national accounts statistics (real and nominal) according to UBOS and medium-term projections.	Quarterly	4 weeks

INTERNATIONAL MONETARY FUND

UGANDA

Sixth Review Under the Policy Support Instrument and Request for an Extension of the Policy Support Instrument —Informational Annex

Prepared by the African Department
(In consultation with other departments)

December 1, 2009

- **Relations with the Fund.** Describes financial and technical assistance by the IMF and provides information on the safeguards assessment and exchange system. Outstanding Fund credit was SDR 6 million (3.3 percent of quota) at end-October, 2009.

- **Joint Bank-Fund Work Program.** Describes Bank-Fund collaboration through June 2010.

Contents Page

APPENDIX I. UGANDA: RELATIONS WITH THE FUND
(As of October 31, 2009)

I. Membership Status: Joined: September 27, 1963; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	180.50	100.00
Fund holdings of currency	180.51	100.00

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	173.06	100.00
Holdings	143.69	83.03

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
PRGF Arrangements	6.00	3.32

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Sep 13, 2002	Jan 31, 2006	13.50	13.50
ESAF/PRGF	Nov 10, 1997	Mar 31, 2001	100.43	100.43
ESAF	Sep 06, 1994	Nov 09, 1997	120.51	120.51

VI. Projected Payments to Fund[9]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal		0.20	1.00	1.20	1.20
Charges/Interest	0.04	0.12	0.12	0.11	0.11
Total	0.04	0.32	1.12	1.31	1.31

VII. Implementation of HIPC Initiative:

I. Commitment of HIPC assistance	Original Framework	Enhanced Framework	Total
Decision point date	Apr 1997	Feb 2000	

[9]When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Assistance committed by all creditors (US$ Million) [10]	347.00	656.00	
Of which: IMF assistance (US$ million)	68.90	91.00	
(SDR equivalent in millions)	51.51	68.10	
Completion point date	Apr 1998	May 2000	
II. Disbursement of IMF assistance (SDR Million)			
Assistance disbursed to the member	51.51	68.10	119.61
Interim assistance	--	8.20	8.20
Completion point balance	51.51	59.90	111.41
Additional disbursement of interest income [11]	--	2.06	2.06
Total disbursements	**51.51**	**70.16**	**121.67**

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)[12]	87.73
Financed by: MDRI Trust	75.85
Remaining HIPC resources	11.88

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	GRA	PRGF	Total
January 2006	N/A	87.73	87.73

[10] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[11] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[12] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

IX. Safeguards Assessments

Under the Fund's safeguards policy, assessments with respect to the PSI are voluntary. An update assessment of the Bank of Uganda (BOU) was completed on April 10, 2007 and concluded that the BOU had strengthened its safeguards framework since the 2003 assessment. The main developments included implementation of International Financial Reporting Standards, publication of financial statements, establishment of an audit committee, and strengthening of the internal audit function. Staff made recommendations to address remaining vulnerabilities in the legal and internal control areas.

X. Exchange Rate Arrangement

The official exchange rate is determined on the interbank market for foreign exchange. As of October 30, 2009, the official exchange rate was U Sh 1883.8 per U.S. dollar. The exchange system is free of restrictions on the making of payments and transfers for current international transactions. Uganda's exchange rate regime is classified as floating.

XI. Article IV Consultation

The Executive Board concluded the last Article IV consultation on January 7, 2009. The next Article IV consultation with Uganda will be held on the 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

In February and April 2001, joint World Bank/Fund missions visited Kampala as part of the Financial Sector Assessment Program (FSAP). A final report was provided to the authorities in November 2001, and an MFD mission discussed the report with the authorities during the Article IV consultation discussion in November 2002; the Financial System Stability Assessment was prepared for Board discussion in February 2003. In November 2004, a joint World Bank/Fund missions visited Kampala for a FSAP update.

XII. Policy Support Instrument (PSI)

Uganda initiated a 16-month PSI with the Fund in January 2006. The 16-month PSI was replaced by a new three-year PSI in December 2006.

XIII. Technical Assistance

Uganda has received extensive technical assistance from the Fund in recent years.[13]

[13] For a description of technical assistance provided prior to 2006, see the staff report for Uganda's request for a three-year PSI (Country Report 06/155).

FAD has provided TA to the Uganda Revenue Authority (URA) in the areas of revenue administration and oil revenue management, with three missions from headquarters visiting Kampala during 2008. FAD—represented by three public financial management (PFM) advisors and one revenue administration advisor at AFRITAC East—continues to provide follow-up TA in several fiscal areas, such as cash management; the design of a comprehensive donor-supported PFM reform strategy; and revenue collection enhancements.

A TA mission on enhancing the effectiveness of monetary policy implementation and developing financial markets was conducted in August 2005; in April 2006 MCM and the BOU held a joint workshop on financial market development. In 2008 and 2009 MCM has provided TA to build capacity to undertake financial stability analysis and reporting; and more recently MCM has provided TA in the monetary operations area.

XIV. Future Technical Assistance Priorities

The priorities for Fund technical assistance in the next few years will be in the areas of tax administration, public expenditure management, especially control and monitoring of public arrears at both central and local government levels, monetary and exchange rate management, bank supervision, national accounts statistics, reporting standards for government finance statistics, monetary and balance of payments statistical reporting, central bank accounting, and audit and debt management.

XV. Resident Representative

The Fund has maintained a resident representative in Uganda since July 1982.

APPENDIX II. **JOINT BANK-FUND WORK PROGRAM, OCTOBER 2009 – JUNE 2010**

Title	**Products**	**Provisional timing of missions (if relevant)**	**Expected delivery date**
1. Bank Work Program	Poverty Reduction Support Credit to enhance effectiveness of service delivery, public sector management, and human development issues.		March 2010
	Prepare an upstream JSAN that can help advance preparations for the JSAN and Country Assistance Strategy (CAS) while awaiting finalization of the authorities National Development Plan (NDP).		Oct-Dec 2009
	The work program will continue to concentrate on areas within the existing portfolio, including infrastructure development (transport and energy), secondary education, health infrastructure, agricultural research, advisory services and training, Kampala infrastructure development, and local government service delivery (including Northern Uganda rehabilitation). In addition, the Bank project to support public service performance enhancement, Northern Uganda social protection, minerals development and environment sustainability will be maintained.		Dec 2009
	Public Expenditure Review on budget composition trends and efficiency in the road sector will be delivered to client.		June 2010
	Study on fostering financial deepening "Making Finance work for Uganda" has been discussed with the client and will be publicly disseminated in Dec 2009		Dec 2009
	Strategy paper for GOU's negotiation with other member states on the efforts towards elimination of non-tariff barriers.		Dec 2009

	Follow-up work on implementation of the report recommendations with particular emphasis on adaptation of experiences from other RECs, in depth study of the diary sector in the region, will be initiated.		
	A new study on shared/spatial growth with special focus on agriculture, labor and integration of leading and lagging areas, will be initiated.		Dec 2009
2. Fund Work Program	Sixth Review and Request for an Extension of the PSI	Oct 2009	Dec 2009
	Seventh Review and Request for a new PSI including development of a macroeconomic scenario incorporating oil; and a cost-benefit analysis of tax exemptions.	March 2010	May 2010
	Staff visit on the government budget	May 2010	June 2010
3. Joint Work Program	1. Joint DSA	March 2010	May 2010
	2. JSAN on the NDP (new PRSP) when it is completed.		May 2010

Press Release No. 09/476
FOR IMMEDIATE RELEASE
December 22, 2009

IMF Executive Board Completes Sixth Review and Extends the Policy Support Instrument for Uganda for One Year

The Executive Board of the International Monetary Fund (IMF) completed today the sixth review under a three-year Policy Support Instrument (PSI) for Uganda. The Executive Board also approved an extension of the PSI for one year through December 14, 2010 to align a possible successor arrangement with the budget cycle and the National Development Plan currently under preparation.

Uganda's PSI was approved on December 15, 2006 (see Press Release No. 06/281). The program goals include macroeconomic stability, sustainable economic growth, poverty reduction, financial sector deepening, and improved public sector financial management. The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. This is intended to ensure that PSI-supported programs are consistent with a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty. Members' performance under a PSI is reviewed semi-annually, irrespective of the status of the program (see Public Information Notice No. 05/145).

Following the Executive Board's discussion, Mr.Takatoshi Kato, Deputy Managing Director and Acting Chair, stated: " Prudent economic management and strong fundamentals have enabled Uganda to weather the global crisis relatively well. Despite a slowdown in economic activity, growth remains strong by regional and international standards. Core inflation has declined in spite of an increase in headline inflation driven by higher food prices. The external current account has performed better than expected, buoyed by strong cross-border exports, and international reserves remain adequate. Uganda's flexible exchange rate regime has facilitated adjustment to external shocks. The financial sector has been largely spared by the crisis and remains sound.

“Looking forward, macroeconomic policies in FY2009/10 continue to aim at overcoming infrastructure bottlenecks while mitigating the impact of external shocks on domestic activity. Addressing technical and administrative capacity constraints is key to improving budget execution, providing a healthy stimulus to the economy. Plans to step up public investment will help address Uganda’s large infrastructure deficit. At the same time, caution is needed to preserve fiscal and debt sustainability, and leave space for private sector growth. More generally, borrowing to finance infrastructure projects should be evaluated on a case-by-case basis in terms of cost effectiveness and the impact on debt and fiscal sustainability. It will be essential to embed borrowing decisions in a well-articulated debt management strategy and sound medium-term public expenditure management framework.

“On the monetary side, increased flexibility in the liquidity management framework should allow the central bank to support private demand while bringing down inflation. In this regard, the Bank of Uganda should closely monitor incipient inflationary pressures and stand ready to make policy adjustments should inflation fail to decline as expected.

“ A renewed emphasis on a comprehensive and well-coordinated structural reform agenda would raise both the implementation and absorptive capacity of Uganda. In particular, strengthened public financial management would help improve the quality and efficiency of fiscal spending. Uganda also needs to enlarge the local tax base and boost the efficiency of revenue collection to reduce its dependency on aid.

“The commercial exploitation of oil, though still some years away, will raise additional fiscal and institutional challenges. The authorities are committed to managing oil revenue carefully and transparently through the budget process,” added Mr. Kato.

Statement by Samuel P. Itam, Executive Director for Uganda
December 22, 2009

1. My Ugandan authorities have persevered with prudent macroeconomic policies and deepened structural reforms in spite of the challenging external environment. Reflecting this stance, the Ugandan economy remains on a sound footing and has so far weathered the impact of the global financial and economic crisis. Like in other parts of the world, real GDP growth has slowed down though still strong by regional and global standards. Ugandan external sector's resilience is mainly attributed to the diverse nature of its export markets. While the country's exports to Europe and the United States declined, its total exports increased mainly due to regional trade. In addition to remaining one of Africa's fastest growing economies, Uganda was also named in May 2009 as one of the fastest growing destinations for foreign direct investment (FDI) by fDi Intelligence, the research and analytics division of *the London-based* Financial Times.

2. The commitment of my authorities to the program continues to be very strong. All end-June 2009 assessment criteria for the sixth review were met, and all but two structural benchmarks were observed on time. The 2009/10 budget framework is well in line with the program, and the new National Development Plan (NDP) launched last week for the period 2010-2015 aims at strengthening the country's macroeconomic framework. The recent Board approval of the extension of the PSI by one year will enable my authorities to consolidate recent economic fundamentals and, with the support of staff, develop the successor PSI arrangement that conforms to the NDP's objectives. In view of the strong performance under the program, the authorities request Directors' support for the completion of the sixth review of the PSI.

Recent developments and prospects

3. Uganda's impressive economic performance did not escape the threat of the adverse effects of the global economic downturn. Real GDP growth, that was 8.7 percent in 2007/08 because of strong performance in the key economic sectors, is now estimated to decline to 6.3 percent in 2009/10 as a result of severe external shocks on the country's traditional exports, tightening of liquidity, and a marked slowdown in the construction sector. Deterioration in the global environment was partly offset by a surge in exports to regional markets, and hence the better than expected performance in the external current account. International reserves have remained strong in line with the overall performance in the external account, supported by a rebound in capital inflows. On the near-term outlook, the authorities consider that the implementation of public investment program and a sustainable economic recovery of the key trading partners would help recovery in Uganda. In that respect, the macroeconomic policy will continue to aim at alleviating the impact of the recent external shocks on domestic activity.

4. The fiscal outturn in 2008/09 reflects the challenges the country is facing. Revenue relative to GDP is estimated to have stagnated, but overall expenditure fell appreciably below the original budget estimates, resulting in a smaller-than-programmed budgetary shortfall of 4.4 percent of GDP. Though the authorities are determined to sustain the level of spending under the major recurrent categories, the lower-than-expected disbursements for the

donor-funded projects and weaknesses in project implementation continue to impact on overall budget execution.

5. The monetary framework of the Bank of Uganda (BOU) has continued to be guided by its strategy that includes a mix of policy instruments for sterilization of liquidity and broadening of monetary policy transparency. To that end, the framework continues to use reserve money as the operating target and broad money as the intermediate target. Core inflation has been easing, but headline inflation rose because of higher food prices attributed to high demand for food and drought.

6. The country's financial system has remained resilient to the global financial crisis, mainly due to its limited exposure to toxic assets and distressed financial institutions abroad, and well-supervised and capitalized banks. Limited exposure of the banking system to trade financing (export crops and other products) and personal loans has helped protect the bank's balance sheets from the effects of the economic downturn. The banks are liquid, their loan quality is relatively good, and non-performing loans have remained relatively low.

Policy response

7. As stressed in the LOI and MEFP, my authorities' main challenge in the short-term continues to be the restoration of growth to its potential trajectory, without undermining medium-term macroeconomic stability.

Fiscal policy

8. The authorities' fiscal policy will continue to be tilted toward providing a stimulus to the economy and re-orientation of the budget towards capital expenditures. In this regard, expenditures and net lending for the 2009/10 are to increase by 0.9 percent of GDP. The financing requirement would be met primarily through external sources, projected at 2.4 percent of GDP on a net basis.

9. The authorities are aware of the low tax-to-GDP ratio of about 12 percent, which suggest that there may be scope to raise tax revenue. In this regard, they are taking measures to enhance domestic revenue mobilization, including by rolling out the medium taxpayer office and stepping up enforcement and audit.

10. My Ugandan authorities are also aware of the underexecution of donor-funded projects, which is largely due to lower-than-expected disbursement by donors, coupled with implementing agencies' absorption constraints. Actions to address these challenges in the period ahead include engaging the development partners to advance the alignment of their procurement procedures to those of the authorities in line with the 2006 Paris Declaration on aid effectiveness.

Monetary and exchange rate policies

11. The monetary policy framework will continue to be underpinned by the objective of price stability and credit growth to support economic activity. To strengthen the framework, the BOU with the support of the Fund has revised its operational procedures to de-link

structural liquidity management from daily liquidity management. The authorities are also committed to the establishment of the East African Monetary Union (EAMU) with its EAC partners, and, in this respect, greatly appreciates staff's effort at addressing regional macro financial issues as part of the PSI review.

12. On the exchange rate, the Bank of Uganda continues to maintain a flexible exchange rate regime limiting interventions to smoothing excessive volatility. The flexible exchange rate policy has helped the economy navigate volatility in trade and capital flows.

Financial sector

13. The BOU will continue to closely supervise the regulated financial institutions to ensure that appropriate remedial measures are implemented in the event of any weakening in their financial condition. Further, the authorities intend to strengthen the regulatory framework for financial institutions by updating the Financial Institutions Act of 2004 and Microfinance Deposit-taking Institutions Act of 2003. This new framework will include an upward revision of minimum capital requirements; provisions to cover Islamic banking products; and regulations to cover insurance products offered by banks and other non-banking financial institutions. The BOU will also review the regulatory restrictions on lending with maturity of over three years with a view to encouraging longer term lending by banks. Also, measures will be implemented to strengthen information sharing and regulation of financial institutions that operate across borders with other central banks in the East African Community.

Structural reforms

14. The National Development Plan (NDP) was launched recently and it sets out the development goals and priorities for the medium-term. The new strategy is expected to transform Uganda from peasantry to a modern and prosperous country within 30 years. The authorities' drive at addressing the infrastructure deficit underpins the NDP objectives and thrust of the structural reforms. Reforms in improving the pension sector, strengthening of the public financial management, and deepening of the financial market are also currently under way.

15. The authorities are also committed to continue strengthening the Public Financial Management (PFM) through further rolling out of the Integrated Financial Management System to cover all stakeholders. They also intend to implement a five-year financial markets development plan, to deepen financial markets and strengthen financial intermediation. The plan includes measures to establish a credit reference bureau, strengthen the payment system, and revise the commercial laws to enforce contracts.

16. The authorities recognize that the future oil revenue would present opportunities as well as challenges. In this regard, a sound legal and institutional framework for the oil sector will be established, and resource management capacity strengthened. The authorities welcome Fund TA and active engagement in the assessment of the macroeconomic impact of oil exploitation to the rest of the economy, including the Dutch disease effects.

17. On the regional front, the authorities consider the deepening of the EAC integration framework as an important catalyst to enhance Uganda's medium-term growth. Their plan to establish a new facility port on Lake Victoria is in line with this strategic objective. They have recently concluded a common market protocol that is foreseen to come into effect in July 2010; the customs union is expected to come into effect in January 2010. The authorities, therefore, would also appreciate the Fund TA to facilitate regional policy discussions and coordination between EAC members.

Conclusion

18. Despite the difficult global economic and financial environment, Uganda's strong macroeconomic fundamentals and policy framework have helped the economy to weather the storm. The reforms undertaken over recent years have helped to strengthen these macroeconomic fundamentals and, hence, Uganda entered the global crisis from a position of strength. The authorities are committed to continue with implementation of sound macroeconomic and structural reform policies, and in line with the program. They also remain committed to promote and participate actively in regional policy discussions and coordination. They are aware of the future opportunities and challenges arising from the imminent exploitation of the oil resources. They, therefore, request the continuous support of the Fund, other international financial institutions, and development partners in their effort to strengthen macroeconomic stability, restore high growth rates with low inflation for poverty reduction, and attain the MDGs.