October 2011
IMF Country Report No. 11/308

Uganda: Second Review Under the Policy Support Instrument and Request for Waiver of Assessment Criteria—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uganda.

In the context of the second review under the Policy Support Instrument and request for waiver of assessment criteria, the following documents have been released and are included in this package:

- The staff report for the second review under the Policy Support Instrument and request for waiver of assessment criteria, prepared by a staff team of the IMF, following discussions that ended on March 31, 2011, 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 June 16, 2011. 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 staff supplement dated June 16, 2011 containing an update to the Debt Sustainability Analysis.

- A Press Release summarizing the views of the Executive Board as expressed during its June 29, 2011 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

Second Review Under the Policy Support Instrument and Request for Waiver of Assessment Criteria

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

Approved by Saul Lizondo and Dominique Desruelle

June 16, 2011

Discussions: Held in Kampala during March 16-31, 2011, and continued in Washington during the Spring Meetings. The mission met with Finance Minister Bbumba, Bank of Uganda Governor Tumusiime-Mutebile, Permanent Secretary/Secretary of Treasury Kassami, and other senior officials, as well as the media, representatives of parliament, the private sector, NGOs/CSOs, and development partners.

IMF team: Thomas Richardson (head and senior resident representative), Laure Redifer, Nabil Ben Ltaifa (all AFR), Amina Lahreche (SPR), and Jack Grigg (FAD). Ahmed Ndyeshobola (OED) and Rachel Sebudde (World Bank) participated in the discussions. The mission was supported by the staff of the Kampala office of the Fund, all seconded from the Bank of Uganda. Kyung-Seol Min (FAD) and Shengzu Wang (SPR) contributed to finalization of the papers after the mission.

Fund relations: The 3-year PSI was approved by the Executive Board on May 12, 2010. In February 2011, the Executive Board concluded the 2010 Article IV consultations and also conducted the first review under the PSI, but decided not to complete it.

PSI Second Review: Four of the six quantitative assessment criteria (for end-December 2010) were met; NIR and NDA were missed, owing mainly to timing issues in the settlement of exceptional security-related spending. Progress with structural reforms was good. Staff recommends that waivers be granted for nonobservance of the two assessment criteria, and supports completion of the second review under the PSI. Staff also proposes establishment of end-June 2011 and end-December 2011 quantitative assessment criteria along with several new structural benchmarks aimed especially at boosting revenue and strengthening public financial management.

Contents

List of Acronyms

AFD	Agence Française de Développement
AfDB	African Development Bank
BFP	Budget Framework Paper
BoU	Bank of Uganda
CCS	Commitment Control System
CIT	Corporate Income Tax
CY	Calendar Year
EAC	East African Community
EU	European Union
FAD	IMF Fiscal Affairs Department
FSAP	Financial Sector Assessment Program
FY	Fiscal Year (July 1 to June 30)
HFB	Housing Finance Bank
IPPS	Integrated Personnel and Payroll System
ITL	Inflation Targeting "Lite"
MCM	IMF Monetary and Capital Markets Department
MEFP	Memorandum of Economic and Financial Policies
MoFPED	Ministry of Finance, Planning and Economic Development
NCB	Nonconcessional Borrowing
NCG	Net Credit to Government
NDA	Net Domestic Assets
NDP	National Development Plan
NIR	Net International Reserves
NPLs	Non-performing Loans
NSSF	National Social Security Fund
PAF	Poverty Alleviation Fund
PFAA	Public Finance and Accountability Act
PFM	Public Finance Management
PRSC	World Bank Poverty Reduction Support Credit
PSI	Policy Support Instrument
PV	Present Value
QAC	Quantitative Assessment Criterion
RMP	Reserve Money Program
STP	Straight-through Payment
TA	Technical Assistance
TMU	Technical Memorandum of Understanding (part of MEFP)
UBOS	Uganda Bureau of Statistics
UNRA	Uganda National Roads Authority
URA	Uganda Revenue Authority
VAT	Value Added Tax

EXECUTIVE SUMMARY

Economic growth has recovered, but higher food and fuel prices—supported by accommodative monetary policy—have sparked a sharp rise in inflation. The main factor has been food inflation, stemming from supply and demand side effects, combined with fuel prices, currency depreciation and accommodative monetary policy. An expected strong June harvest should help ease pressure on food prices.

Monetary policy has been tightened to contain core inflation and second round effects of the food and fuel price shocks. Headline CPI reached 16 percent in May 2011, but core inflation rose to 11 percent, suggesting a need for a less accommodative stance of monetary policy. The authorities will tighten further if inflation does not abate as expected.

After significant fiscal expansion this year, the authorities will tighten the fiscal stance while allowing for scaling up of infrastructure investment spending. Conclusion of exceptional spending this year and further current spending adjustment will reduce the fiscal deficit, while new resources will be applied to priority infrastructure investment in line with the authorities' National Development Plan. The authorities are seeking to enhance government revenues by eliminating some tax exemptions and strengthening tax administration, including by introducing a national identification system and new guidelines on transfer pricing. The authorities have also committed to refrain from central bank borrowing in FY2011/12, and will begin repaying central bank loans in FY2012/13. At the same time, the central bank will gradually restore a comfortable buffer in its stock of international reserves.

Progress in implementing structural reforms through end-March was good, and four of six quantitative assessment criteria for the end-December test date were met. Two criteria were missed due to an unanticipated frontloading of exceptional spending: the criteria were devised with the expectation that the spending would take place in the second half of the year rather than the first half.

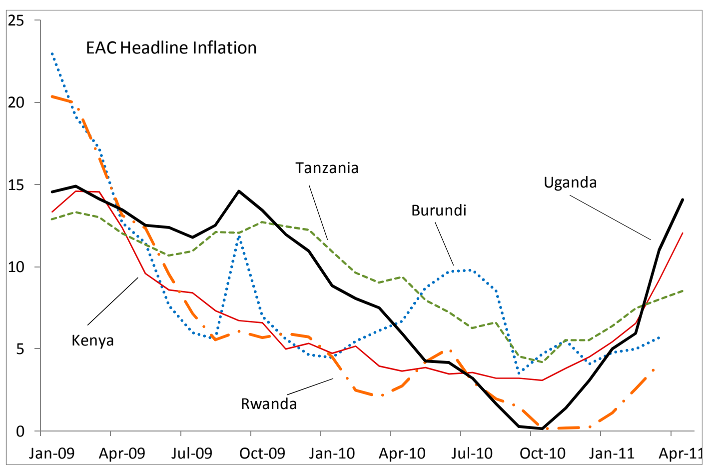
Staff supports the authorities' request for a waiver of nonobservance for two quantitative assessment criteria missed at end-December, and recommends completion of the second review under the PSI, including an increase in Uganda's ceiling on external non-concessional borrowing. The authorities are taking measures to address the breach of the QACs, progress under the PSI otherwise has been good, and the authorities have committed to concrete actions to set fiscal policy on a more sustainable path and ensure that the program's growth and poverty reduction objectives are attained.

I. Recent Developments

1. **President Museveni was inaugurated into the new term of office on May 15, and a new parliament was seated the next week**. He was re-elected in February by a wide margin (68 percent). A new finance minister, Ms. Maria Kiwanuka, has been appointed. Since March, higher food and fuel prices have sparked opposition-led protests that have in some cases ended in violence.

2. **GDP growth is recovering** (Figure 1). Growth was robust in the first half of the fiscal year (9.0 percent y/y or 7.4 percent on a cyclically-adjusted basis), and imports and private sector credit growth have been strong, after troughs in 2009. Growth was driven by industry and services, with agricultural growth—where the preponderance of the informal economy and the poor are concentrated—moving to strongly negative.

3. **However, inflation has accelerated sharply**. Headline inflation rose from almost zero in mid-autumn to 16 percent in May. The main driver has been food prices, which rose 44 percent over the previous year, partly due to dry weather conditions and strong demand from neighboring countries. Higher food inflation has accounted for more than 60 percent of the increase in headline inflation, which has been the highest in the EAC. Uganda's position as a net food exporter (particularly to South Sudan, western Kenya and organic markets in Europe) is important to the authorities, who have resisted domestic political pressure to limit food exports as a way of reducing prices in Uganda. The authorities are considering reducing excises taxes on kerosene and sugar, which would have a minimal impact on fiscal revenues (about 0.04% of GDP). They have resisted pressure to cut excise taxes on other petroleum products, noting that the implicit subsidy would be poorly targeted and could have a significant impact on domestic revenues. Other contributing factors to inflation include increased global fuel prices, strong domestic demand and strong money growth, the latter being reflected in increases in core inflation.



4. **The shilling lost value in the lead up to the elections, but pressure on the exchange rate has declined somewhat since then.** The authorities explained that the depreciation stemmed mainly from pre-election hedging by corporates. The Bank of Uganda continued its regular small daily purchases of foreign exchange in order to build reserves, but since the beginning of the year has engaged in somewhat larger than usual net foreign exchange sales (intervention) of around US$130 million to help contain the pace of exchange rate depreciation prior to elections and in the face of political tensions.

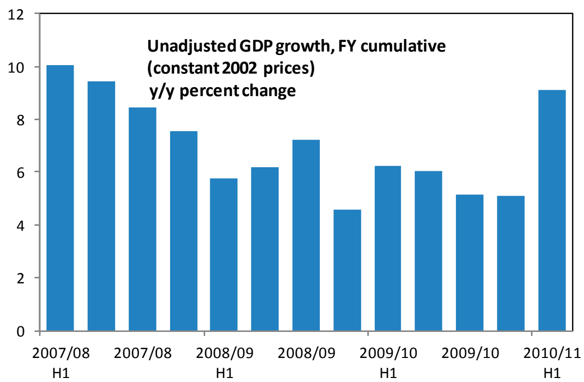
5. **Spending pressures, including in the context of elections, led to a reprioritization of government activities in the first three quarters of the fiscal year**. During this period, non-wage recurrent spending exceeded program projections by around 1 percent of GDP. This spending, on police, security and other election-related activities, obliged the authorities to compensate by compressing spending in other sectors. Execution of the domestically-financed development budget was compressed as well, and wage growth was moderated.

6. **Domestic revenues continue to perform strongly in nominal terms, limiting recourse to domestic financing.** Tax collection was aided by currency depreciation: around 50 percent of tax revenues are collected on imports, which became increasingly more valuable in shilling terms. Disbursement of the World Bank's PRSC tranche also helped avoid further recourse to borrowing from the central bank. Finally, a first payment of capital gains taxes related to the sale of an oil exploration license was set aside for future investment in infrastructure (see below).

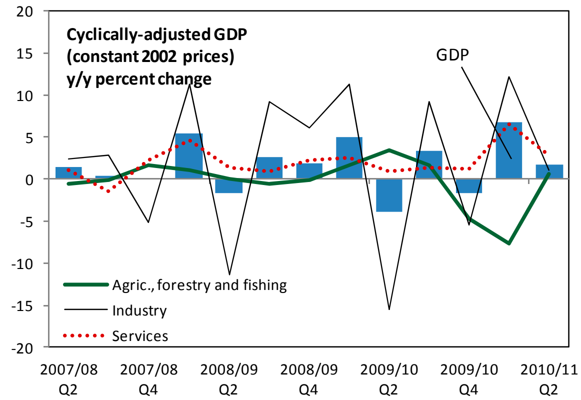
7. **The monetary policy stance has been tightened since early 2011, in response to rising inflation**. The monetary policy stance was accommodative for most of 2010: by end-January, growth rates of broad and base money had increased significantly, to 40 percent and 39 percent y/y, respectively; growth in credit to the private sector reached about 37 percent (compared with 25 percent in June 2010 and 18 percent at end-2009). In recent months, the BOU has raised interest rates more forcefully, to help contain core inflation and curb second round inflationary pressures resulting from recent surges in food and fuel prices.

Figure 1. Real and External Developments

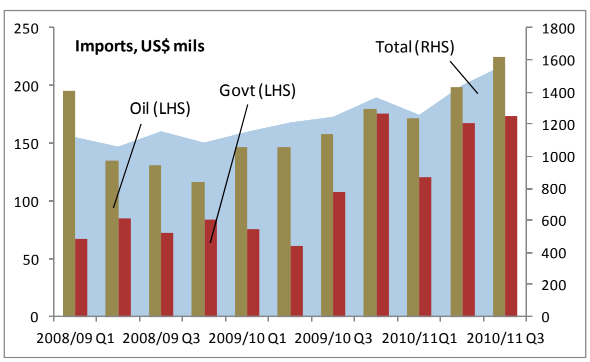
Real GDP growth has picked up sharply …



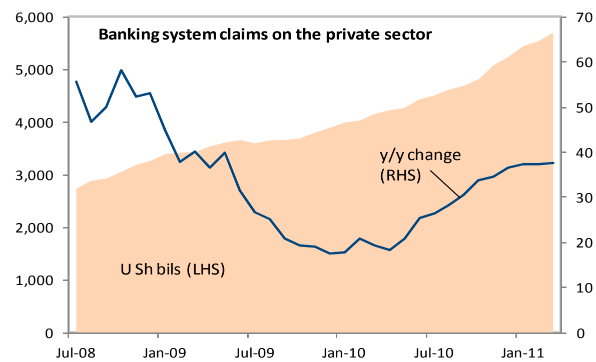
…driven by activity in industry and services....



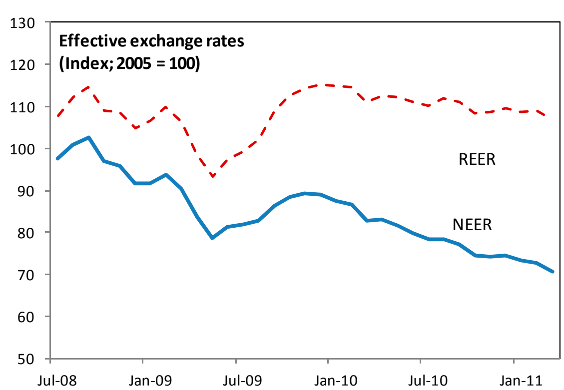
…import demand has remained strong, driven partly by oil products…



…and robust private sector credit growth is beginning to stabilize.



Despite nominal depreciation, the real exchange rate has remained relatively stable …



…while reserve coverage has dropped .

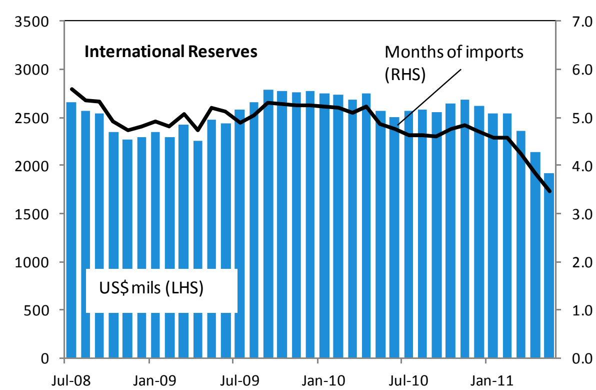
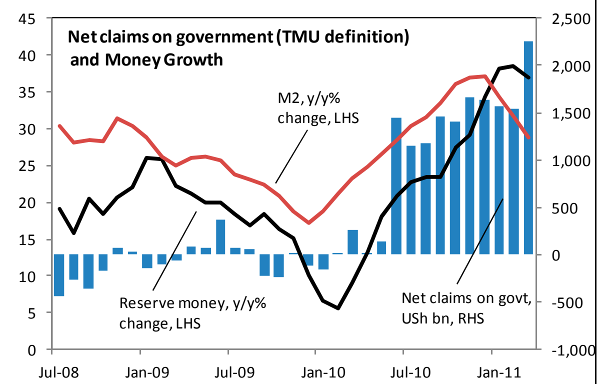
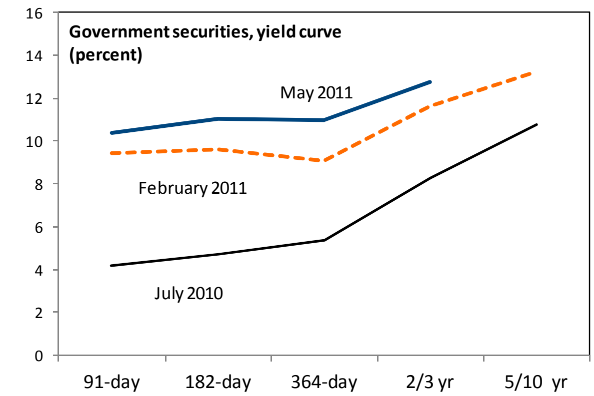


Figure 2. Recent Fiscal and Monetary Developments

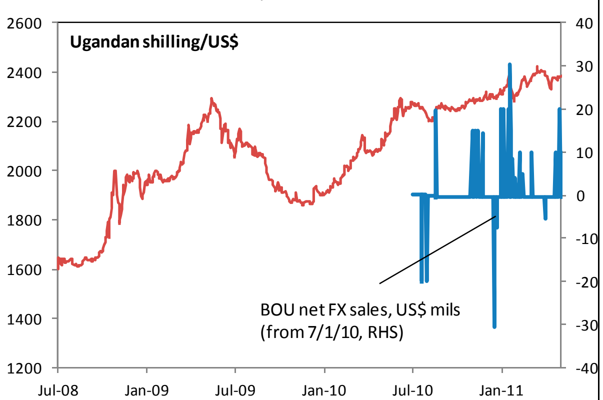
Money growth had picked up sharply, along with credit to government, and is now coming down.



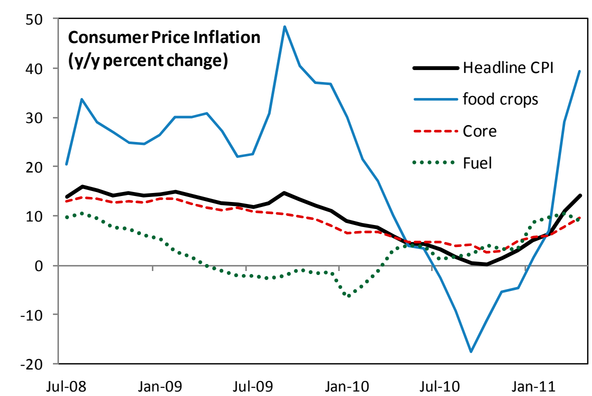
..and yields on government securities have risen considerably since mid-2010.



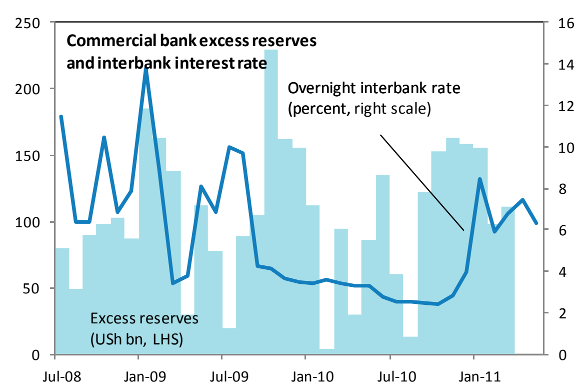
The shilling showed some pre-election volatility, contained somewhat by BOU FX sales….



…while annual inflation is picking up rapidly, driven by food and fuel prices.



System liquidity has tightened recently with rising interest rates….



…which, however, are now negative in real terms (deflated by headline inflation).

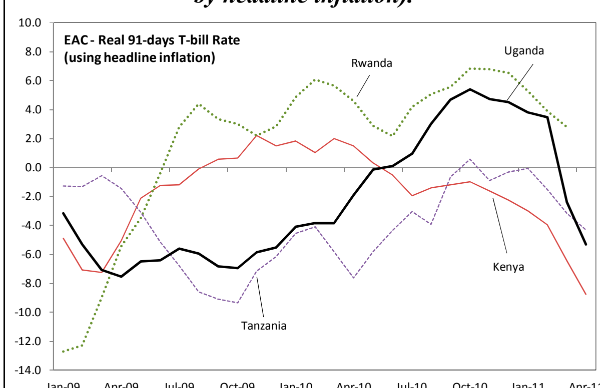
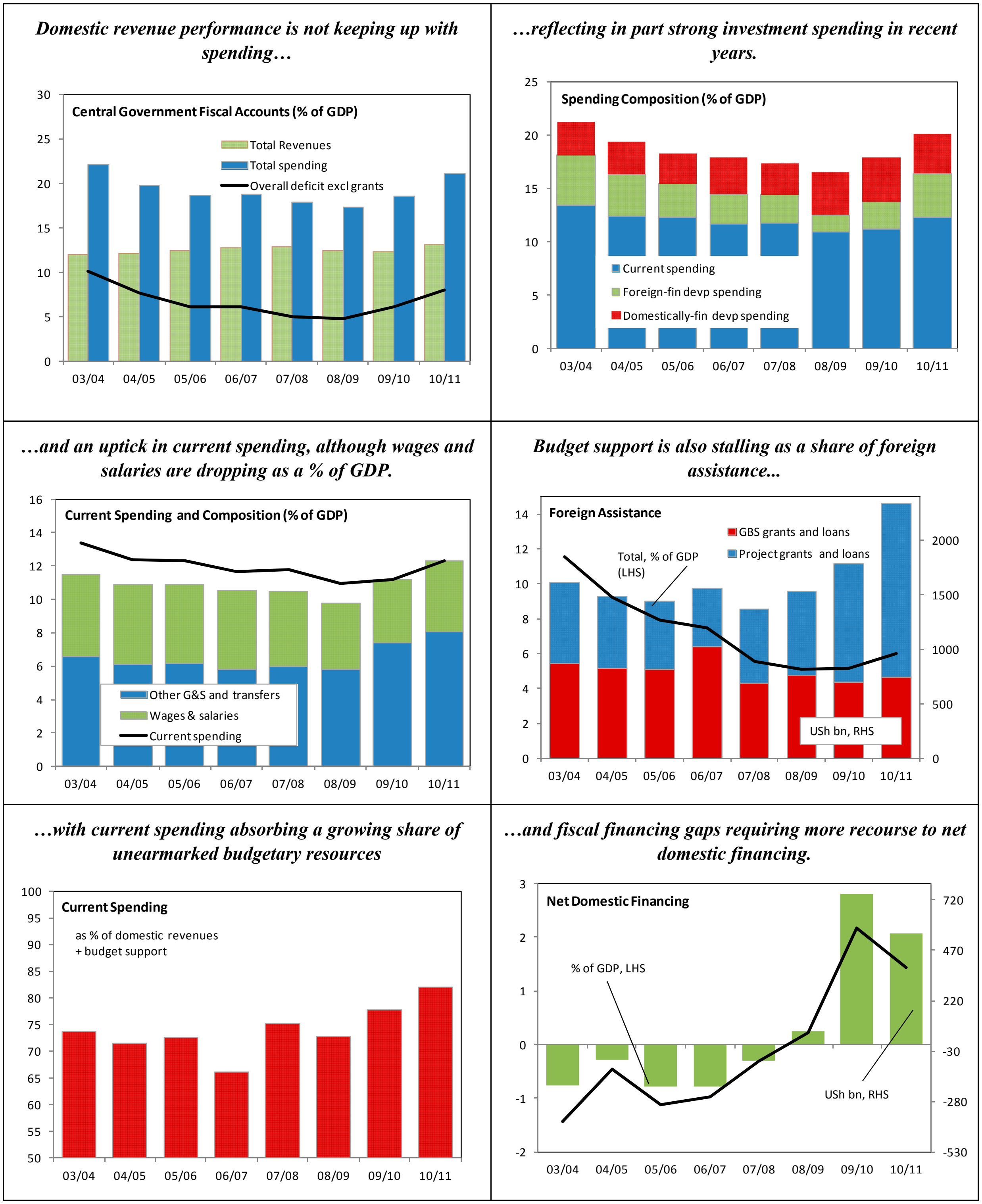


Figure 3. Longer Term Fiscal Developments[1]



[1] Exceptional security-related spending (FY09/10-10/11) and capital gains tax from oil (FY10/11) not included.

II. PROGRAM PERFORMANCE

8. **The Executive Board decided on February 11 not to complete the first review of the PSI**. A supplementary spending bill equal to 1.3 percent of GDP was approved by Parliament in early January, rendering the level of authorized spending inconsistent with the agreed spending envelope in the PSI. The new spending was to be financed by net domestic financing well in excess of program targets. More generally, there was a heightened risk that additional spending pressures could arise and be accommodated, and the outlook for macroeconomic policies had become highly uncertain. The Executive Board did, however, approve modifications to the quantitative assessment criteria (QAC) for end-December 2010 (second review test date). Program targets for end-June 2011 (test date for third review) were left as indicative, with the QACs to be set at the time of the second review.

9. **Four of six quarterly assessment criteria for end-December were met** (Table 5)**.** However, the floor on net international reserves (NIR) and the ceiling on net domestic assets (NDA) were missed by 0.3 and 0.8 percent of GDP, respectively. The breaches were due to the timing of the security-related exceptional spending: expenditures were frontloaded in the first half of the year by about 1¼ percent of GDP more than had been assumed in setting the quantitative assessment criteria for end-December. The total for security-related exceptional spending for the year as a whole was not affected. Net credit to government by the banking system was met, however, due to an unexpected capital gains tax payment by an oil exploration company. Base money was 0.4 percent of GDP higher than the indicative target, and minimum spending for the Poverty Action Fund (PAF) fell short of target by a minimal amount.

10. **Good progress was made on structural reforms, with most benchmarks met for end-December 2010, and March-April 2011** (Table 6). By end-December, an inventory of government accounts was undertaken, with about half of the accounts (about 800) closed or frozen pending further review. The Integrated Personnel and Payroll System (IPPS) was rolled out in the pilot spending units, albeit with a one-month delay. About half of the procurement officers and accountants in spending units were rotated by December 31. The structural benchmark for March 31 to develop a set of leading economic indicators was met – the new series has been developed, but is not yet in operational use. Three structural benchmarks for April 1 were broadly met in the context of the Budget Framework Paper (BFP) for FY 2011/12: it contained details on the utility consumption of spending units and a partial timetable for introducing the national identification system. The spending in the BFP also included the exceptional security-related spending, but more importantly, full information on this transaction is now in the public domain, and the spending has been authorized by Parliament in a special supplementary budget. The benchmark to begin submitting to Cabinet regular reports on unpaid bills of spending units, based on data in the Commitment Control System (CCS) for the previous quarter of the financial year was not met, and is proposed to be reset for June 30.

III. Policy discussions

A. Overview

11. **Program discussions centered on ensuring that the fiscal stance was aligned with PSI objectives and that monetary policy is being tightened to contain second-round inflation effects.** The authorities reiterated their strong commitment to the PSI and its objectives. While regretting the circumstances that led to non-completion of the first review, they expressed appreciation for the Fund's continued constructive engagement. They explained that they set stricter cash limits on spending for the remainder of FY 2010/11 to keep overall spending envelope constant—offsetting the higher spending authorizations in January to deal with unexpected election-related expenses. They reiterated their commitment to strong policies including tightening macroeconomic policies in 2011/12, repaying central bank lending associated with the exceptional security-related spending, and to work to create fiscal space for stepped up infrastructure spending over the medium-term.

B. Macroeconomic Outlook

12. **Growth is expected to be about 6½ percent in 2011/12, and inflation should gradually recede with more favorable harvest conditions and tighter monetary policy**. Demand for Ugandan exports in Southern Sudan is projected to remain strong, and several large infrastructure projects are getting underway. Further, some investment related to preparations for oil production is beginning to register in the national accounts. Inflation is expected to abate, particularly as a result of a strong June harvest, but not immediately, given base effects (food prices fell very sharply in the middle of CY 2010 after the start of the summer crops).

C. Fiscal Policy

13. **Fiscal policy is aimed at containing the fiscal deficit for the remainder of the current fiscal year, with corrective policies commencing in FY 2011/12.** For the remainder of FY 2010/11, the authorities have imposed tight cash ceilings in order to contain the fiscal deficit (including grants) to about 7½ percent of GDP and domestic financing to 5 percent of GDP. They sought to limit non-essential spending while protecting poverty alleviation priorities, wages, utilities, defense and policing, grants to local governments and other statutory items. The result, in the authorities' view, has been a squeeze on other non-wage recurrent spending and delays in some development projects that were moving slowly. Staff welcomed this commitment to spending discipline, but expressed concern that such tight cash limits could result in accrual of domestic arrears.

14. **The authorities acknowledged the risk that large shifts in spending priorities midway through the fiscal year could lead to domestic arrears.** Data on expenditure arrears is prepared only once per year with a significant lag, meaning that data on arrears in FY2010/11 is not available at this time. Staff welcomed the authorities' commitment to produce quarterly arrears reports to monitor this risk (structural benchmark for end-June).

They also agreed to move to direct treasury ("straight-through") payment for electricity and water bills of central government spending units (MEFP ¶ 14, 25).

15. **Staff stressed the importance of submission to Parliament of a FY2011/12 budget consistent with agreed PSI targets**. In light of consultation lapses in the past year (the exceptional spending and the January supplementary budget), staff wished to ensure that the FY 2011/12 budget would be consistent with the PSI macroeconomic framework. The Minister's Budget Speech on June 8 (including the associated Finance Act) is closely aligned to the PSI.[2]

Uganda: 2011/12 Budget
Percent of GDP

	2010/11	2011/12	
	Proj.	PSI	Budget Speech
Revenue and Grants	**16.2**	**16.2**	**17.5**
Domestic revenue 1/	13.1	13.8	13.7
Grants	3.1	2.5	3.8
Expenditure	**23.7**	**21.2**	**21.4**
Deficit (including grants)	**7.5**	**5**	**4**
Net external financing	2.5	3	2
Net domestic financing	5	2	2
Memo:			
Nominal GDP (Ush billions)	38,730	45,681	45,888

Sources: MoFPED and IMF staff calculations
1/ Excludes one-off oil revenues.

16. **The FY2011/12 budget reduces the underlying fiscal deficit significantly, while applying new resources to long-awaited priority infrastructure projects.** The fiscal stance for FY2011/12 is tightened about 2.5 percentage points of GDP relative to FY 2010/11: in addition to unwinding of election-related spending and sharply reduced outlays for security-related exceptional expenditures, the draft budget envisages additional reductions in current spending. Relative to the agreement at the time of the first review, medium term fiscal consolidation is slightly slower, based on more consolidation of current spending and scaling up of investment spending (text table). The additional investment spending includes some large high priority infrastructure projects, consistent with Uganda's National Development Plan (NDP), financed by use of the petroleum and energy funds – both already earmarked for this use.[3] Even with a slightly slower pace of fiscal consolidation, Uganda's risk of debt distress remains very low (see accompanying Bank-Fund DSA update).

[2] The budget speech reflects a somewhat different mix of external financing (more grants versus loans) based on updated information. This reduces the fiscal deficit since loans are a financing item, but leaves spending broadly consistent.

[3] Another large project will be financed by new external nonconcessional borrowing, which had not yet been incorporated into the macroeconomic framework at the time of the first review.

Fiscal Policy Stance and Infrastructure Spending

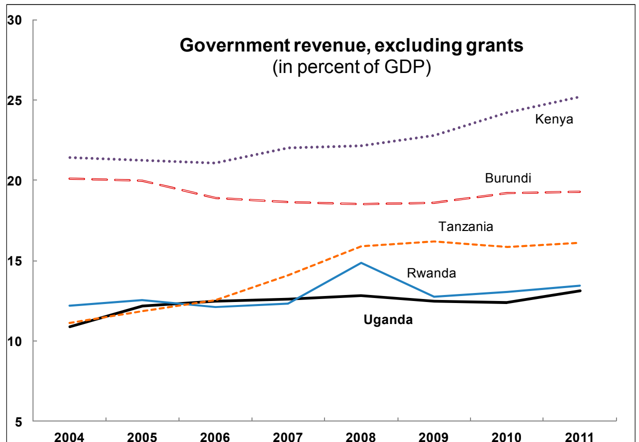
	FY2010/11 Proj	FY2011/12 Proj	FY2012/13 Proj	FY2013/14 Proj	FY2014/15 Proj
			(percent of GDP)		
Current spending	14.8	10.6	10.3	10.2	9.9
Development spending	7.8	10.4	11.7	10.6	8.8
Fiscal balance, incl grants	-7.5	-5.0	-6.2	-5.0	-2.9
Fiscal balance, excl large infra. projects 1/	-7.5	-3.2	-4.2	-3.4	-2.4
Nominal GDP (US$ mils)	38,730	45,681	52,027	58,452	65,671

17. **The authorities stressed their commitment to cease direct central bank financing of the deficit beginning with the FY 2011/12 budget**. The remaining exceptional security-related spending of 0.6 percent of GDP will be financed from domestic revenues. Central bank financing will therefore reflect only the use of the government's resources earmarked for infrastructure financing, particularly the shilling-denominated Energy Fund.

18. **Medium term fiscal policy reflects a further reduction of the deficit, while scaling up infrastructure investment and repaying advances from the Bank of Uganda.** Domestically-financed investment spending is projected to increase rapidly in FY 2012/13–2013/14 for already-identified infrastructure projects, particularly a hydropower project (Karuma falls dam) and the Kampala-Entebbe toll road (MEFP ¶ 21). Larger investment spending, plus slightly lower grant projections, is expected cause a temporary deterioration in fiscal balances in FY 2012/13, which will improve thereafter. Modest further consolidation of current expenditures and gradual revenue enhancement will provide the resources to gradually repay the outstanding central bank loans.

Box 1. Revenue Efficiency and Tax Exemptions in Uganda

When introduced ten years ago, Uganda's value-added tax (VAT) reflected good international practice, with a single positive rate, a broad base, and limited exemptions. However, the introduction of numerous exemptions has undermined VAT effectiveness, and is a contributing factor to Uganda's disappointing domestic revenue effort. Uganda's VAT intake was 3.8 percent of GDP in FY2009/10, in comparison to 5.8, 4.6 and 4.1 percent for Kenya, Tanzania and Rwanda, respectively, despite all having a standard VAT rate of 18 percent (16 percent for Kenya). In particular, the lower intake is due to a large number of exemptions that have been adopted for *intermediate* goods, transforming the current VAT into something closer to an old-style manufacturer's turnover tax in some sectors. The exemption on petroleum products, for example, will pose a serious problem in the context of future oil production.



Source: *IMF*, African Regional Economic Outlook

The corporate income tax (CIT) provides a ten-year tax holiday for export businesses and an exemption for agro-processing firms. These two exemptions are being streamlined in FY2011/12 by: (a) requiring that the Revenue Authority re-certify on an annual basis the eligibility of each taxpayer to benefit from the exemptions; and (b) narrowing the scope of the eligibility criteria, particularly for agro-processing.

After a hiatus of some years, a tax policy technical assistance mission visited Kampala in early 2011 and made a number of recommendations to enhance the revenue effort, including elimination of a number of VAT exemptions. The authorities incorporated some of these in the FY2011/12 budget, and have agreed to include further measures in the FY2012/13 budget.

19. **Revenue enhancement, particularly improved VAT efficiency, will also make an important contribution to the restoration of fiscal space over the medium term**. The budget for FY 2011/12 envisages a 0.6 percent of GDP increase in domestic revenues, as a result of efforts to begin streamlining numerous exemptions and investment incentives (MEFP ¶ 18) while also strengthening tax administration, following up on FAD technical assistance recommendations (text table and Box 1). To improve tax administration, the government is introducing a modern e-tax system, and establishment of the national identification system will contribute to reduced tax evasion. Significantly, Uganda will begin to catch up with Kenya and other partners by introducing guidelines to help the Uganda Revenue Authority (URA) manage transfer pricing situations. Looking forward, the authorities agree on the importance of eliminating additional tax exemptions and incentives FY 2012/13 and beyond (text table), recognizing the importance of avoiding a tax

competition "race to the bottom" within the EAC Common Market. Finally, the e-tax system—once it is in place—will facilitate direct provision of VAT refunds by URA.

Uganda: Measures to Enhance Revenue Performance

Revenue measures to become effective from the start of FY 2011/12:

Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods;

Streamline agricultural processing exemptions and 10-year export holiday under the CIT;

Eliminate government incentives for construction materials for hotels;

Eliminate investment trader regime under the VAT;

URA to issue and begin to enforce proposed transfer pricing guidelines; and

Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.

Revenue measures to become effective in FY 2012/13:

Introduce a capital gains tax on non-business assets of individuals;

Eliminate VAT exemptions on the following intermediate products:

► Supply of petroleum fuels subject to excise duty, except for kerosene (motor spirit, gas oil, spirit type jet fuel, kerosene type jet fuel, as well as residual oils for use in thermal power generation to the national grid);

► Supply of any goods and services to the contractor and subcontractors of hydro-electric power projects;

► Supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges construction, public water works, agriculture, education and health sectors; and

► Supply of computers, computer parts and accessories, computer software and software licenses, printers and accessories.

URA to begin to pay VAT refunds directly, rather than through budgetary appropriation.

Revenue measures to become effective in FY 2013/14:

Eliminate the following VAT exemptions:

► Supply of machinery used for the processing of agricultural or dairy products;

► Supply of packaging material exclusively used by the milling industry for packing milled products or used by the dairy industry for packing milk; and

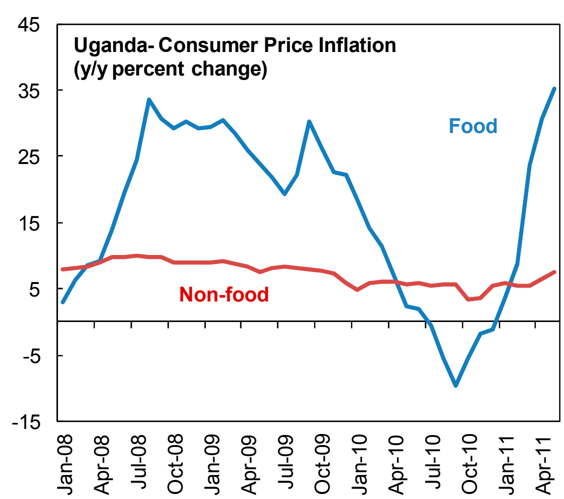
► Supply of feeds for poultry and livestock.

20. **The authorities intend to strengthen budget management through extensive revisions to the Public Finance and Accountability Act (PFAA).** Reform of the PFAA, which is Uganda's organic budget law, will focus on limiting the use of supplementary budgets to critical national emergencies and formalizing and tightening procedures for reallocating spending authority within a fiscal year. The new act is meant to address the issue of carrying forward unspent cash balances into a new fiscal year, strengthen internal controls to limit accumulation of arrears, and move in the direction of best international practice for securing ex ante parliamentary approval for classified expenditures (MEFP ¶ 13). The authorities are considering accelerating the budget preparation process (as has been done in Kenya) to ensure that Parliament has adequate time for approval of the budget prior to the start of the fiscal year.

21. **Unexpected receipt of early oil revenues has prompted the authorities to accelerate establishment of an appropriate oil revenue management framework.** Although oil will not flow at production levels for another 4-5 years, large capital gains receipts from the sale of oil exploration licenses are being paid to government. These revenues—expected to total about US$900 million—are being placed in a special subaccount at the central bank (precursor to a petroleum fund), and are earmarked to finance the large hydroelectric power project to be executed over the next four years (MEFP ¶ 21, 26). The resources belong to government and are not part of international reserves. They will be professionally managed by the central bank and be subject to quarterly public reporting. The authorities' handling of these receipts is a precursor to a more formal oil revenue management framework that will be integrated in the revised PFAA. A key feature of the framework will be a petroleum fund to safeguard oil revenues, spending of which will be effected according to strict criteria set by Parliament and only through the budget. Keen to avoid typical "resource curse" externalities, the authorities have requested and are receiving Fund technical assistance on establishment of this framework, drawing on the experience of other Fund member countries.

D. Monetary and Exchange Rate Policies

22. **Inflation has been driven predominantly by food prices, and the BoU wishes to avoid inflation contagion to the rest of the CPI basket.** Nonfood prices have been far more stable.[4] The authorities have tightened monetary policy since late last year, particularly by raising short-term interest rates by about 700 basis points. However, they expect that inflation will abate starting in June, as food prices are already declining with the start of the harvest season. If food prices do not abate as



[4] Food accounts for 27 percent of the CPI basket; about half of thi
inflation.

expected, the authorities have indicated that they will continue tightening to contain underlying inflation. Staff considers that—along with the food price shock—a much smaller component of Uganda's higher inflation reflects lagged effects of relatively accommodative monetary policy last year. The program targets a decline in broad and reserve money growth rates in 2011/12. Staff and the authorities agree on the need for vigilance going forward, and on the fact that more determined action on the part of the BOU may be needed.

23. **Monetary policy management has continued to face challenges stemming from unpredictable shifts in short-run fiscal policy.** Over the past two years, the BOU has generally been successful in implementing its reserve money program (RMP) flexibly to control inflation while stabilizing money market rates. However, liquidity management has been complicated by uneven execution of fiscal spending, leading to episodes of unintended tightening or loosening of liquidity conditions. Further, unexpected shifts in money demand have contributed to dissatisfaction with the quantity-based RMP framework, and the authorities are considering shifting their operational target away from base money to short-term interest rates. The authorities and staff agreed on the need to maintain a flexible exchange rate regime. The authorities expressed their commitment to continue to use foreign exchange intervention only to smooth out excess volatility in exchange rate movements.

24. **In particular, the BoU is considering moving to a form of inflation targeting "lite"** (ITL). Under their proposed framework—which would maintain the primary objective of keeping core inflation at around 5 percent over the medium term—the operating target would be a publicly-announced central bank interest rate centered on the seven-day interbank rate. As part of the proposed framework, the main tools of monetary policy would be secondary market operations (especially repos and reverse repos). Primary issues of government securities would not be used as an active tool of monetary policy, as responsibility for domestic debt management would be transferred to the ministry of finance. The central bank and the government would need to clarify financial relations between them, and formalize the current policy commitment to refrain from direct central bank financing of the deficit. Staff stressed the need for having a better understanding of the interest rate transmission mechanism, while enhancing liquidity management and forecasting. The authorities have sought technical assistance from the IMF on this issue, including with regard to central bank capital arrangements, which might need to be upgraded in tandem. Finally, the BoU is also working to upgrade its communication strategy to strengthen the link between central bank actions and inflationary expectations on the market.

E. External Sector

25. **Gross reserves coverage will be gradually rebuilt over the medium term.** The external sector outlook has worsened since the first review, reflecting higher energy prices and investor nervousness arising both from events in North Africa (some countries there have trade ties with Uganda) and particularly from political protests in Uganda that have occasionally turned violent in April and May. A modest drawdown in gross reserves of about US$51 million is expected in FY 2011/12, bringing the stock to around 3.2 months worth of the following year's goods and services imports. However, in large part this decline stems

from the composition of domestic financing of infrastructure projects (use of the shilling-denominated Energy Fund creates pressure on the foreign exchange market that use of the dollar-denominated Petroleum Fund does not). It also reflects the agreed schedule for repayment by government to the BoU of past advances for exceptional spending (government will undertake the last approximately $140 million out of domestic revenues in FY2011/12 out of domestic revenues, and will repay about $100 million per year to BoU for 6 years thereafter). Excluding the capital imports financed by foreign exchange resources that are not counted in reserves, reserve coverage is reduced to around 3.6 months of next year's imports, gradually recovering to 3.9 months by FY2014/15. This relatively conservative accumulation path reflects more cautious current assumptions about the provision of donor assistance and overall capital inflows over the medium term. [5] Finally, based on the experience of recent years, it is likely that some of the planned infrastructure spending will end up being delayed, with the result that the outturn for reserve cover may well prove to be more favorable than is presented here.

F. Financial Sector

26. **The mission highlighted the risks stemming from the rapid increase in private sector credit and encouraged the BoU to monitor closely bank balance sheets**. The BoU, reassured by the increase in bank profitability in 2010, was confident that banking sector health is improving. It indicated that there has been no indication in the data of risks from the rapid increase in credit growth. The authorities also noted that banks are now better capitalized with the introduction of new higher minimum capital requirements.[6] The share of nonperforming loans in total loans (NPLs) declined to 2.1 percent in 2010, from 4.2 percent in 2009, and banking sector profitability and average return on assets improved across banks (Table 7), however, owing to rapid expansion of branch networks, some (mainly smaller) banks continue to make losses.

27. **However, the authorities concurred on the need for close monitoring of bank portfolios in light of uncertainty from rising inflation and exchange rate volatility**. The BoU has begun to use new stress testing techniques developed with the assistance of MCM, and found no signs of heightened risk. The authorities remain, however, vigilant and ready to act quickly to prevent any banking sector weaknesses from spreading, if and when they arise.

28. **The new pension regulatory bill paves the way for future reforms in the nonbank financial sector**. The long-awaited bill, previously a structural benchmark under

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[5] The framework also does not include oil production revenues, which should commence in 3-4 years, since the amount of production is still under debate. While such revenues will be earmarked for infrastructure projects, and thus will not count in international reserves, they will nevertheless represent foreign exchange resources that the government can use for specified imports.

[6] By end-March 2011, all banks had complied with the new minimum capital regulations, which raised the floor on paid-up capital for existing banks to Ush 10 billion (US$4.2 million). The new regulations require all new banks to have a minim capital of Ush 25 billion (US$10.4 million) and allow existing banks until March 2013 to meet this higher requirement.

the PSI, was passed by Parliament in April 2011. The new bill creates an independent regulatory authority for the pension sector, including for the public National Social Security Fund (NSSF). Future reforms of the pension sector are expected to allow for increased competition and free entry and exit of private pensions.

29. **Progress in enhancing the supervision of nonbank financial institutions beyond the pension sector, notably the insurance sector, has been slow**. Recent efforts by BoU to improve supervision of deposit-taking microfinance institutions (MDIs) have been met with resistance by the sector. An FSAP update, planned for late August, will explore these issues in detail.

G. External Borrowing

30. **A debt sustainability analysis (DSA)—conducted jointly with the World Bank—continues to show that Uganda remains well below debt distress thresholds.** In the baseline scenario, in the long run, the present value (PV) of public and publicly-guaranteed debt-to-GDP ratio stabilizes at about 20 percent, even with the current infrastructure investment drive, and the PV of debt-to-exports ratio plateaus at about 80 percent. This assessment is robust to the standard shocks. Debt is also sustainable on the fiscal side, with the most worrisome shock being a permanent negative blow to growth. The DSA scenarios do not encompass significant oil revenue flows, given the still large degree of uncertainty regarding their timing and size. The DSA next year is expected to present an explicit oil scenario, which should further improve the debt sustainability outlook.

31. **The authorities are requesting an increase in the nonconcessional borrowing (NCB) ceiling**—from US$500 million to US$800 million. This would allow room for such borrowing foreseen during the remainder of the PSI program period – in light of the authorities' commitment to use this for infrastructure scaling up in line with the NDP, and the ample borrowing room implied by the DSA, staff supports this request: most of the current ceiling has been used up, and the authorities will need further space as they move to ramp up infrastructure spending in line with the NDP.[7] The authorities consider that gradually raising the ceiling would support fiscal discipline and promote careful project appraisal and selection. Staff emphasized the importance of strengthening processes for project selection, appraisal and implementation to ensure good value for the money and to maximize the growth return on infrastructure investment.

32. **A publicly-owned financial institution, Housing Finance Bank (HFB), is proposed to be excluded from the external nonconcessional borrowing (NCB) ceiling—** on the grounds that it is a commercially-run concern, poses little or no fiscal risk to the government, and can borrow without government guarantee. HFB proposes to borrow about

[7] Use of the ceiling is based on contracting, while the macroeconomic framework reflects disbursements of the loans. US$460 million has been contracted so far, although the loans from Chinese lenders (US$100 million for road construction equipment and US$350 million for the new Kampala-Entebbe toll road) just barely miss the 35 percent grant element needed to qualify as concessional.

US$30 million from the African Development Bank (AfDB) and Agence Française de Développement (AFD) to support mortgage and housing development. Staff is confident that the bank satisfies the requirements set out in the *Staff Guidance Note on Debt Limits in Fund-Supported Programs*, and has explained to the authorities (as well as HFB) that, should this assessment change at future reviews, new borrowing by HFB would again need to be captured under the NCB ceiling.[8]

IV. PROGRAM ISSUES

33. **The authorities have requested waivers for the nonobservance of the quantitative assessment criteria (QACs) on NIR and NDA**. As mentioned above, they explain that the deviation was due mainly to the timing of exceptional security-related spending, and does not signify a shift in the stance of policy for the year as a whole. In addition, by way of corrective actions, the monetary policy stance has been tightened since end-December, and fiscal policy will be tightened in FY2011/12 and in the medium term, including the revenue measures discussed above. On this basis, staff supports their request for a waiver, also noting the authorities' willingness to undertake corrective actions to strengthen the fiscal position going forward in response to the concerns raised at the time of the first PSI review.

34. **New QACs for end-June and end-December 2011 (test dates for the third and fourth reviews under the PSI), and supportive structural measures, are presented in the authorities' MEFP** (Attachment I to the Minister's Letter of Intent). QACs were not established for end-June at the first review, but were left as indicative targets given the potential slippage implied by the supplementary spending authorized in January. The authorities also ask that state-owned Housing Finance Bank be excluded from the ceiling on nonconcessional borrowing under the PSI.

35. **The key risk to the program is the possibility that expenditure arrears may have accrued as a result of tight cash limits imposed this fiscal year.** Data on possible arrears will not be available for some months. If there are arrears, they could put pressure on execution of the FY2011/12 budget. The authorities acknowledge that their cash-based PFM system should be strengthened in key areas, such as more realistic budgeting and a stricter commitment control system. This would ensure that spending execution is more consistent with spending priorities as laid out by Parliament. They are taking steps to address these concerns, most prominently by amending the PFAA, but also by strengthening data reporting on unpaid obligations of spending units and introducing direct Treasury payments ("straight-through payments") for electricity and water bills of government agencies.

36. **Another risk to the program is that inflation may be higher or abate more slowly than currently foreseen**. This could have a significant social impact, particularly considering Uganda's lack of a formal social safety net. The World Bank is working with

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[8] See http://www.imf.org/external/np/pdr/conc/, Annex 3.

the authorities to devise possible options for targeted spending that could be absorbed within the existing budget, and could help alleviate the impact on the most vulnerable. Other risks include: delays in securing donor financing, and the impact on investor sentiment of any further political turmoil. Finally, execution of infrastructure projects may take longer than assumed given capacity constraints: this would result in lower fiscal deficits.

V. Staff Appraisal

37. **The programmed adjustment of fiscal and monetary policies will help put Uganda on a more sustainable medium term trajectory**. It will be important for the authorities to rebuild those policy buffers that contributed to macroeconomic stability over the past two years. In particular, exceptional security-related spending will end early in the fiscal year, affording some badly-needed fiscal space while ceasing pressure on reserves.

38. **Staff encourages the authorities to act decisively to tighten the stance of monetary policy if inflationary outcomes continue to outpace expectations**. Much of the spike in headline CPI can be attributed to food and fuel prices, but there is a domestic component. The BoU will need to remain vigilant to the risk that accommodation of the first round effects of these price shocks could spill over into underlying core inflation. This will require better coordination of short-term liquidity management and the cash management needs arising from budget execution. Looking forward, staff cautions against moving too quickly to change the monetary policy framework. ITL may be appropriate in the future, but the current juncture, with inflation well outside the authorities' target range, is unlikely to be the most propitious time for this shift in policy.

39. **Eliminating tax exemptions and incentives is the right way to address Uganda's revenue gap**. Many exemptions in the VAT are on goods that are mainly used as *intermediate* inputs, rather than for final consumption, thus undermining the logic of the VAT. These statutory exemptions—like the myriad investment incentives under the corporate income tax and those ad hoc tax breaks granted by government directly—vastly complicate the work of the URA, provide scope for abuse and tax evasion, and contribute to an uneven playing field within the EAC Common Market. Importantly, the effectiveness of such exemptions in achieving investment or other social objectives is never carefully assessed, highlighting the need to establish a formal "tax expenditure budget" process.

40. **Stronger processes for investment project selection will be critical for maximizing the growth return from higher infrastructure spending**. Infrastructure gaps are a key bottleneck to growth. Plans to improve spending efficiency through better public financial management must be combined with robust processes for project planning, appraisal and implementation to ensure good value for money. Otherwise, an important opportunity will have been missed to ameliorate Uganda's sustained growth outlook.

41. **Similarly, improving the realism of the budget is important to limit the accumulation of expenditure arrears**. The planned revision of the PFAA is an opportunity to address this issue, as well as other weaknesses in the PFM system, including by devising a way to ensure that classified expenditures are subject to ex ante parliamentary approval.

Establishment of an appropriate oil revenue management framework within the PFAA will be a top priority for government in FY 2011/12. Staff welcomes the authorities' commitment to establish a credible framework to monitor arrears accumulation.

42. **The authorities' planned oil revenue management framework is encouraging**. The draft plan, which is to be implemented in the context of revision to the PFAA, establishes clear roles and responsibilities for the various actors: parliament, ministry of finance, Bank of Uganda, and institutes strict requirements for transparency and accountability. Uganda's oil wealth would be invested in infrastructure—exclusively through the budget and subject to parliamentary approval—but savings would be managed professionally subject to clear investment criteria.

43. **Staff welcomes parliamentary approval of the bill creating a regulatory framework for the pension sector, as an initial step to strengthen oversight of the non-bank financial sector.** Banks in Uganda are well-regulated and generally profitable. But some components of the nonbank financial sector, albeit still small, could pose risks to stability down the road. The upcoming FSAP is an important chance to identify nascent challenges to systemic stability and to discuss possible steps to head them off at an early stage.

44. **Staff recommends completion of the second review under the PSI.** Staff supports the authorities' request for waivers for nonobservance of two QACs at end-December and establishment of QACs for end-June and end-December 2011. Structural reforms are advancing, and staff supports the authorities' proposed structural benchmarks, which aim to boost revenue and strengthen public financial management.

Table 1. Uganda: Selected Economic and Financial Indicators, FY2008/09–2013/14 [1]

	2008/09	2009/10	2010/11 Proj.	2011/12 Proj.	2012/13 Proj.	2013/14 Proj.	2014/15 Proj.
GDP and prices (percent change)							
Real GDP	7.2	5.2	6.4	6.6	7.0	7.0	7.0
GDP Deflator	14.6	9.1	5.4	10.7	6.4	5.0	5.0
CPI (end of period)	12.3	4.2	15.0	7.2	6.5	5.0	5.0
CPI (average)	14.2	9.4	6.4	12.5	6.4	5.2	5.0
Core inflation (average)	12.5	7.8	6.1	10.1	6.3	4.8	4.9
External sector (percent change)							
Terms of trade (Based on commodities, deterioration –)	18.8	24.5	12.4	-13.9	-10.7	-6.5	0.1
Terms of trade (based on all exports, deterioration -)	18.2	9.8	14.0	-5.8	-2.2	-0.5	1.2
Real effective exchange rate (depreciation –)	…	0.2	-4.7	--	--	--	--
Money and credit (percent change)							
Broad money (M2)	26.3	30.3	25.3	24.2	18.6	17.0	17.0
Credit to the central government [2]	9.4	12.9	-6.8	8.0	6.3	4.5	0.5
Private sector credit	31.6	25.3	35.3	30.8	21.4	20.6	20.7
Savings and investment gap (percent of GDP)	-10.4	-11.3	-12.7	-11.7	-10.1	-9.3	-7.0
Domestic investment	23.5	24.3	25.3	27.9	29.5	28.6	27.0
Public	5.4	6.6	7.7	10.3	11.6	10.6	8.8
Private	18.0	17.7	17.6	17.6	17.8	18.0	18.2
External sector (percent of GDP)							
Current account balance (excluding grants)	-10.4	-11.3	-12.7	-11.7	-10.1	-9.3	-7.0
Net donor inflows	4.0	4.6	4.8	4.4	3.9	3.6	2.9
Public External debt (including Fund)	13.8	15.5	17.7	19.1	23.5	28.3	30.6
External debt-service ratio [3]	2.0	1.9	1.5	1.7	2.1	2.1	2.4
Government budget and debt (percent of GDP)							
Revenue	12.5	12.4	13.1	13.8	14.0	14.2	14.4
Grants	2.6	2.5	3.1	2.5	2.0	1.9	1.7
Total expenditure and net lending	-17.3	-19.8	-23.7	-21.2	-22.2	-21.0	-19.0
Overall balance (including grants)	-2.2	-4.9	-7.5	-5.0	-6.2	-5.0	-2.9
Stock of domestic debt	8.4	9.4	12.0	10.8	8.8	6.8	4.3
Memorandum items:							
Nominal GDP (U Sh billions)	30,101	34,530	38,730	45,681	52,027	58,452	65,671
Average exchange rate (U Sh per US$)	1,905	2,030	…	…	…	…	…
Gross foreign exchange reserves							
(months of next year's imports of goods and services)	5.1	4.7	3.4	3.2	3.4	3.7	3.8
(excl. large infrastructure projects) [4]	**5.1**	**4.7**	**3.5**	**3.4**	**3.6**	**3.8**	**3.9**

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

1 Fiscal year begins in July.

2 Percent of M3 at start of the period. Oil capital gains is included in FY10/11.

3 Percent of exports of goods and nonfactor services.

4 Excluding imports associated with capital spending financed by petroleum fund.

Table 2. Uganda: Fiscal Operations of the Central Government, FY2008/09–2014/15 [1]

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
			Proj.	Proj.	Proj.	Proj.	Proj.
				(USh Billions)			
Total revenue and grants	4,546	5,136	6,275	7,420	8,324	9,401	10,573
Revenue	3,758	4,273	5,066	6,285	7,280	8,308	9,426
Tax	3,560	4,067	4,818	6,002	6,978	8,004	9,122
International trade taxes	361	352	441	503	579	650	735
Income taxes	1,094	1,361	1,635	2,161	2,540	2,906	3,307
Excises	921	1,025	1,111	1,340	1,562	1,817	2,048
Value-added tax	1,184	1,329	1,630	1,832	2,095	2,394	2,765
Additional revenue effort	0	0	0	167	202	237	267
Nontax	198	206	248	283	302	304	304
Grants	787	863	1,209	1,136	1,044	1,093	1,146
Budget support	531	467	505	488	538	534	540
Project grants	257	396	704	647	506	559	607
Expenditures and net lending	5,205	6,836	9,162	9,705	11,556	12,297	12,455
Current expenditures	3,291	4,308	5,749	4,838	5,352	5,972	6,530
Wages and salaries	1,184	1,308	1,639	1,758	2,029	2,368	2,561
Interest payments	357	386	409	441	607	515	471
Other current	1,750	2,614	3,700	2,639	2,716	3,089	3,497
o/w exceptional security		437	990	268			
Development expenditures	1,688	2,312	3,033	4,743	6,089	6,211	5,810
Donor-supported projects	481	889	1,592	1,819	1,875	2,008	2,152
Government of Uganda investment	1,207	1,423	1,441	2,924	4,214	4,203	3,658
o/w Karuma			181	858	1,047	918	917
o/w Oil Refinery			…	15	682	798	0
o/w Kampala-Entebbe highway			…	171	907	309	272
Net lending and investment	-57	-37	-57	-40	-34	-36	-35
Other spending [2]	283	253	437	164	150	150	150
Overall balance							
Including grants	-660	-1,699	-2,887	-2,284	-3,232	-2,896	-1,882
Excluding grants	-1,447	-2,562	-4,096	-3,420	-4,276	-3,989	-3,029
Including grants, excluding large infra spending 3/	**-660**	**-1,699**	**-2,887**	**-1,455**	**-2,185**	**-1,978**	**-1,571**
Financing	658	1,507	2,888	2,284	3,232	2,896	1,882
External financing (net)	592	758	951	1,355	2,317	2,105	1,697
Disbursement	746	919	1,125	1,538	2,535	2,337	1,979
Budget support	233	236	237	122	130	137	144
Concessional project loans	513	683	888	1,172	1,369	1,449	1,545
Non-concessional borrowing				244	1,036	752	289
Amortization (–)	-126	-135	-156	-171	-205	-229	-277
Exceptional financing 2//	-29	-26	-19	-13	-14	-4	-5
Domestic financing (net)	66	749	1,937	929	915	792	185
Bank financing	475	811	1,545	829	815	692	85
o/w Bank of Uganda	277	473	1,796	829	815	692	85
o/w Petroleum fund withdrawals			0	316	1,047	918	311
o/w Energy Fund drawdowns			0	513			
o/w Bank of Uganda Repayments			0	0	-231	-226	-226
o/w commercial banks	198	338	-252	0	0	0	0
Nonbank financing	-409	-62	392	100	100	100	100
Errors and omissions/financing gap	-2	-193	0	0	0	0	0
Memorandum Items:				--			
Petroleum revenue fund (US$ million)							
Inflows (including interest)			909	27	24	13	3
Petroleum fund withdrawals			--	129	404	336	108
Stock at end period			909	807	427	105	-
Rev, including petroleum revenue inflows (Ush bils)	3,758	4,273	7,178	6,352	7,343	8,343	9,435
Overall bal, incl. grants and petr. rev. inflows (Ush bils)	-660	-1,699	-775	-2,217	-3,169	-2,861	-1,873

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

[1] Fiscal year begins in July.

[2] Includes arrears.

[3] Excludes spending financed by petrol/energy funds.

Table 2. Uganda: Fiscal Operations of the Central Government, FY2008/09–2014/15 [1] (concluded)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
			Proj.	Proj.	Proj.	Proj.	Proj.
			(Percent of GDP)				
Total revenue and grants	15.1	14.9	16.2	16.2	16.0	16.1	16.1
Revenue	12.5	12.4	13.1	13.8	14.0	14.2	14.4
Tax	11.8	11.8	12.4	13.1	13.4	13.7	13.9
International trade taxes	1.2	1.0	1.1	1.1	1.1	1.1	1.1
Income taxes	3.6	3.9	4.2	4.7	4.9	5.0	5.0
Excises	3.1	3.0	2.9	2.9	3.0	3.1	3.1
Value-added tax	3.9	3.8	4.2	4.0	4.0	4.1	4.2
Additional revenue effort	0.0	0.0	0.0	0.4	0.4	0.4	0.4
Nontax	0.7	0.6	0.6	0.6	0.6	0.5	0.5
Grants	2.6	2.5	3.1	2.5	2.0	1.9	1.7
Budget support	1.8	1.4	1.3	1.1	1.0	0.9	0.8
Project grants	0.9	1.1	1.8	1.4	1.0	1.0	0.9
Expenditures and net lending	17.3	19.8	23.7	21.2	22.2	21.0	19.0
Current expenditures	10.9	12.5	14.8	10.6	10.3	10.2	9.9
Wages and salaries	3.9	3.8	4.2	3.8	3.9	4.1	3.9
Interest payments	1.2	1.1	1.1	1.0	1.2	0.9	0.7
Other current	5.8	7.6	9.6	5.8	5.2	5.3	5.3
o/w exceptional security		1.3	2.6	0.6			
Development expenditures	5.6	6.7	7.8	10.4	11.7	10.6	8.8
Donor-supported projects	1.6	2.6	4.1	4.0	3.6	3.4	3.3
Government of Uganda investment	4.0	4.1	3.7	6.4	8.1	7.2	5.6
o/w Karuma			0.5	1.9	2.0	1.6	1.4
o/w Oil Refinery			…	0.0	1.3	1.4	0.0
o/w Kampala-Entebbe highway			…	0.4	1.7	0.5	0.4
Net lending and investment	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other spending [2]	0.9	0.7	1.1	0.4	0.3	0.3	0.2
Overall balance							
Including grants	-2.2	-4.9	-7.5	-5.0	-6.2	-5.0	-2.9
Excluding grants	-4.8	-7.4	-10.6	-7.5	-8.2	-6.8	-4.6
Including grants, excluding large infra spending 3	**-2.2**	**-4.9**	**-7.5**	**-3.2**	**-4.2**	**-3.4**	**-2.4**
Financing	2.2	4.4	7.5	5.0	6.2	5.0	2.9
External financing (net)	2.0	2.2	2.5	3.0	4.5	3.6	2.6
Disbursement	2.5	2.7	2.9	3.4	4.9	4.0	3.0
Budget support	0.8	0.7	0.6	0.3	0.2	0.2	0.2
Concessional project loans	1.7	2.0	2.3	2.6	2.6	2.5	2.4
Non-concessional borrowing	0.0	0.0	0.0	0.5	2.0	1.3	0.4
Amortization (–)	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Exceptional financing [2]	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Domestic financing (net)	0.2	2.2	5.0	2.0	1.8	1.4	0.3
Bank financing	1.6	2.3	4.0	1.8	1.6	1.2	0.1
o/w Bank of Uganda	0.9	1.4	4.6	1.8	1.6	1.2	0.1
o/w Petroleum fund withdrawals			0.0	0.7	2.0	1.6	0.5
o/w Energy Fund drawdowns			0.0	1.1			
o/w Bank of Uganda Repayments			0.0		-0.4	-0.4	-0.3
o/w commercial banks	0.7	1.0	-0.7	0.0	0.0	0.0	0.0
Nonbank financing	-1.4	-0.2	1.0	0.2	0.2	0.2	0.2
Errors and omissions/financing gap	0.0	-0.6	0.0	0.0	0.0	0.0	0.0
Memorandum Items:							
Petroleum revenue fund (US$ million)							
Inflows (including interest)			5.5	0.1	0.1	0.1	0.0
Petroleum fund withdrawals			0.0	0.7	2.0	1.6	0.5
Stock at end period			5.5	4.3	2.1	0.5	0.0
Revenue, including petroleum revenue inflows	12.5	12.4	18.5	13.9	14.1	14.3	14.4
Overall bal, incl. grants and petrol rev. inflows	-2.2	-4.9	-2.0	-4.9	-6.1	-4.9	-2.9
Nominal GDP (Ush bils)	30,101	34,530	38,730	45,681	52,027	58,452	65,671

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

[1] Fiscal year begins in July.

[2] Includes arrears.

[3] Excludes spending financed by petrol/energy funds.

Table 3. Uganda: Monetary Accounts, FY2008/09–2013/14 [1]
(U Sh billions; end of period, unless otherwise indicated)

	2008/09	2009/10		2011/12	2012/13	2013/14	2014/15
			Proj.	Proj.	Proj.	Proj.	Proj.
			Monetary survey				
Net foreign assets	5,711	6,384	7,919	7,830	8,020	8,312	9,206
Net domestic assets	586	1,909	2,416	5,002	7,203	9,504	11,644
Claims on public sector (net) [2]	-545	284	-284	545	1,360	2,051	2,137
Claims on government (net)	-580	231	-337	492	1,306	1,998	2,083
excluding oil revenue inflows		231	1,775	…	…	…	…
Claims on private sector	3,599	4,510	6,103	7,983	9,690	11,688	14,111
Other items (net) [3]	-2,468	-2,885	-3,403	-3,526	-3,847	-4,235	-4,604
Money and quasi-money (M3)	6,298	8,293	10,335	12,832	15,223	17,816	20,850
Broad money (M2)	4,921	6,412	8,033	9,974	11,832	13,847	16,206
Foreign exchange deposits	1,377	1,881	2,302	2,858	3,391	3,969	4,644
			Bank of Uganda (BOU)				
Net foreign assets	5,119	5,741	6,965	6,718	6,759	6,892	7,605
Net domestic assets	-3,169	-3,307	-3,846	-2,856	-2,212	-1,578	-1,393
Claims on public sector (net) [2]	-2,145	-1,672	-1,988	-1,159	-344	348	433
Claims on government (net)	-2,145	-1,672	-1,988	-1,159	-344	347	433
Claims on commercial banks	124	-51	99	99	99	97	95
Other items (net) [3]	-1,148	-1,584	-1,957	-1,796	-1,966	-2,022	-1,920
Base money	1,950	2,434	3,119	3,862	4,548	5,315	6,212
Currency outside banks plus cash in vaults	1,469	1,739	2,276	2,826	3,324	3,891	4,553
Commercial bank deposits with BOU	482	695	843	1,036	1,223	1,424	1,659
Memorandum items:			(12-month change, percent)				
Base money	20.8	24.8	28.1	23.8	17.8	16.9	16.9
M3	25.0	31.7	24.6	24.2	18.6	17.0	17.0
Credit to the private sector	31.6	25.3	35.3	30.8	21.4	20.6	20.7
			(Units indicated)				
M0-to-GDP ratio (percent)	6.5	7.0	8.1	8.5	8.7	9.1	9.5
M3-to-GDP ratio (percent)	20.9	24.0	26.7	28.1	29.3	30.5	31.7
Base money multiplier (M2/base money)	2.52	2.63	2.58	2.58	2.60	2.61	2.61
Credit to the private sector (percent of GDP)	12.0	13.1	15.8	17.5	18.6	20.0	21.5
Gross reserves of BOU (US$ millions)	2,442	2,498	1,877	1,826	2,086	2,302	2,517

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.

Table 4. Uganda: Balance of Payments, FY2008/09-2013/14 [1]

	2008/09	2009/10	2010/11 Proj.	2011/12 Proj.	2012/13 Proj.	2013/14 Proj.	2014/15 Proj.
				(US$ millions)			
Current account	-1,238	-1,490	-694	-1,716	-1,616	-1,580	-1,199
Trade balance	-1,846	-1,698	-2,018	-2,209	-2,239	-2,387	-2,266
Exports, f.o.b.	2,216	2,317	2,481	2,611	2,903	3,203	3,580
Of which: coffee	337	262	313	336	353	371	390
Imports, f.o.b.	-4,062	-4,015	-4,499	-4,820	-5,142	-5,590	-5,847
Of which: oil	-537	-486	-499	-613	-667	-725	-787
Of which: government, infrastructure related		-171	-386	-692	-836	-945	-813
Services (net)	-440	-570	-640	-504	-354	-213	-29
Income (net)	-287	-290	-221	-243	-261	-296	-276
Of which: interest on public debt	-24	-29	-32	-33	-45	-55	-66
Transfers	1,335	1,068	2,186	1,240	1,239	1,316	1,371
Private transfers	933	643	757	775	836	916	974
Of which: workers' remittances (inflows)	897	851	894	962	1,034	1,108	1,188
Official transfers	401	425	1,430	465	403	400	397
Of which: budget support	224	189	167	150	157	133	134
project support	135	195	303	265	195	205	210
capital gains tax			910	0	0	0	0
Capital and financial account	1,250	1,439	450	1,623	1,854	1,787	1,394
Capital account	0	0	0	0	0	0	0
Financial account	1,250	1,439	450	1,623	1,854	1,787	1,394
Foreign direct and portfolio investment	727	731	790	1,150	1,180	1,275	1,386
Other investment	522	708	-341	473	674	513	8
Medium- and long-term	577	563	-477	702	1,170	1,304	947
Of which:							
Public sector (net)	322	386	-493	689	1,153	1,282	909
SDR allocation		224	0	0	0	0	0
Build-up/drawdown of petroleum fund		0	-910	129	404	336	108
Disbursements	388	453	484	759	1,232	1,366	1,005
Project support	270	337	382	580	778	980	847
Budget support	118	116	102	50	50	50	50
Non-concessional borrowing		0	0	100	250	450	312
Amortization due	-65	-67	-67	-70	-79	-84	-96
Private sector (net)	255	177	15	13	17	22	38
Short-term	-55	145	136	169	-72	-312	-489
Errors and omissions	-58	121	-372	0	0	0	0
Overall balance	-47	70	-616	-38	274	237	230
Financing	47	-70	616	38	-274	-237	-230
Central bank net reserves (increase = –)	62	-57	620	49	-261	-218	-216
Memorandum items:							
Net donor support	684	770	-8	881	594	372	495
Of which: budget support	342	305	269	200	207	183	184
project support	404	532	685	845	973	1,185	1,057
Current account balance (percent of GDP)	-7.3	-8.8	-4.2	-9.2	-8.1	-7.4	-5.3
Trade balance (percent of GDP)	-10.9	-10.0	-12.1	-11.8	-11.2	-11.2	-10.0

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 December 2010 [1]

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

	December 31 2010			
	31-Dec Prog.	31-Dec Adjus. Target	31-Dec Actual	
	Billions of Uganda Shillings			
Assessment criteria				
Ceiling on the increase in net domestic assets of the Bank of Uganda [3]	362	52.9	344.6	Not observed
Ceiling on the increase in net claims on the central government by the banking system [3]	771	229	218	Observed
	(Millions of U.S. dollars unless otherwise specified)			
Ceiling on the stock of external payments arrears incurred by the public sector [4]	0	0	0	Observed
Ceiling on the contracting or guaranteeing of new nonconcessional external debt with maturities greater than one year by the public sector [4 5]	500	500	110	Observed
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector [4 6]	0	0	0	Observed
Minimum increase in net international reserves of the Bank of Uganda (US$mn)	-48	87.6	-34	Not observed
Indicative target	(Billions of Uganda shillings)			
Ceiling on the increase in base money liabilities of the Bank of Uganda [3]	302	302	450	Not observed
Stock of domestic budgetary arrears under the Commitment Control System (CCS) [7]	…	…		
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	689	689	648.3	Not observed

[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] Cumulative changes are from June 2010 (averages for NDA and BM), as defined in the TMU.

[4] Continuous assessment criterion.

[5] To be used exclusively for infrastructure investment projects. Cumulative change from May, 2010.

[6] Excluding normal import-related credits.

[7] Monitored annually.

Table 6. Uganda—Current Structural Benchmarks Under the PSI
Status of Implementation

Policy Measure	Macroeconomic rationale	Date	Status
Fiscal Sector			
Implement pilot Integrated Personnel and Payroll System (IPPS) in four (4) commissions four (4) ministries, judiciary (courts and judicature) and two (2) local governments	Strengthen oversight and control of public payroll	December 31, 2010	Met with Delay.
Report on the implementation of mandatory rotation of accountants and procurement officers	Enhance governance and accountability	December 31, 2010	Partly met.
Undertake an inventory of existing government accounts and close immediately those which are no longer justified by a current project or legitimate activity	Enhance transparency and monitoring of public finances	December 31, 2010	Met.
Prepare and include in Budget Framework Paper (BFP) a detailed report on actual and paid consumption of electricity and water, broken down by individual spending unit at the central government level, for FY2007/08, FY2008/09, and FY2009/10	To facilitate introduction of "straight-through payments" (STP) system in FY2011/12 (see measure below).	April 1, 2011	Met.
In the context of the BFP, announce a detailed workplan and timetable for introduction of the National Identification System—including building an interface with URA records—by 2012	To enhance tax administration and facilitate the combating of money laundering and the financing of terrorism.	April 1, 2011	Met.
In the context of the BFP, the Minister will report full information to Parliament on the amounts of the exceptional spending	To enhance fiscal management and transparency.	April 1, 2011	Met.
Begin submitting to Cabinet regular quarterly reports on unpaid bills of spending units, based on data in the Commitment Control System (CCS) for the previous quarter of the financial year	To facilitate control and elimination of government expenditure arrears.	April 1, 2011	Not met.
Extend the "straight-through payment" system (STP) now employed for pensions to the utility sector (electricity, water, telephone, and rental payments)	Help control accumulation of arrears	June 30, 2011	Pending.
Other			
Develop a set of high frequency indicators designed to capture activity and demand in the formal sector of the economy	Enhance macroeconomic information	March 31, 2011	Met.

Table 7. Banking Sector Indicators

	Dec-08	Jun-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Regulatory capital to risk-weighted assets	20.7	21.1	20.9	22.7	21.7	21.2	20.2	21.2
Regulatory tier 1 capital to risk-weighted assets	18.7	19.3	18.7	19.9	19.2	18.8	17.5	18.9
NPLs to total gross loans	2.2	4.0	4.2	3.7	3.3	2.8	2.1	2.5
NPLs to total deposits	1.6	2.8	3.0	2.5	2.1	1.8	1.4	1.7
Earning assets to total assets	75.6	79.0	78.0	82.4	74.9	76.7	77.1	73.6
Large exposures to gross loans	31.0	30.4	32.2	41.0	35.4	35.5	35.7	38.6
Large exposures to total capital	106.9	99.2	94.3	123.9	112.8	116.1	124.4	129.8
Return on assets	4.0	3.1	2.0	2.3	3.0	2.4	3.0	3.3
Return on equity	27.7	20.3	12.7	14.8	20.2	16.9	21.3	22.9
Net interest margin	11.3	10.7	10.2	10.0	9.8	10.0	10.3	10.5
Liquid assets to total deposits	48.1	42.2	44.7	45.5	41.6	40.5	39.8	40.5
Interbank borrowings to total deposits	9.3	8.2	5.9	3.4	1.8	1.9	1.7	2.6
Forex exposure to regulatory tier 1 capital	-1.4	-2.9	-0.7	-3.0	-3.5	-11.8	-1.6	-2.1
Forex loans to forex deposits	65.5	57.3	57.9	59.2	52.1	54.4	65.2	63.4
Forex assets to forex liabilities	102.7	109.8	107.0	101.1	98.4	96.3	98.0	98.1

APPENDIX. LETTER OF INTENT

June 15, 2011

Mr. John Lipsky
Acting Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Lipsky:

On behalf of the Government of Uganda, I would like to provide you with an update on the progress we have made under our program backed by the IMF's Policy Support Instrument (PSI).

As you know, the Executive Board of the IMF was not able to complete the first review under the PSI. However, I am pleased to inform you that we have taken measures since that time to address the concerns of the Executive Board, and we remain fully committed to the policy objectives the PSI aims to support.

Growth has rebounded, notwithstanding some new challenges. The recovery in economic activity has been particularly strong in service and trading sectors. However, inflation has picked up, owing mainly to higher international fuel prices and to a spike in food prices within Uganda that relate to drought conditions and to robust demand for Ugandan food products from our neighbors. I wish to note that—as was the case during the 2008 round of higher food prices—Uganda has refrained from taking any steps to limit food exports to keep domestic prices low. We aim to be the breadbasket of East Africa, and are deeply committed to maintaining a liberal trade regime in the region.

We missed two of the six assessment criteria at end-December 2010 (net international reserves and net domestic assets), and request waivers for the nonobservance of these two targets. These targets were missed because some of the exceptional spending, which we had expected to take place in the second half of the fiscal year, actually had to be effected in December. While regrettable, this shift in the timing of payments had no impact on the full year cost of the exceptional spending. Looking ahead, we request the establishment of quantitative assessment criteria for end-June 2011 and end-December 2011, as set out in the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU) that is a part of the MEFP.

The MEFP sets out the Government's objectives and policies for the coming financial year. These are drawn from our National Development Plan (NDP), and emphasize the importance of scaling up infrastructure development to clear the most critical bottlenecks to growth and poverty reduction. The government is taking measures to tighten fiscal and monetary policies in the short run to contain inflationary pressures, and to strengthen the macroeconomic policy framework for the medium-term, to enable the scaling up of infrastructure spending while rebuilding gross international reserves in line with the PSI objectives.

The Government believes the policies set forth in the MEFP are fully sufficient to achieve the objectives of our PSI-supported program, but we as always stand ready to take any further measures that may become appropriate for this purpose. We intend to work with the IMF and other development partners in the implementation of our program, and will consult with Fund staff in advance should revisions to the policies contained in the PSI be contemplated by Government.

Sincerely yours,

/s/

Ms. Maria Kiwanuka
Minister of Finance
Ministry of Finance, Planning and Economic Development

cc: Governor Emmanuel Tumusiime-Mutebile, Bank of Uganda

Attachment I. Memorandum of Economic and Financial Policies
June 15, 2011

I. INTRODUCTION

1. Peaceful elections were successfully conducted on February 18, 2011, providing President Museveni and the ruling National Resistance Movement with a strong mandate for the coming five years. A key element of the new mandate will be to implement the National Development Plan (NDP), particularly the effort to begin closing the infrastructure gap without losing sight of our immediate poverty reduction objectives.

Purpose of the MEFP

2. This memorandum updates Uganda's economic program under the three-year Policy Support Instrument (PSI) for the period 2010-13, approved by the IMF Executive Board on May 12, 2010. The first review of the PSI was not completed. However, the authorities have taken the necessary steps to address the issues which prevented the completion of the first review and request that the Executive Board completes the second review.

3. This memorandum outlines the performance of the economy to date during the 2010/11 fiscal year and the expected outturns for the remainder of the year. It also discusses policies and projections for the 2011/12 fiscal year and the medium term.

Performance under the PSI

4. As noted in the Letter of Intent above, four of the six quantitative assessment criteria for December 31, 2010 were met. The exceptions were the net international reserves and the net domestic assets of the central bank, which were missed only because government foreign exchange expenditures were effected in the first half of the fiscal year instead of the second half as had been envisaged when the assessment criteria were drawn up. One of the structural benchmarks for December 2010 was fully met (inventory of government accounts), one was partly met, and one was met with a slight delay. About half of accountants and procurement officers were rotated, and the integrated personnel and payroll system (IPPS) went live at the pilot sites on January 31. The structural benchmark for March 31 to develop a set of leading economic indicators was partly met, as new series were developed and have partly been aggregated into an index to inform the path of monetary policy. The three structural benchmarks for April 1 were broadly met: the Budget Framework Paper (BFP) included a report on utility consumption of spending units and a partial timetable for introduction of the national identification system. Full information on the classified exceptional expenditures is now in the public domain, and the BFP captures the associated spending.

II. Economic and Policy Developments

Outturn in 2010/11

5. Economic activity picked up in the first half of 2010/11 after a relatively (by recent historical standards) subdued outturn in 2009/10. The recovery was driven by domestic demand, notably more buoyant private sector consumption and investment demand and a more expansionary fiscal stance. Strong private sector credit growth contributed to the rebound in private sector demand. Real GDP is now expected to grow at 6.4 percent in 2010/11 compared to 5.2 percent in 2009/10. The sources of the rebound in growth include a strong recovery in private sector aggregate demand, with private sector credit expanding by about 38 percent since the start the fiscal year; continued growth of exports as demand in export markets improves in the aftermath of the recent global financial crisis; and faster growth in the industry and service sectors.

6. Inflation had been falling for most of 2010 but began to pick up in the final quarter of the year. Annual rates of headline and core inflation stood at 14 percent and 10 percent respectively in April 2011. The rise in inflation is attributable to a number of factors: the renewed buoyancy of consumer demand; high demand for Ugandan food from neighbouring countries; higher international food and fuel prices; poor domestic harvests for food crops; and higher inflation in the countries from which Uganda sources most of its imports.

7. The balance of payments has weakened in 2010/11, mainly because of a widening of the trade deficit by almost 2 percentage points of GDP. Imports are growing strongly because of higher international fuel prices, as well as the rebound in domestic demand and large one-off government imports, whereas export growth, projected at about 7 percent in dollar values, is more modest. The current account of the BOP has been boosted by the receipt of about a billion dollars in capital gains tax revenues from the oil industry, but these resources are being transparently recorded and held in a petroleum fund in the BoU. Thus, the overall BOP is projected to incur a deficit of approximately $600 million in 2010/11, reducing gross international reserves to the equivalent of 3.4 months of imports of goods and services, compared to 4.7 months in the previous fiscal year.

8. The shilling has weakened as a result of the BoP deterioration, as well as rapid broad money growth. In addition, investor caution surrounding the elections, combined with nervousness surrounding events in North Africa, caused some volatility in the market that the BoU only partly attenuated through intervention on the inter-bank foreign exchange market. Cumulatively, the nominal effective exchange rate depreciated by 11 percent in the first 10 months of 2010/11.

Monetary policy

9. The BOU began gradually tightening monetary policy in the third quarter of 2010/11 in response to the re-emergence of inflationary pressures in the economy. Growth in the

monetary and credit aggregates had been relatively subdued during most of 2009/10 but began to pick up significantly in mid-2010. Banks faced strong demand for credit from the private sector, especially from firms seeking to fund capital investments. The tightening of monetary stance by the central bank led to an increase in both interbank interest rates and yields on all tenors of government securities. Growth in the money and credit aggregates began to decelerate in the third quarter of 2010/11.

The financial sector

10. The financial soundness of the banking system strengthened in the first half of 2010/11. The banking system's annualised return on assets, which had dipped in 2009, climbed back to almost 3 percent in the second quarter of 2010/11, while non performing loans as a share of total loans fell to around 2 percent, from 4 percent in 2009. The ratio of total capital to risk-weighted assets fell slightly to 20 percent, because of very strong growth in risk-weighted assets, rather than a fall in capital. Higher minimum capital regulations came into force in March 2011. All new banks are required to have a minimum of Shs 25 billion in paid up capital, while the existing banks had to have Shs 10 billion in paid up capital by March 2011, and need to have Shs 25 billion by March 2013. All of the existing banks were able to comply with the new minimum capital requirement in March 2011. Legislation to enable banks to undertake bancassurance and offer Islamic financial products, and to introduce a capital charge for market risk, is before cabinet. Legislation to strengthen anti-money laundering is before Parliament, and Parliament has now passed the Uganda Retirement Benefits Regulatory Authority bill.

Fiscal performance during FY 2010/11

11. Revenue collections during the first ten months of FY2010/11 were slightly above target, mainly due to the effects of exchange rate depreciation. The VAT on local goods and services performed poorly, however, particularly on mobile telephone airtime, electricity, and cement. There are also structural problems in the application of VAT which Government will address as a matter of priority. Tax to GDP is projected at 12.4% by June 2011. The improvement in the tax to GDP ratio is on account of domestic income and trade taxes, due to the recovery in import volumes particularly in dutiable items, and the exchange rate depreciation.

12. The expenditure to GDP ratio is projected at almost 24% of GDP, a significant increase compared to last fiscal year. The fiscal deficit excluding foreign grants and oil revenues is projected at 10.6% of GDP compared to 7.4% in 2009/10, and is 4.5% of GDP above the target for FY2010/11. The sharp increase in Government spending was due to: increased security-related exceptional spending; wages and salaries for the lower-paid cadre of civil servants; unanticipated pension obligations; and higher thermal power costs due rising fuel prices; and unexpected elections costs.

13. The main thrust of the supplementary budgets passed during FY2010/11 was to reallocate expenditure within the spending envelope of the originally-approved budget. This has inevitably involved the reallocation of resources across and within spending ministries, but government has sought to protect PAF expenditures at approximately 95% of the indicative budgets. In addition, the exceptional classified spending was financed by a drawdown at the Bank of Uganda, and has been authorized by a supplementary budget passed by Parliament. Government plans to make good its position with the Central Bank over the medium term. Government is reviewing and intends to propose amendments to the Public Finance and Accountability Act (PFAA) to enhance the predictability of the budget by creating a contingency fund to finance emergencies and supplementary budgets, with clear criteria for its use. The revised act would also restrict virements (reallocations) between and within spending ministries and working toward best international practice in the treatment of classified expenditures.

14. Government continues to face challenges in respect of the control of expenditure arrears. In part these claims arise because of under-budgeting for fixed costs like utilities, rent, subscriptions for international organizations and term contracts under the development budget. Outside these fixed costs, a major cause of concern is court awards, whose incidence and magnitude are unpredictable. To address this problem, Government commits to provide adequate resources to cover fixed costs such as utilities, rent and pensions, and to extend the "straight-through payment" (STP) system to electricity and water, beginning with the 2011/12 Budget. In practice, this means that the Treasury will effect payment directly for spending unit obligations on water and electricity, deducting the amount paid from the releases made available to spending units.

Outlook and Medium Term Policies

Macroeconomic Objectives

15. Government's primary macroeconomic objective is to promote rapid, broad based and sustainable economic growth, consistent with the quest to transform the country to a middle income status in the medium term. Consistent with this objective, economic growth is projected to average at least 7% per annum over the medium term. The specific medium term macroeconomic objectives in support of this transformation are to:

- Maintain annual consumer price inflation to no more than 5 percent.
- Promote increased private sector investment as the engine of growth, through *crowding in* the private sector in credit markets.
- Rebuild foreign exchange reserves equivalent to a minimum level of 5 months of imports, to provide a cushion to the economy against any shocks from the external environment.

- Maintain a flexible real exchange rate, which is required to ensure the competitiveness needed to support export sector growth and diversification.
- Ensure that the medium term fiscal strategy gives priority to investments which improve productive capacity in the economy and employment creation.
- And finally introduce a system of petroleum revenue management which is transparent, integrated in the budget process, and which emphasizes growth-enhancing infrastructure investments through the budget.

Economic Outlook

16. The economy is expected to remain buoyant in 2011/12, with real GDP growth edging up to 6.6 percent on the back of stronger domestic investment. Inflation will remain above target, mainly because of the persistence of the effects of higher fuel and food prices, but it will decline over the course of the fiscal year as monetary policy proceeds in a tightening phase. The balance of payments is expected to improve, with the overall deficit being reduced to almost zero in 2011/12 as a result of stronger capital and financial account inflows. Both foreign direct investment and donor-financed government project financing are projected to increase in 2011/12.

Monetary policy

17. The priority for monetary policy in the first half of 2011/12 will be to curb the rise in core inflation. Given the impetus from the rise in global fuel and commodity prices, as well as inflation from Uganda's major trade partners, it is likely that headline inflation will rise to around 15 percent by the end of 2010/11 before falling back during the course of 2011/12. In 2011/12, both broad and base money growth will slow to about 24 percent, and the BoU stands ready to tighten policies further if needed to rein in core inflation. The BoU intends to keep core inflation contained to below 5 percent over the medium term, and increasingly rely on the short term interest rate as an operational target for monetary policy in the process of preparing to move toward a form of inflation targeting (see below).

Fiscal strategy for 2011/12 and the medium term

18. The budget for FY 2011/12 will be consistent with the understandings reached in the context of the PSI. Government recognizes the importance of revenue enhancement for ensuring fiscal sustainability. Petroleum revenue, when it comes, will not be a panacea, so there is a need to begin catching up with neighboring countries in terms of revenue performance. The measures we intend to adopt will eliminate many exemptions or incentives in the tax system which have outlived their usefulness. In FY2011/12 government intends to take a number of important measures to help secure the revenue yield of that year and lay the groundwork for more robust revenue performance over the medium term. These measures, which will be outlined in the Minister's Budget Speech and—where appropriate—in the

Finance Act 2011/12, include:

- Eliminate VAT exemption on supply of motor vehicles or trailers of a carrying capacity of 3.5 tons or more designed for the transport of goods (Finance Act);

- Streamline agricultural processing exemption and 10-year export holiday under the corporate income tax, particularly by requiring that URA recertify on an annual basis the eligibility of each taxpayer for the exemption (Finance Act);

- Terminate government incentives for construction materials for hotels;

- Scrap investment trader regime under the VAT (Finance Act);

- URA to issue (by June 30, 2011) and begin to enforce (from July 2011) proposed transfer pricing guidelines; and

- Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.

19. Some tax policy reforms will take time to prepare, and in a few cases additional technical assistance may be required. We therefore intend, in the context of the 2012/13 budget, to eliminate a number of additional exemptions, particularly of intermediate sales under the VAT. Beginning in 2012/13, URA will also begin to pay VAT refunds directly, rather than through budgetary appropriation, in order to speed refunds and improve the efficiency of this tax.

20. Government expenditure policy in 2011/12 will emphasize a prudent expansion in public investment in line with the NDP. Beyond these flagship investment projects, expenditures will be restrained in view of our limited resources, including in light of declining donor assistance. Large scale classified expenditures will abate. Nevertheless, we recognize that the major risk to the fiscal outlook for 2011/12 is the possibility of expenditure arrears. If, in the event, expenditure arrears are found to have accumulated in FY2010/11, government will seed to clear them in FY 2011/12 through reallocations from lower priority spending.

21. In the medium term, the fiscal strategy will focus on implementing a few identified priority infrastructure projects in the NDP to unlock the most critical binding constraints to economic growth. In addition to the on-going infrastructure projects already in the MTEF, the new projects which will commence in FY2011/12 include Karuma hydropower project, the oil refinery, and the Kampala-Entebbe express highway. These projects are to be financed mainly by savings accumulated in previous years (Energy Fund), oil revenues, some nonconcessional borrowing for the highway, and government's own current domestic revenues. Other projects to be implemented in the medium term include the rehabilitation of Tororo-Pakwach railway, construction of Kampala-Jinja dual carriage way, and Kampala

metropolitan roads to decongest the traffic in and around Kampala. In light of the large backlog of critical infrastructure projects, we seek an increase in the ceiling on nonconcessional borrowing (NCB) under the program (see below). The Government will work closely with Fund staff to ensure that financing mechanisms, particularly nonconcessional, do not pose any threat to macroeconomic or debt sustainability.

III. Structural Issues and Reforms

Revenue administration modernization

22. Government plans to continue with revenue administration reforms in addition to the tax policy changes noted above. To improve tax administration and reduce cost of compliance, the use of e-tax services is being rolled out across the country to facilitate taxpayers' registration, filing and payments. In addition, Government will introduce Electronic Tax Registers (ETRs) and e-tax receipting and auditing system to reduce taxpayer compliance costs. The implementation of the E-tax will continue in a phased manner, starting with large and medium taxpayers. Government will support VAT taxpayers to install Electronic Cash Registers at their premises to record and relay sales information to the URA automatically. Introduction of e-tax will allow URA to pay VAT refunds directly, rather than through budgetary appropriation, beginning in 2012/13. Introduction of the national identification system will proceed in stages, with an initial 4 million citizens covered by June 30, 2012.

Public Finance Management

23. During FY 2011/12, the Government will propose to Parliament revisions to the Public Finance and Accountability Act (PFAA) of 2003 with the aim of strengthening public finance management. Key objectives in this regard include measures to limit strictly the use of supplementary budgets to serious national emergencies, and to restrict virement (reallocation) abilities both across and within spending ministries. In the new PFAA, Government will ensure that any significant reallocation of spending authorities will require ex-ante approval from parliament. In the context of introducing amendments to the PFAA, Government intends to move to a treasury single account system for administering government finances, recognizing this practice will improve cash management and reduce the cost of government borrowing. Further, to ensure realism and credibility of the budget, and strict adherence to annual work plans of spending units, the authorities plan to consider in the PFAA amendments advancing the budget timetable to enable Parliamentary budgetary approval before the start of each new fiscal year.

24. It is hoped that the revised PFAA will also clarify and limit the ability of government to carry forward expenditure appropriation from one fiscal year to the next. In the meantime, to limit the potential for abuse and diversion of funds, government will take the following measures regarding unspent balances at the end of FY 2011/12: (i) publishing the balances on all government accounts both in the BoU and in commercial banks as at June 30 and

September 30, (ii) Minister responsible for finance to present these accounts to parliament by July 31 and October 30, respectively; (iii) parliamentary approval, as well as supporting work and procurement plans, will be required in order to spend any balances held over from the previous year; and (iv) all unspent balances which have not been re-appropriated by parliament by end-September must be returned immediately to the government Consolidated Fund.

25. Government acknowledges that internal controls to prevent the accumulation of expenditure arrears need to be strengthened. In the context of amendments to the PFAA, Government will take steps to strengthen the Commitment Control system (CCS), including by introducing strong sanctions on accounting officers who are found to have incurred expenditure obligations outside the CCS. The ministry of finance will also begin to report to cabinet on a quarterly basis information on the unpaid claims on spending units. In the meantime, to minimize accumulation of arrears, beginning with FY2011/12 government will extend the "straight-through payment" (STP) system now employed for pensions to utility payments (electricity and water payments) of spending units.

Oil Revenue Management

26. Government aims to provide for the prudent management and accountability of petroleum resources in the context of amendments to the PFAA. Our objective is to ensure that the necessary mechanisms for transparency and accountability are in place before large scale oil revenues begin to accrue. We intend to establish a Petroleum Fund into which all oil and gas revenues will be deposited, and we will ensure that all spending is done through the budget. The BoU is to act as the investment manager for these resources on behalf of government, and they will pursue an investment strategy that is—at least in the short run—consistent with their handling of Uganda's foreign exchange reserves. Until the revised PFAA is passed, we are handling the payments of significant capital gains tax revenues consistent with these objectives. We have placed these funds on a special account in the BoU, on which we will report publicly on at least a quarterly basis. Flows out of this account will only be made to the budget and for the near term will be used for financing the Karuma hydropower project.

27. Looking to the medium term, the manner in which oil revenue will be managed must not compromise the growth and export potential of non-oil sectors in order to enhance employment creation in the country. This will entail building capacity in managing oil resources and also research capacity.

Debt sustainability in the context of improved asset and liability management

28. Government plans to update our debt strategy to ensure continued debt sustainability in the context of accelerated public infrastructure investment. We envisage an increase in the nonconcessional borrowing ceiling under the program (from $500 million to $800 million), still earmarked for infrastructure, with the state-owned Housing Finance Bank excluded from

the ceiling. With technical support from the IMF and other partners, we intend to review options for external and domestic financing, including the use of public-private partnership (PPP) arrangements. At this time we have no concrete plans to move to international capital markets or to place large-scale domestic debt issuance dedicated to infrastructure.

29. Government recognizes that the most pressing constraint to stepped up infrastructure investment is our own system of project assessment, planning, and implementation. We intend to put in place an evaluation and appraisal criteria to ensure that all projects funded are economically and financially viable and consistent with the overall macroeconomic framework to ensure continued stability.

30. As we establish the legal framework for administering petroleum wealth through the amended PFAA, we will need to review our preparedness for asset management. The petroleum fund will be administered by the BoU, but the investment guidelines and risk tolerance will be set by the government. In this regard, we also look forward to technical support from the IMF, insofar as asset and liability management must be viewed as a package.

Enhancing the framework for monetary policy

31. The authorities are considering reforms to the BoU's operating framework for monetary policy, which would entail replacing the current monetary targeting framework with an inflation targeting lite (ITL) framework, the primary policy objective of which will continue to be maintaining core inflation (which excludes the prices of fuel and food crops) at an annual level of 5 percent on average over the medium term.

32. In this regard, it will be important to clarify the financial relations between the Bank of Uganda and the government, including reviewing central bank capital arrangements and limiting direct central bank financing of the government borrowing requirement. Our intention is also to strictly delineate and ringfence the stock of government securities useable for liquidity management purposes as distinct from that intended for fiscal financing purposes. The BoU will begin regular inclusion in its Quarterly Report of data on the net and gross positions of government in the BoU.

33. The central bank will upgrade its communication strategy to provide the public with clarity about the stance and objectives of monetary policy. The authorities have requested the Fund to provide technical assistance and advice on the introduction of inflation targeting, in particular to draw lessons from the experience of other African and developing country central banks, including in the context of IMF program monitoring.

34. Further, the BoU is working with the Uganda Bureau of Statistics to develop high frequency indicators of activity and demand in the formal sector of the economy. The following data have so far been collected and compiled: index of agricultural production (2-month lag); quarterly GDP; index of manufacturing production based on the 50 large

companies; index of construction; and sales data on selected consumer products, building materials, and petroleum (all with a 3-month lag). Efforts are being made to extend the coverage of the index of agricultural production, and collect data on urban employment and the transport & communication sector. We intend to produce and begin disseminating a synthetic index of economic activity to help guide the conduct of monetary policy by September 30, 2011.

IV. PROGRAM MONITORING

35. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), indicative targets (IT), and structural benchmarks (SBs), detailed in the attached Tables 1 and 2 and through semiannual reviews. Assessment criteria are added for end-June 2011 and proposed for end-December 2011, to be monitored respectively at the third and fourth reviews. The third review is expected to be completed by end-December 2011, and the fourth review by end-June 2012. The attached Technical Memorandum of Understanding—which is an integral part of this Memorandum—contains definitions and adjustors. During the program period, we will refrain from imposing or intensifying exchange restrictions as well as restrictions on imports for balance of payments reasons, or from introducing multiple currency practices.

Table 1. Uganda: Quantitative Assessment Criteria and Indicative Targets for December 2010 - June 2012 [1]

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

	December 31 2010				2011	2011 3/	2011	2012 3/	2012 3/
	31-Dec Prog.	31-Dec Adjus. Target	31-Dec Actual		June 30	Sep. 30	Dec. 31	March 31	June 30
	Billions of Uganda Shillings								
Assessment criteria									
Ceiling on the increase in net domestic assets of the Bank of Uganda 4/	362	52.9	344.6	Not observed	2,093	409	877	1,167	1,150
Ceiling on the increase in net claims on the central government by the banking system 4/	771	229	218	Observed	1,545	274	633	987	829
	(Millions of U.S. dollars unless otherwise specified)								
Ceiling on the stock of external payments arrears incurred by the public sector 5/	0	0	0	Observed	0	0	0	0	0
Ceiling on the contracting or guaranteeing of new nonconcessional external debt with maturities greater than one year by the public sector 5/ 6/	500	500	110	Observed	500	800	800	800	800
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector 5/ 7/	0	0	0	Observed	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda (US$mn)	-48	87.6	-34	Not observed	-622	-66	-121	-147	-51
Share of oil revenue placed into Petroleum Fund					100	100	100	100	100
	(Billions of Uganda shillings)								
Indicative target									
Ceiling on the increase in base money liabilities of the Bank of Uganda 4/	302	302	450	Not observed	685	187	399	557	743
Stock of domestic budgetary arrears under the Commitment Control System (CCS) 8/	…	…			176				50
Minimum expenditures under the Poverty Action Fund (including the Universal Primary Education component of development expenditure)	689	689	648.3	Not observed	1285	…	650	…	1400
Memorandum item									
Oil revenue inflows to the petroleum fund (in millions of U.S. dollars)					909				27

[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 are from June 2010 (averages for NDA and BM) for December 2010 and June 2011 targets and from June 2011 for FY 2011/12 targets, as defined in the TMU; all targets excluding oil revenue inflows to the petroleum fund

[5] Continuous assessment criterion.

[6] To be used exclusively for infrastructure investment projects. Cumulative change from May, 2010.

[7] Excluding normal import-related credits.

[8] Monitored annually.

Table 2. Structural Benchmarks

Policy Measure	**Macroeconomic Rationale**	**Deadline**
Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.	Enforce discipline in issuance of tax exemptions.	September 30, 2011, and quarterly thereafter
URA to issue and begin to enforce proposed transfer pricing guidelines. (¶18)	To reduce tax planning and prepare for large scale petroleum revenues.	Issued by June 30, 2011, for enforcement beginning in July 2011.
Government to maintain transparency over the treatment of unspent budgetary funds at the end of the fiscal year by (i) publishing the balances as at June 30 and September 30 on all government accounts in the BoU and commercial banks, and (ii) in order to spend any balances held over from the previous year beyond end-June, parliamentary approval as well as supporting work and procurement plans will be required. (¶24)	To enhance budgetary discipline and promote fiscal transparency.	July 31, 2011, and October 30, 2011, respectively.
Begin submitting to Cabinet regular quarterly reports on unpaid bills of spending units based on data in the Commitment Control System (CCS) for the previous quarter of the fiscal year. (¶25)	To facilitate control and elimination of expenditure arrears	June 30, 2011, for the report covering Q3 of FY2010/11, and quarterly thereafter.
Extend the "straight-through payment" system (STP) now employed for pensions to the utility sector (electricity, water) (¶25)	Help control accumulation of arrears	July 1, 2011.
As part of introduction of national identification system, 4 million additional citizens will have received IDs. (¶22)	To support efforts to strengthen revenue collection and combat money laundering and the financing of terrorism.	June 30, 2012.
Produce and disseminate within government a monthly index of economic activity relying on the various high-frequency indicators available. (¶32)	To facilitate the conduct of monetary policy.	September 30, 2011, and quarterly thereafter.
BoU to include in Quarterly Report data on the net and gross positions of government in the BoU. (¶31)	Enhance central bank independence and prepare Bank of Uganda to move toward inflation targeting.	September 30, 2011, and monthly thereafter.

Attachment II. Uganda: Technical Memorandum of Understanding

I. Introduction

1. This memorandum defines the quarterly assessment criteria and indicative targets described in the memorandum of economic and financial policies (MEFP) for the period of July 1, 2011-May 2013 financial program supported by the IMF Policy Support Instrument (PSI), and sets forth the reporting requirements under the instrument.

II. Ceiling on the Cumulative Increase in 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 excluding oil revenues in the petroleum fund. 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 referred to in the table below for the various currencies and then converted into Uganda shillings using the program average U.S. dollar-Uganda shilling exchange rate for October 2010.

Program Exchange Rates (US$ per currency unit, unless indicated otherwise)	
USD	1.0000
British Pound	1.5851
Euro	1.3888
Kenya Shilling	0.0124
Tanzania Shilling	0.0007
Japanese Yen	0.0122
SDR	1.5691
Uganda Shilling	**2,264.8**

3. 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 ceilings on the cumulative change from the monthly average based on daily data for June 2010 to the same monthly average for June 2011, and cumulative changes from the monthly average based on daily data for June 2011 to the same monthly averages for September 2011, December 2011, March and June 2012.

In billions of Uganda Shillings					
	June 30, 2011 1/	September 30, 2011 2/	December 31, 2011 2/	March 2012 2/	June 30, 2012 2/
Cumulative change in base money	685	187	399	557	743
Cumulative change in NFA	-1408	-222	-478	-610	-408
Cumulative change in NDA	2093	409	877	1167	1150

1/ Cumulative from July 1, 2010; and 2/ Cumlative from July 1, 2011

III. BASE MONEY

4. 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 change from the monthly average based on daily data for June 2010 to the same monthly average for June 2011, and cumulative changes from the monthly average for June 2011 to the same monthly average for September and December 2011, and March and June 2012.

IV. CEILING ON THE CUMULATIVE INCREASE IN NET CLAIMS ON THE CENTRAL GOVERNMENT BY THE BANKING SYSTEM[1]

5. 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 oil revenues in the petroleum fund and 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 resources freed by the 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.

V. FLOOR ON NET INTERNATIONAL RESERVES OF THE BANK OF UGANDA

6. 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,

[1] The central government comprises the treasury and line ministries.

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.

7. 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 the stock from their original currency denomination at program exchange rates (as specified in para 2).

VI. Ceiling on the Stock of Domestic Budgetary Arrears of the Central Government

8. 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 by end of fiscal year, under the recurrent expenditure budget (excluding court awards, subscription to international organization and pensions) or the development expenditure budget. For the purpose of program monitoring, the CCS reports, which will include arrears accumulated at IFMS and non-IFMS sites, prepared by the Accountant General, will be used to monitor arrears. Arrears can be cleared in cash or through debt swaps. According to the report prepared by Office of the Auditor General, the stock of arrears was estimated at USh 176.5 billion as of June 2010.[2]

VII. 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).

VIII. 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.

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

[2] The Auditor General's report (http://www.oag.go.ug/annual_reports.php?dId=1) for FY 2009/10 indicates that some agencies could not disclose their outstanding operating commitments in their financial statements at year's end..

assumptions regarding automatic access by commercial banks to the BOU's rediscount and discount window facilities.

12. The Uganda shilling equivalent of projected 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.

Schedule A: Budget Support Plus Total HIPC Initiative Assistance

(Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year)

Quarter	6/30/2011 [1/]	9/30/2011 [2/]	12/31/2011 [2/]	3/31/2012 [2/]	6/30/2012 [2/]
Budget support, including HIPC Initiative grants	742.0	255.7	426.4	499.9	620.3

[1/] Cumulative from July 1, 2010; and [2/] Cumulative from July 1, 2011

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[3] 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).

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

Schedule B: Debt Service					
(Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year)					
Quarter	6/30/2011 1/	9/30/2011 2/	12/31/2011 2/	3/31/2012 2/	6/30/2012 2/
Debt Service due before HIPC excluding exceptional financing	243.0	49.9	144.8	210.9	263.2
1/ Cumulative from July 1, 2010; and 2/ Cumulative from July 1, 2011					

14. The ceiling on the increase in NCG will be adjusted downward (upward) by any excess (shortfall) in nonbank financing[4] less payment of domestic arrears on pensions, to international organizations, and court awards, relative to the programmed cumulative amounts presented in Schedule C. For the purpose of this adjuster, payment of such arrears cannot exceed the programmed amount by more than Ush 45.0 billion.

Schedule C: Nonbank Financing Minus Repayment of Domestic Arrears					
(Cumulative billions of Uganda's shillings, beginning July 1 of the fiscal year)					
Quarter	6/30/2011 1/	9/30/2011 2/	12/31/2011 2/	3/31/2012 2/	6/30/2012 2/
(A) Nonbank Financing	392.00	23.85	54.4	72.0	100.0
(B) Repayment of domestic arrears on pensions, to international organizations, and for court awards	184.00	21.45	71.5	71.5	71.5
(C) Total = (A) - (B)	208.00	2.40	-17.14	0.49	28.50
1/ Cumulative from July 1, 2010; and 2/ Cumulative from July 1, 2011					

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

[4] 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).

requirement multiplied by the actual amount of required reserves (Uganda shillings and foreign-currency denominated) at the end of the previous calendar month.

IX. Ceiling on the Contracting or Guaranteeing of New Nonconcessional External Debt by the Public Sector, and Ceiling on the Stock of External Payments Arrears Incurred by the Public Sector[5]

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 public sector. Excluded from this assessment criterion are normal import-related credits and non-resident holdings of government securities and government promissory notes. The definition of "debt" is set out in paragraph 18.

18. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the public sector.[6] Nonconcessional borrowing is defined as loans with a grant element of less than 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, not only current as defined below, but also contingent, on nonconcessional terms. External debt for the purpose of this assessment criterion means borrowing giving rise to liabilities to non-residents. Excluded from the limits are changes in indebtedness resulting from non-resident holdings of government securities and government promissory notes, 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 participated in the HIPC Initiative do not constitute nonconcessional external borrowing. Excluded from these limits are also nonconcessional borrowing within the limits specified in Table 1 of the MEFP. The ceiling also excludes nonconcessional borrowing by one state-owned bank, Housing Finance Bank,

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[5] Public sector comprises the general government (which includes the central government, local governments, and monetary authorities), and entities that are public corporations which are subject to 'control by the government', defined as the ability to determine general corporate policy or by at least 50 percent government ownership.

[6] Contracting and guaranteeing is defined as approval by a resolution of Parliament as required in Section 20(3) and 25(3) of the Public Finance and Accountability Act, 2003

which poses limited fiscal risk and is in a position to borrow without a government guarantee.

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. 6230-(79/140), as amended by Decision No 14416-(09/91, effective December 1, 2009). 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., 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 public sector from their level at end-June 2006. External debt payment arrears consist of external debt service obligations (reported by the Statistics Department of the BOU, the Macro Department of the Ministry of Finance) that have not been paid at the time they are due as specified in the contractual agreements but shall exclude arrears on obligations subject to rescheduling.

X. 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 .

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, on quarterly basis, review the reconciliations of monetary survey data with the financial records and the audited financial statements. Any revisions to monetary survey data 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 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 verified domestic arrears comprising the stock of CCS/IFMS arrears incurred after end-June 2004.	annually	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

Second Review Under the Policy Support Instrument and Request for Waiver of Assessment Assessment Criteria—Informational Annex

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

June 16, 2011

- **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 5.4 million (2.99 percent of quota) at end-April, 2011.

- **Joint Bank-Fund Work Program.** Describes Bank-Fund collaboration through June 2011.

Contents Page

APPENDIX I. UGANDA: RELATIONS WITH THE FUND
(As of October 31, 2010)

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	142.94	82.60

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	5.40	2.99

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF[1]	Sep 13, 2002	Jan 31, 2006	13.50	13.50
ECF[1]	Nov 10, 1997	Mar 31, 2001	100.43	100.43
ECF[1]	Sep 06, 1994	Nov 09, 1997	120.51	120.51

VI. Projected Payments to Fund[2]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	0.60	1.20	1.20	1.20	1.00
Charges/Interest	0.12	0.18	0.17	0.17	0.17
Total	0.72	1.38	1.37	1.37	1.17

VII. Implementation of HIPC Initiative:

	Original Framework	Enhanced Framework	Total
I. Commitment of HIPC assistance			

[1] Formerly PRGF.

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

[3]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 cannot be added.

Decision point date	Apr 1997	Feb 2000	
Assistance committed			
by all creditors (US$ Million) [3]	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 [4]	--	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)[5]	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

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[4] 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.

[5] 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 April 29, 2011 the official exchange rate was USh 2375 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 February 11, 2011. 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 September 28, 2010.

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. More recently, at the request of the authorities, a new FSAP update is scheduled for August, 2011, which once undertaken, would complete a set of FSAP updates for all five EAC members.

XII. Policy Support Instrument (PSI)

The Executive Board approved a new three-year Policy Support Instrument (PSI) and completed the seventh and final review under the previous PSI on May 12, 2010. The new PSI follows on the first three-year PSI, which was approved in December 2006 and extended by one year in 2009, then concluded successfully in May 2010.

XIII. Technical Assistance

Uganda has received extensive technical assistance from the Fund in recent years.[6]

FAD has continued to provide TA to the Uganda Revenue Authority (URA) in the areas of revenue administration and oil revenue management. In 2010, two IMF FAD technical assistance missions went to Kampala. The first one to advise the authorities on the URA's modernization program and next phase of revenue administration reforms, and the second one to advise them on the drafting of a new comprehensive budget and public financial management law. FAD 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. During November 2010 a mission from FAD headquarters and AFRITAC worked on redrafting the Public Finance and Accountability Act, in part to build in an oil revenue management framework. The statistical advisor in AFRITAC East has also visited the Uganda Bureau of Statistics several times to advise on rebasing GDP and also to support revisions to the informal cross border trade estimates in the balance of payments.

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. In August 2010, MCM conducted a multi-topic technical assistance mission to help authorities enhance the central bank capacity in the areas of monetary operations, money market development, and financial stability assessment.

XIV. Future Technical Assistance Priorities

The priorities for Fund technical assistance in the next few years will be in the areas of tax administration and tax policy reforms, oil revenue management, public expenditure management, especially control and monitoring of government arrears, 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.

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[6] For a description of technical assistance provided prior to 2006, see the staff report for Uganda's request for a three-year PSI (IMF Country Report No. 06/43).

APPENDIX II. JOINT BANK-FUND WORK PROGRAM, JUNE 2010 – JUNE 2011

Title	Products	Provisional timing of missions (if relevant)	Expected delivery date
1. World Bank Work Program	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.		
	Public Expenditure Review on budget composition trends and efficiency in the road sector will be delivered to client. Public Expenditure Review on Investment Planning concept discussed with government and work started	 May 2010	June 2010 December 2010
	Poverty Reduction Support Credit to enhance effectiveness of service delivery, public sector management, and human development issues.	June 2010	August 2010
	Strategy paper for GOU's negotiation with other member states on the efforts towards elimination of non-tariff barriers. 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 completed		September 2010
	A new study on shared/spatial growth with special focus on agriculture, labor and integration of leading and lagging areas, will be initiated.	June 2010	May 2011

2. Fund Work Program	Seventh Review and Request for a new PSI.	March 2010	May 2010
	Staff visit on the government budget	May 2010	June 2010
	2010 Article IV and First review under the PSI	October 2010	February 2011
3. Joint Work Program	JSAN on the NDP (new PRSP).	March 2010	April 2010
	Joint DSA Joint DSA update	March 2010 June 2011	May 2010 June 2011

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND

UGANDA

Joint World Bank/IMF Debt Sustainability Analysis Update

Prepared by staffs of the International Development Association and
International Monetary Fund

Approved by Marcelo Giugale and Jeffrey Lewis (IDA)
and Saul Lizondo and Dominique Desruelle (IMF)

June 16, 2011

UGANDA: DEBT SUSTAINABILITY ANALYSIS[1]

Based on the joint Low-Income Country Debt Sustainability Framework of the World Bank and the IMF, Uganda continues to be assessed as a low risk of debt distress. While the authorities will continue to rely primarily on highly concessional financing to fund their infrastructure investment needs, they are planning to rely on non-concessional financing for a number of critical infrastructure projects. The DSA update incorporates an increase in the non-concessional borrowing ceiling to US$ 800 million over the next three years from US$ 500 million to help finance large infrastructural projects critical for growth.

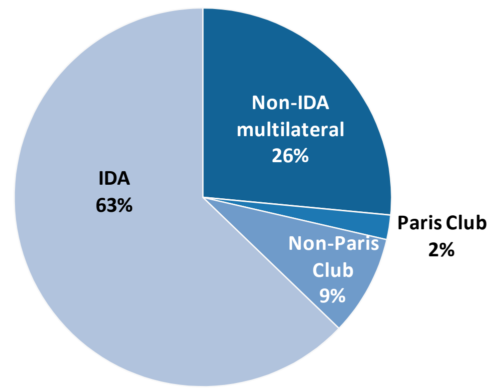
However, it does not include the macroeconomic consequences of the oil discoveries given the uncertainties about revenue sharing, production modalities, and export potential. Under these baseline assumptions, external debt is expected to remain well below the thresholds over the medium and long term, and public debt exhibits stable debt dynamics. The sensitivity of Uganda's debt indicators to a growth shock suggests that careful selection of public investment projects have a key role to play in the maintenance of debt sustainability over the near and medium term, requiring continued attention from the Ugandan authorities to improving investment planning processes and strengthening implementation capacity.

[1] As Uganda is an IDA only country, the DSA is prepared jointly by the IMF and World Bank staff in consultation with the African Development Bank (AfDB) under the IMF-WB DSA framework for Low-Income Countries. The fiscal year of Uganda starts from July 1st.

I. Background

1. **Uganda has maintained a sustainable debt position, thanks to the sound macroeconomic policies and cautious public borrowing following debt relief**. HIPC (in 1999/2000) and MDRI (in 2005/06 and 2006/07) debt relief reduced Uganda's debt burden sharply, with all debt indicators declining to levels well below their policy-dependent thresholds.[2] Prudent fiscal management and modest public sector deficits further strengthened the debt position. Debt management has remained cautious since debt relief (Box 1). New external borrowing was mainly financing productive sectors, particularly transport, energy and agriculture and was contracted on highly concessional terms, mostly from IDA and the AfDB. In line with the revised IMF/IDA's Nonconcessional Borrowing Policy (NCBP)[3], Uganda borrowed US$ 100 million on nonconcessional terms, although the ceiling under the PSI was up to US$ 500 million. Nonetheless, public and publically guaranteed external debt has remained low as a percent of GDP, and is mostly owed to multilaterals (IDA accounts for 63 percent of total debt – Figure 1). Domestic debt is low, at about 8 percent of GDP.

Figure 1. Breakdown of the stock of external debt (end FY09/10)



[2] The World Bank's Country Policy and Institutional Assessment (CPIA) ranks Uganda as a "strong performer." Debt burden thresholds for strong performers are NPV of debt to GDP ratio of 50 percent, NPV of debt-to-exports ratio of 200 percent, NPV of debt-to-revenue ratio of 300 percent, debt-service-to-exports ratio of 25 percent, and debt-service-to-revenue ratio of 35 percent.

[3] The 2010 adjustments to implementation of the IDA/IMF Non-concessional Borrowing Policy enhanced flexibility by allowing debt limits to be set based on a country's macroeconomic and public financial management capacity (now commonly referred to as "capacity") and their debt vulnerability. Uganda is classified as a "low debt vulnerability and low capacity" country, and hence eligible for increased flexibility in setting annual non-zero non concessional debt limits.

Box 1. Changes in Debt Indicators since the Last DSA

- **Public and publicly guaranteed external debt** increased from US$ 2.0 billion (15.3 percent of GDP) to US$ 2.3 billion (16.8 percent of GDP) between 2008/09 and 2009/10.
- The d**ebt service to exports ratio**, increased from a revised 0.6 percent to 3 percent over this period, partly on account of a statistical correction in the export data.[4]
- Domestic debt declined from 8.4 percent of GDP to 8.1 in 2009/10 (mostly on account of high growth), but **total public and publically guaranteed debt** increased to 24.9 percent of GDP, from 23.7 percent recorded in 2008/09.
- The **debt-service-to-revenue ratio** declined from 28.3 to 27.9 percent over this period on the back of stagnated revenue performance.

2. **The authorities are stepping up their plans to implement large-scale critical infrastructure projects with a view to removing persistent growth bottlenecks.** In line with its National Development Plan, Uganda's main medium-term priorities are in the energy sector, in particular the realization of the Karuma hydropower plant, of which construction is expected to commence in 2012/13, as well as the further development of roads infrastructure. Financing is expected to come from a combination of domestic and external sources.

3. **The authorities are committed to raise domestic revenue over the medium term, partly to make up for the expected decline in aid.** While a large share of their financing needs will continue to be filled by concessional borrowing, the government also intends to use limited amounts of nonconcessional borrowing, notably for infrastructure projects. Consequently, the authorities have requested for a raise in the ceiling on non-concessional borrowing to US $ 800 million over the next 3 years of the PSI.

II. ASSUMPTIONS

4. **Long-term assumptions are consistent with the recent performance of the Ugandan economy and only slightly different from those in the previous DSA.** In 2010/11 and 2011/12 growth is projected to be around 6-6.5 percent, slightly below historical averages partly on account of the secondary effects of the global economic slowdown as well as consecutive exogenous shocks, particularly the increased oil prices and the adverse effects of weather. Growth would rebound to 7 percent, slightly above the historical average of the past ten years thereafter, as public investments in roads and energy[5] start to unlock additional growth potential. A sound monetary policy would help keep inflation around 5 percent in the medium term, as exogenous inflationary pressures relate. The public sector deficit (including

[4] The trade data between Southern Sudan and Uganda were revised due to better survey data becoming available in 2010. This led to a downwards revision of total export receipts.

[5] Bujagali hydropower plant is expected to be commissioned in 2011/12.

grants) increases in the near term on account of the public investment drive before stabilizing at about 3 percent of GDP. Compared with the 2009 Joint IMF-World Bank DSA, the current baseline scenario assumes a less ambitious growth path over the medium term, reflecting the back-loading of infrastructure investment in light of the authorities' wish to carefully assess and select their projects before implementing them (Box 2).

Box 2: Ex post analysis of the 2009 DSA

- **Exports have under-performed compared to the last DSA**, following statistical correction that led to downward revision of informal cross-border trade (in particular) with Southern Sudan.
- **Slower growth than initially envisaged has led to lower imports**. Assumptions on the behavior of exports and imports over the long term are similar to the 2009 DSA, and the trade and current account balances are therefore similar.
- **The current baseline scenario includes slightly less external borrowing** compared to the 2009 DSA, in line with the smoother public expenditure path.
- **On the fiscal side, both public revenue and expenditure have not performed as well as envisaged in the 2009 DSA**. They are assumed to grow smoothly over the projection period, as improved tax policy increases fiscal resources and implementation and absorption capacity constraints are addressed.

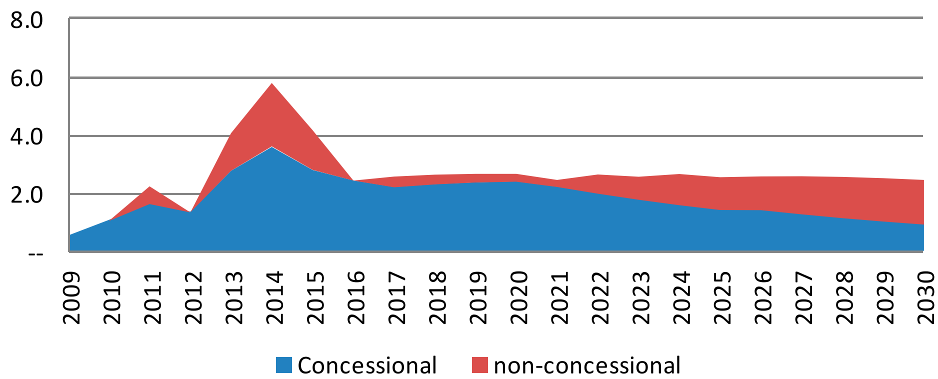
5. **The external position over the long run is adequate.** The medium term trade balance deficit, which reflects the high import content of infrastructure investments as well as solid domestic growth, stabilizes over the long term at about 7 percent of GDP. , while the current account deficit stabilizes around 3 percent of GDP. Total transfers are assumed to decline slightly over time, from 6 to 4 percent of GDP, reflecting the gradual transition of Uganda away from aid dependency, with the current account deficit stabilizing at around 3 percent of GDP. Remittances are assumed to stabilize just below 4 percent of GDP over the long term, with a slowly declining trend. Non-oil FDI stabilizes at about 4 percent of GDP.

6. **Concessional donor inflows are projected to continue to contribute to budget financing but gradually taper off.** As concessional assistance decline, the use of nonconcessional resources grows to provide about half the new external financing at the end of the projection period (Figure 2)[6], in spite of the fact that Uganda is not expected to graduate from IDA in the medium term. The overall grant element of new public borrowing declines over time, from over 40 percent to about 10 percent by the end of the projection

[6] Nonconcessional borrowing is assumed to be contracted on IBRD-like terms, with 4.9 pc rates (about 400 bp above LIBOR), 10 years of grace and 20 years of repayment.

period. Public domestic debt grows in line with GDP, hovering over 5-6 percent of GDP. Financing projections are somewhat below those of the previous DSA, reflecting the lower base on which projections are based.

Figure 2. New concessional and non-concessional borrowing in the baseline scenario (in percent of GDP)



III. External Debt Sustainability Analysis

7. **The authorities agreed with the results of the DSA, which were in line with the results of their own DSA.** The authorities intend to rely primarily on highly concessional borrowing, and based their DSA on more conservative assumptions regarding nonconcessional borrowing. They were however well aware that the nonconcessional borrowing envisaged over the medium term was likely to continue in the longer term and agreed that such a borrowing would remain consistent with the NCB policies of the World Bank and Fund so as to ensure that debt remains debt sustainable.

8. **Public and publicly guaranteed external debt is expected to remain sustainable over the next 20 years** (Table 1 and Figures 1a). All five debt-burden indicators remain well below their policy-dependent thresholds throughout the period. The PV of debt-to-GDP ratio is expected to rise in the first part of the period (from 8 percent in 2009/10 to 17 percent in 2014/15) in line with the public investment drive; it then stabilizes to about 20 percent in the outer years. The PV of debt-to-exports is expected to peak at 86 percent of GDP in 2020/21 before going down gradually to 76 percent at the end of the projection period. The debt service-to-exports ratio remains very low, reflecting the continued large share of highly concessional borrowing in the debt stock.

9. **External debt is expected to remain resilient to all standardized shocks** (Figure 1a, Tables 1 and 3). The stress tests point to a low risk of debt distress. Under all standardized stress tests, the debt-to-GDP, debt-to-exports, and debt service-to-exports indicators of public and publicly guaranteed external debt remain below their indicative threshold values throughout the next twenty years.

10. **Historical scenarios reflect to a large extent Uganda's performance over the last ten years**, notably with respect to GDP and export growth, inflation, transfers, and FDI inflows. However, there is a need to remain vigilant as reserves have fallen to 3 months of import cover and would need to be rebuild to the more comfortable historical levels of 4-5 months of import cover to provide sufficient cushion in event of foreign financing shocks.

11. **Uganda is due to become significant oil producer**. Due to paucity of data and uncertainties regarding the expected policy framework, this DSA update does not include the macroeconomic consequences of the anticipated oil exploration. Fund and World Bank staff are, however, assisting in collaboration with other development partners the government of Uganda to ensure that Uganda can harness the windfall from its oil. Staffs anticipate that these uncertainties will be resolved over the coming twelve months and therefore the next DSA will include the macroeconomic consequences of oil exploration on Uganda's debt sustainability.

IV. Fiscal Debt Sustainability Analysis

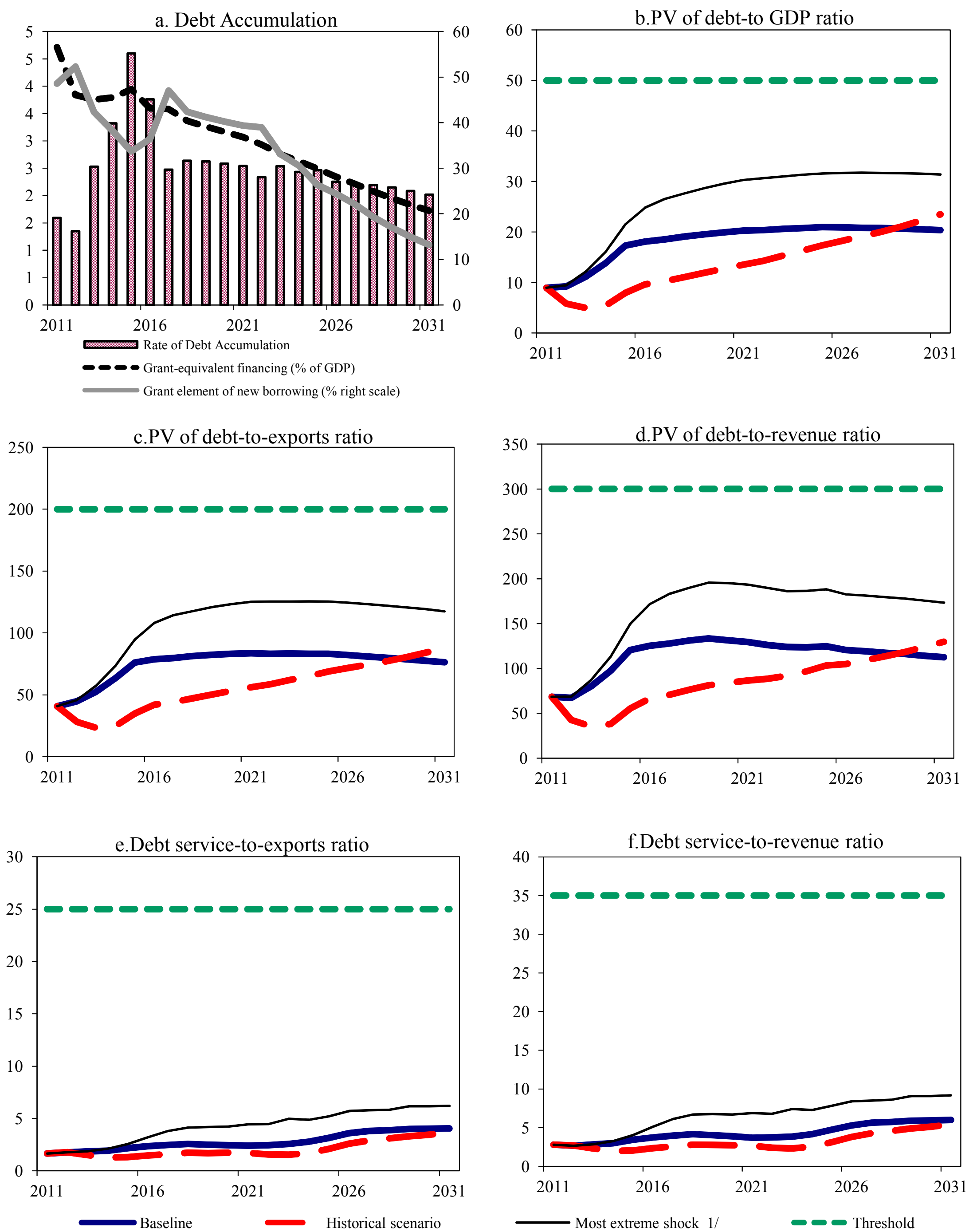
12. **The path of total public debt, which includes external debt and domestic public debt, is sustainable under all stress tests.** (Tables 2 and 4, and Figure 1b). Under the baseline, the PV of public debt to GDP and revenue increases slightly in the medium term, and both remain at sustainable levels over the long term. Debt service is broadly stable as a share of revenue.

13**. Of all bound tests, a permanent shock to growth stands out as bearing the strongest impact on debt indicators** by increasing the PV of debt to GDP ratio to 35 percent**.** The PV of debt to GDP is relatively unaffected by other bound tests, and remains below 30 percent and close to the baseline under all scenarios. The PV of debt to revenue is relatively robust to most shocks, but is significantly affected by a shock to growth. Finally, a permanent shock to growth would raise the PV of the debt service-to-revenue ratio close to 20 percent and would constrain fiscal spending significantly. This reveals how critical public investment selection and its effective implementation is to ensure long-term debt sustainability.

V. CONCLUSION

14. **Uganda's public and external debt are expected to remain sustainable under the baseline scenario as well as under alternative shock scenarios**, owing to a cautious strategy that combines reliance to concessional borrowing, cautious selection of nonconcessionally financed infrastructure projects and a conservative fiscal stance. Uganda's public debt indicators are however sensitive to a protracted adverse growth shock. This highlights the importance of ensuring that a shift towards nonconcessional borrowing is combined with medium-term improvements in project selection, investment planning processes and implementation capacity.

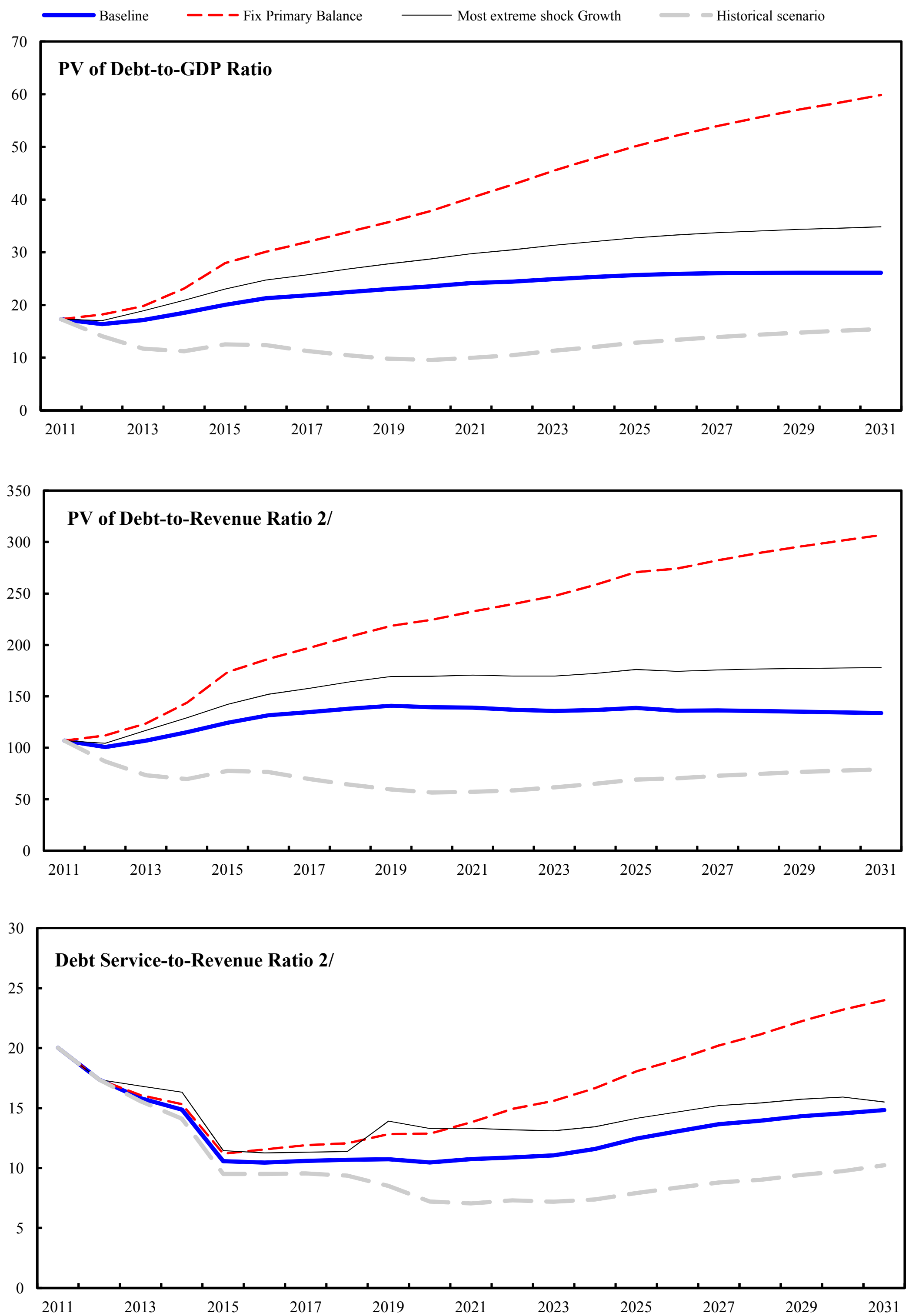
Figure 1a. Uganda: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a Terms shock; in c. to a Terms shock; in d. to a Terms shock; in e. to a Terms shock and in figure f. to a Terms shock

Figure 1b.Uganda: Indicators of Public Debt Under Alternative Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021.

2/ Revenues are defined inclusive of grants.

Table 1. External Debt Sustainability Framework, Baseline Scenario, 2008-2031 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 6/	Standard Deviation 6/	Projections									
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-2016 Average	2021	2031	2017-2031 Average
External debt (nominal) 1/	**18.1**	**22.7**	**24.7**			**26.7**	**26.3**	**28.8**	**32.3**	**29.2**	**37.2**		**39.6**	**36.5**	
o/w public and publicly guaranteed (PPG)	11.8	15.3	16.8			18.6	19.0	21.9	25.8	22.9	30.8		32.9	27.0	
Change in external debt	-0.4	4.6	2.0			2.0	-0.3	2.5	3.5	-3.1	8.0		0.1	0.4	
Identified net debt-creating flows	-5.0	2.1	3.0			-2.1	1.9	1.6	0.7	-0.9	-1.2		-2.5	-4.0	
Non-interest current account deficit	**2.4**	**6.9**	**8.1**	**3.0**	**2.8**	**3.9**	**9.3**	**8.8**	**8.6**	**6.8**	**5.2**		**4.1**	**1.5**	3.4
Deficit in balance of goods and services	10.0	14.5	13.3			16.0	14.9	13.9	13.6	12.3	11.5		9.8	6.3	
Exports	22.1	19.6	20.3			22.0	20.7	21.3	21.9	22.7	23.0		24.2	26.7	
Imports	32.1	34.1	33.7			37.9	35.6	35.2	35.5	35.0	34.5		34.0	33.0	
Net current transfers (negative = inflow)	-8.8	-8.4	-6.3	-10.2	2.0	-13.1	-6.6	-6.2	-6.2	-6.0	-5.9		-5.1	-4.1	-4.7
o/w official	-3.0	-2.5	-2.5			-8.6	-2.5	-2.0	-1.9	-1.7	-1.7		-1.7	-1.4	
Other current account flows (negative = net inflow)	1.2	0.9	1.1			1.1	1.1	1.0	1.1	0.5	-0.5		-0.5	-0.7	
Net FDI (negative = inflow)	**-4.8**	**-4.2**	**-4.2**	**-3.7**	**1.4**	**-4.7**	**-6.0**	**-5.8**	**-6.3**	**-6.0**	**-5.0**		**-4.8**	**-4.3**	-4.6
Endogenous debt dynamics 2/	**-2.6**	**-0.7**	**-0.9**			**-1.4**	**-1.3**	**-1.4**	**-1.6**	**-1.7**	**-1.4**		**-1.9**	**-1.3**	
Contribution from nominal interest rate	0.7	0.9	0.7			0.3	0.3	0.3	0.3	0.4	0.4		0.5	0.7	
Contribution from real GDP growth	-0.2	-1.2	-1.1			-1.6	-1.6	-1.7	-1.9	-2.1	-1.8		-2.4	-2.0	
Contribution from price and exchange rate changes	-3.1	-0.4	-0.5			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**4.6**	**2.5**	**-1.0**			**4.1**	**-2.3**	**0.9**	**2.9**	**-2.2**	**9.2**		**2.6**	**4.4**	
o/w exceptional financing	0.2	0.1	0.1			0.0	0.1	0.1	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	15.8			17.1	16.6	18.1	20.4	19.4	24.5		27.0	29.8	
In percent of exports	...	...	77.6			77.8	79.9	84.9	93.4	85.4	106.7		111.4	111.6	
PV of PPG external debt	**...**	**...**	**7.9**			**9.0**	**9.3**	**11.2**	**13.9**	**13.1**	**18.1**		**20.3**	**20.4**	
In percent of exports	**...**	**...**	**38.9**			**40.8**	**44.7**	**52.5**	**63.4**	**57.5**	**78.8**		**83.6**	**76.3**	
In percent of government revenues	**...**	**...**	**64.0**			**68.5**	**67.4**	**79.9**	**97.5**	**91.1**	**125.3**		**129.4**	**112.6**	
Debt service-to-exports ratio (in percent)	**6.0**	**8.0**	**7.4**			**3.5**	**4.0**	**4.1**	**4.2**	**4.3**	**4.8**		**4.6**	**6.7**	
PPG debt service-to-exports ratio (in percent)	**2.4**	**3.0**	**2.9**			**1.7**	**1.8**	**1.9**	**1.9**	**2.2**	**2.4**		**2.4**	**4.1**	
PPG debt service-to-revenue ratio (in percent)	**4.1**	**4.8**	**4.7**			**2.8**	**2.7**	**2.8**	**3.0**	**3.4**	**3.7**		**3.7**	**6.0**	
Total gross financing need (Billions of U.S. dollars)	-0.2	0.7	0.9			0.0	0.8	0.8	0.7	0.4	0.3		0.2	0.0	
Non-interest current account deficit that stabilizes debt ratio	2.9	2.4	6.1			2.0	9.6	6.3	5.0	9.9	-2.8		4.0	1.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	1.1	7.2	5.2	6.6	2.6	6.4	6.6	7.0	7.0	7.0	7.0	6.8	6.7	6.2	6.6
GDP deflator in US dollar terms (change in percent)	19.9	2.0	2.3	3.9	10.0	-7.9	5.3	0.3	-0.4	-0.6	3.8	0.1	4.0	4.4	4.1
Effective interest rate (percent) 5/	4.4	5.3	3.3	2.6	1.3	1.0	1.1	1.1	1.2	1.4	1.5	1.2	1.5	2.1	1.7
Growth of exports of G&S (US dollar terms, in percent)	58.7	-2.7	11.6	19.3	18.6	5.7	6.1	10.1	9.5	10.5	12.2	9.0	12.1	11.9	12.1
Growth of imports of G&S (US dollar terms, in percent)	39.3	16.3	6.4	15.9	11.7	10.3	5.4	6.1	7.5	4.8	9.4	7.3	10.6	10.5	10.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	48.6	52.3	42.3	38.1	33.7	36.4	41.9	39.4	13.2	30.0
Government revenues (excluding grants, in percent of GDP)	12.8	12.5	12.4			13.1	13.8	14.0	14.2	14.4	14.5		15.7	18.1	16.5
Aid flows (in Billions of US dollars) 7/	0.7	0.8	0.9			1.0	0.9	1.0	1.2	1.4	1.3		1.6	2.4	
o/w Grants	0.4	0.4	0.4			0.5	0.5	0.4	0.4	0.4	0.4		0.7	1.7	
o/w Concessional loans	0.3	0.4	0.5			0.5	0.5	0.6	0.8	1.0	0.9		0.8	0.7	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			4.7	3.8	3.8	3.8	3.9	3.6		3.1	1.7	2.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			73.7	75.7	61.1	54.9	47.7	52.0		59.2	44.3	54.1
Memorandum items:															
Nominal GDP (Billions of US dollars)	14.4	15.8	17.0			16.7	18.7	20.1	21.4	22.7	25.2		42.5	119.7	
Nominal dollar GDP growth	21.3	9.4	7.6			-2.0	12.2	7.3	6.5	6.3	11.0	6.9	11.0	10.9	10.9
PV of PPG external debt (in Billions of US dollars)			1.1			1.4	1.6	2.1	2.7	3.7	4.6		8.6	24.3	
(PVt-PVt-1)/GDPt-1 (in percent)						1.6	1.3	2.5	3.3	4.6	3.8	2.9	2.5	2.0	2.4
Gross workers' remittances (Billions of US dollars)	0.8	0.9	0.6			0.8	0.8	0.8	0.9	1.0	1.1		1.7	4.3	
PV of PPG external debt (in percent of GDP + remittances)	...	...	7.6			8.6	8.9	10.7	13.3	12.5	17.4		19.5	19.7	
PV of PPG external debt (in percent of exports + remittances)	...	...	32.8			33.8	37.3	43.9	53.0	48.5	66.6		71.8	67.2	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.4			1.4	1.5	1.6	1.6	1.8	2.0		2.1	3.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2.Uganda: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008-2031
(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-16 Average	2021	2031	2017-31 Average
Public sector debt 1/	22.5	23.7	24.9			26.9	26.1	27.8	30.4	25.6	34.4		37.2	33.2	
o/w foreign-currency denominated	11.8	15.3	16.8			18.6	19.0	21.9	25.8	22.9	30.8		32.9	27.0	
Change in public sector debt	-1.1	1.2	1.2			2.0	-0.8	1.7	2.6	-4.8	8.8		0.4	-0.6	
Identified debt-creating flows	-1.0	2.0	3.1			5.0	1.7	4.0	3.0	-5.6	7.5		0.0	-0.2	
Primary deficit	1.1	1.1	3.8	1.3	1.5	6.5	4.2	5.4	3.9	2.0	4.1	4.4	2.8	1.8	2.5
Revenue and grants	15.5	15.1	14.9			16.2	16.2	16.0	16.1	16.1	16.1		17.3	19.5	
of which: grants	2.7	2.6	2.5			3.1	2.5	2.0	1.9	1.7	1.7		1.7	1.4	
Primary (noninterest) expenditure	16.6	16.2	18.7			22.7	20.4	21.4	20.0	18.1	20.3		20.1	21.3	
Automatic debt dynamics	-2.1	0.9	-0.7			-1.5	-2.5	-1.4	-1.0	-7.6	3.4		-2.7	-2.0	
Contribution from interest rate/growth differential	-0.7	-1.8	-0.8			-1.0	-1.8	-1.6	-1.4	-1.8	-1.5		-2.1	-1.5	
of which: contribution from average real interest rate	-0.5	-0.3	0.4			0.5	-0.2	0.1	0.4	0.2	0.2		0.2	0.5	
of which: contribution from real GDP growth	-0.3	-1.5	-1.2			-1.5	-1.7	-1.7	-1.8	-2.0	-1.7		-2.3	-2.0	
Contribution from real exchange rate depreciation	-1.3	2.7	0.0			-0.5	-0.7	0.3	0.5	-5.8	4.9		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-0.1	-0.8	-1.9			-3.1	-2.5	-2.3	-0.4	0.8	1.3		0.3	-0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	16.0			17.3	16.4	17.1	18.5	15.8	21.7		24.6	26.5	
o/w foreign-currency denominated	...	...	7.9			9.0	9.3	11.2	13.9	13.1	18.1		20.3	20.4	
o/w external	...	...	7.9			9.0	9.3	11.2	13.9	13.1	18.1		20.3	20.4	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	10.8	9.1	11.0			13.5	10.6	11.1	9.0	5.9	7.1		6.8	7.5	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	107.7			106.9	100.8	107.0	115.1	98.1	134.4		141.5	136.1	
PV of public sector debt-to-revenue ratio (in percent)	…	…	129.5			132.4	119.0	122.3	130.2	110.1	150.1		156.8	146.5	
o/w external 3/	…	…	64.0			68.5	67.4	79.9	97.5	91.1	125.3		129.4	112.6	
Debt service-to-revenue and grants ratio (in percent) 4/	27.3	23.4	23.2			20.0	17.4	15.8	14.9	10.6	10.7		11.0	15.1	
Debt service-to-revenue ratio (in percent) 4/	33.0	28.3	27.9			24.8	20.5	18.1	16.8	11.9	12.0		12.2	16.2	
Primary deficit that stabilizes the debt-to-GDP ratio	2.1	-0.1	2.6			4.5	5.0	3.7	1.4	6.8	-4.7		2.4	2.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	1.1	7.2	5.2	6.6	2.6	6.4	6.6	7.0	7.0	7.0	7.0	6.8	6.7	6.2	6.6
Average nominal interest rate on forex debt (in percent)	1.7	1.6	1.6	1.0	0.4	0.7	0.7	0.8	1.0	1.3	1.4	1.0	1.3	6.1	1.8
Average real interest rate on domestic debt (in percent)	-3.3	-3.7	3.0	4.7	5.5	6.0	-0.3	4.4	10.3	8.0	11.5	6.6	9.7	-9.8	7.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-11.9	24.2	0.2	1.1	12.6	-2.8	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	14.3	14.6	9.1	6.7	5.0	5.4	10.7	6.4	5.0	5.0	2.8	5.9	3.2	4.0	3.5
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.0	0.2	0.1	0.1	0.3	0.0	0.1	0.0	0.0	0.2	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	48.6	52.3	42.3	38.1	33.7	36.4	41.9	39.4	13.2	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3.Uganda: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031
(In percent)

	Projections							
	2011	2012	2013	2014	2015	2016	**2021**	2031
				PV of debt-to GDP ratio				
Baseline	9	9	11	14	17	18	**20**	20
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	9	6	5	5	8	10	**14**	23
A2. New public sector loans on less favorable terms in 2011-2031 2	9	9	12	16	21	25	**30**	31
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	9	9	11	13	17	19	**21**	21
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	9	9	13	15	19	20	**22**	21
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	9	10	12	15	20	22	**24**	24
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	9	10	13	15	19	20	**22**	21
B5. Combination of B1-B4 using one-half standard deviation shocks	9	10	12	15	19	20	**23**	23
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	9	12	14	18	23	25	**28**	28
				PV of debt-to-exports ratio				
Baseline	41	45	53	63	76	79	**84**	76
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	41	28	23	25	35	42	**56**	88
A2. New public sector loans on less favorable terms in 2011-2031 2	41	46	57	73	95	108	**125**	117
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	41	41	48	58	72	79	**83**	76
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	41	47	70	81	95	102	**104**	90
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	41	41	48	58	72	79	**83**	76
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	41	48	60	69	82	88	**89**	78
B5. Combination of B1-B4 using one-half standard deviation shocks	41	41	49	58	71	78	**82**	74
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	41	41	48	58	72	79	**83**	76
				PV of debt-to-revenue ratio				
Baseline	68	67	80	98	121	125	**129**	113
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	68	43	36	38	55	67	**87**	130
A2. New public sector loans on less favorable terms in 2011-2031 2	68	69	87	113	150	172	**193**	173
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	68	63	77	94	120	131	**136**	118
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	68	67	92	108	131	141	**139**	115
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	68	69	88	107	136	149	**155**	134
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	68	73	91	106	129	139	**138**	114
B5. Combination of B1-B4 using one-half standard deviation shocks	68	70	85	103	129	142	**145**	125
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	68	87	103	125	159	175	**181**	157

Table 3.Uganda: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031 (continued)
(In percent)

Debt service-to-exports ratio

Baseline	2	2	2	2	2	2	**2**	4
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	2	2	2	1	1	1	**2**	4
A2. New public sector loans on less favorable terms in 2011-2031 2	2	2	2	2	3	3	**4**	6
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	2	2	2	2	2	2	**2**	4
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	2	2	2	3	3	3	**3**	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	2	2	2	2	2	2	**2**	4
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	2	2	2	2	2	3	**3**	4
B5. Combination of B1-B4 using one-half standard deviation shocks	2	2	2	2	2	2	**2**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	2	2	2	2	2	2	**2**	4

Debt service-to-revenue ratio

Baseline	3	3	3	3	3	4	**4**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	3	3	2	2	2	2	**3**	5
A2. New public sector loans on less favorable terms in 2011-2031 2	3	3	3	3	4	5	**7**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	3	3	3	3	4	4	**4**	6
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	3	3	3	3	4	4	**4**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	3	3	3	4	4	4	**4**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	3	3	3	3	4	4	**4**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	3	4	4	**4**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	3	4	4	4	5	5	**5**	8
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	31	31	31	31	31	31	**31**	31

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock
(implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4.Uganda: Sensitivity Analysis for Key Indicators of Public Debt 2011-2031

		Projections																			
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of Debt-to-GDP Ratio																					
Baseline	17	16	17	19	20	21	22	22	23	24	24	24	25	25	26	26	26	26	26	26	26
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	17	14	12	11	13	12	11	10	10	10	10	10	11	12	13	13	14	14	15	15	15
A2. Primary balance is unchanged from 2011	17	18	20	23	28	30	32	34	36	38	40	43	45	48	50	52	54	56	57	58	60
A3. Permanently lower GDP growth 1/	17	17	17	19	21	23	24	25	26	27	28	29	31	32	33	34	35	36	38	39	40
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	17	17	19	21	23	25	26	27	28	29	30	30	31	32	33	33	34	34	34	35	35
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	17	15	14	16	17	19	19	20	21	22	22	23	23	24	24	25	25	25	25	25	25
B3. Combination of B1-B2 using one half standard deviation shocks	17	15	13	15	17	19	20	21	22	23	24	25	26	27	27	28	28	29	29	29	29
B4. One-time 30 percent real depreciation in 2012	17	20	19	20	21	21	21	21	21	21	22	22	23	23	23	24	24	24	25	25	26
B5. 10 percent of GDP increase in other debt-creating flows in 2012	17	24	25	26	27	27	28	28	28	28	28	28	28	28	29	29	28	28	28	28	28
PV of Debt-to-Revenue Ratio 2/																					
Baseline	107	101	107	115	124	132	135	138	141	140	139	137	136	137	139	136	136	136	135	134	134
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	107	87	73	70	78	77	69	64	60	57	57	58	61	65	69	70	73	75	76	78	79
A2. Primary balance is unchanged from 2011	107	112	124	144	174	186	197	208	218	224	232	240	248	258	271	274	282	289	296	301	307
A3. Permanently lower GDP growth 1/	107	102	109	119	130	140	145	152	158	160	162	164	166	171	178	179	184	188	193	197	202
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	107	104	117	129	142	152	158	164	169	170	171	170	170	172	176	174	176	176	177	177	178
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	107	94	88	97	107	116	120	125	129	129	129	128	128	130	132	130	131	131	131	131	130
B3. Combination of B1-B2 using one half standard deviation shocks	107	91	82	93	106	118	124	130	136	138	140	140	141	144	148	147	148	149	150	150	151
B4. One-time 30 percent real depreciation in 2012	107	120	121	125	129	129	128	129	129	127	126	123	123	124	127	125	126	127	128	128	131
B5. 10 percent of GDP increase in other debt-creating flows in 2012	107	149	154	161	168	170	170	171	171	166	163	158	155	154	155	150	149	147	146	144	143
Debt Service-to-Revenue Ratio 2/																					
Baseline	20	17	16	15	11	10	11	11	11	10	11	11	11	12	12	13	14	14	14	15	15
A. Alternative scenarios																					
A1. Real GDP growth and primary balance are at historical averages	20	17	16	14	10	10	10	9	9	7	7	7	7	7	8	8	9	9	9	10	10
A2. Primary balance is unchanged from 2011	20	17	16	15	11	12	12	12	13	13	14	15	16	17	18	19	20	21	22	23	24
A3. Permanently lower GDP growth 1/	20	17	16	15	11	11	11	11	11	11	12	12	12	13	14	15	16	17	17	18	19
B. Bound tests																					
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	20	18	17	16	11	11	11	12	12	12	12	12	13	13	14	15	16	16	17	17	18
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	20	17	16	14	10	10	10	10	10	9	10	10	10	11	12	12	13	13	14	14	14
B3. Combination of B1-B2 using one half standard deviation shocks	20	18	16	15	10	10	11	11	10	9	10	10	11	11	12	13	14	14	15	15	16
B4. One-time 30 percent real depreciation in 2012	20	18	17	16	12	12	12	13	13	12	13	13	13	14	15	16	17	17	18	18	21
B5. 10 percent of GDP increase in other debt-creating flows in 2012	20	17	17	16	11	11	11	11	14	13	13	13	13	13	14	15	15	15	16	16	16

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

International Monetary Fund
Washington, D.C. 20431 USA

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FOR IMMEDIATE RELEASE
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IMF Executive Board Completes Second Review Under Policy Support Instrument for Uganda

The Executive Board of the International Monetary Fund (IMF) today completed the second review under the Policy Support Instrument (PSI) for Uganda. In completing the review, the Board approved waivers for the nonobservance of the end-December 2010 assessment criteria on net domestic assets and net international reserves.

The PSI for Uganda was approved on May 12, 2010 (see Press Release No. 10/195) and aims at maintaining macroeconomic stability and alleviating constraints to growth. The IMF's framework for PSIs is designed for low-income countries that may not need, or want, IMF financial assistance, but still seek IMF advice, monitoring and endorsement of their policies. PSIs are voluntary and demand driven (see Public Information Notice No. 05/145).

Following the Executive Board's discussion on Uganda, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, stated:

"Thanks to generally sound macroeconomic policies, Uganda withstood the global financial crisis and other shocks. Economic growth has recovered and is expected to strengthen, although inflation risks, mostly related to rising food prices, have increased. Modest intervention by the central bank has mitigated volatility of the exchange rate, and the financial sector remains sound.

"The main challenge facing economic policymakers at present is to adjust fiscal and monetary policies to safeguard macroeconomic stability and rebuild policy buffers, including international reserves. Scaling up infrastructure investment will also be key to faster growth over the medium term.

"To restore fiscal space, the authorities plan to raise domestic revenue by eliminating some tax exemptions, improve spending efficiency by strengthening investment project selection, and enhance budget formulation by revising the Public Finance and Accountability Act. "Going forward, the government's recourse to central bank financing will be strictly limited to foster macroeconomic stability and strengthen the operational independence of the central bank.

"The Bank of Uganda is committed to tighten the stance of monetary policy if price pressures intensify. Over the medium term, reforms to the monetary policy framework—including the proposed adoption of inflation targeting—may be appropriate. The upcoming FSAP update will review financial system stability and chart the path for further financial sector reforms," added Mr. Shinohara.

Statement by Moeketsi Majoro, Executive Director for Uganda
June 29, 2011

1. My Ugandan authorities remain determined to persevere with prudent macroeconomic policies that enabled the economy to recover swiftly from the global economic crisis related downturn. They are also determined to deepen structural reforms to pave way for sustained and broad-based economic growth. With this macroeconomic framework and continued support of the Fund and the international community, my authorities are confident that they stand a good chance of mitigating the effects of the second round of the global commodity price surge and the potential fallout from the sovereign debt risks in advanced economies. To that end, they are committed to strengthen the implementation of their program under the PSI and to continue the track record of macroeconomic stability attained over the years.

2. My authorities are appreciative of the Fund's constructive engagement and support under the PSI and the related technical assistance packages. Going forward, they are determined to further strengthen their macroeconomic framework, and achieve key national and regional objectives set out in their National Development Plan (NDP) and East African single market protocols that are supported by the PSI.

3. To that end, and in view of the strong performance under the program—with all but two of the end-December 2010 quantitative performance/assessment criteria observed with good margins, and implementation of structural reforms on track—they request Directors' support for the completion of the second review of the PSI. They also request Directors' support for the waivers for nonobservance of the two assessment criteria—the NIR and NDA—and agree with staff's recommendation for the establishment of the end-June 2011and end-December 2011 quantitative assessment criteria.

Recent economic developments and respective policy environment

4. Uganda's strengthened economic fundamentals over the years—policy-wise and the broadened economic base—helped the country weather the storm of the global economic downturn and a return swiftly to a growth path. Real GDP growth that had declined from 7.2 percent in 2008 to 5.2 percent in 2009 as a result of deterioration in the external environment, recovered to 6.4 percent in 2010 and is projected to maintain the recent growth momentum in 2011 and in the medium-term. The repetitive drought conditions and the recent spike in global food and fuel prices are exerting pressure on domestic inflation. My authorities are strengthening their monetary policy framework, also in line with staff recommendations, to avert the second round effects of the price surge. They, in this regard, expect inflation to subside to single digits and to revert to the 2009/2010 levels in the medium-term.

5. My authorities' fiscal policy has in the course of the year progressively shifted towards consolidation as security and elections related spending pressures have abated. The

authorities' fiscal discipline and reallocations of spending among budget lines meant that, overall, the fiscal outturns have remained within the PSI targets. This has enabled them to cut down on the fiscal deficit during the latter part of the year, and to scale back on central bank financing. Nevertheless, the authorities concur with staff over the growing risks of accumulating arrears emanating from the reallocation of spending. To that effect, they are committed to sharpen monitoring of the build-up of arrears within the major spending units.

6. On the revenue front, latest data updates indicate improvement in domestic revenue collection. The authorities are determined to build on the current revenue performance to create additional fiscal space needed for their investment program. They view the recent Fund TA recommendations on tax policy as fundamental inputs into their reform effort.

7. The authorities have made progress in raising funds from external non-concessional borrowing and are confident that they will make use of the entire non-concessional borrowing window for this financial year and express preference for a higher limit than the one proposed by staff of $800 million. In light of the debt sustainability assessment that remains well below the distress threshold, and their strong pipeline of large infrastructure projects, the authorities had, during the discussions with Management at the Spring Meetings, requested a non-concessional limit of $1.5 billion. They are, therefore, disappointed that the proposed $800 million falls well below their financing needs.

8. My authorities' monetary policy stance has also shifted from being accommodative in response to the growing inflationary pressures. The financial sector has continued to strengthen and profitability remains high, on account of the limited exposure of the banking system to the toxic assets and the strength of the regulatory framework. Additionally, the banks have generally increased their liquidity buffers and tightened their lending standards. As a result, the non-performing loans (NPLs) have declined substantially. This commendable progress notwithstanding, the authorities are mindful of the remaining risks and stand ready to further support the stability of the financial sector. The recent parliamentary bill that creates an independent regulatory authority for the pension sector is an important step toward strengthening the regulatory framework for the financial sector.

Medium-term policy framework

Fiscal policy

9. My authorities will continue to actively use their fiscal policy to spur economic growth to its potential trajectory and to address the effects of repetitive external shocks. To achieve these objectives, measures including sustaining budgetary spending levels for the priority services, modest scaling-up of investment in infrastructure and primary sectors to shore-up economic growth, and deepening structural reforms to improve the business environment will continue to be prioritized.

10. To maintain prudent spending in these priority areas while embarking on a fiscal consolidation path, the authorities will continue to strengthen domestic and external concessional resource mobilization in the medium-term. Cognizant of the overall resource limitations, they intend to fully utilize this year's non-concessional financing window—about $0.5bn. As earlier noted, they have requested augmentation of this window. They have also made an undertaking to enhance revenue reforms in line with staff recommendations with the view of raising the revenue yield.

11. The authorities are mindful of the huge potential of oil revenues including the sizable capital gains taxes. They have, in this regard, started with the FY 2011/2012 the process to comprehensively review the Public Finance Accountability Act that will incorporate oil revenue management. They also intend to ring-fence oil revenues for infrastructure investments by establishing a petroleum fund to (i) finance expenditures exclusively through the budget, and (ii) generate revenue savings for future generations. The Bank of Uganda (BoU) will manage the latter component. The authorities also intend to strengthen the ongoing measures aimed at enhancing the public sector's absorptive capacity.

12. On the expenditure side, the authorities will pursue expenditure streamlining in line with the program while maintaining a clear focus on the priorities of their National Development Plan especially on road and energy infrastructure paralleled by maintaining spending on the MDG clusters to boost growth and reduce poverty. Additionally, they will take steps to strengthen budget execution, and improve the alignment between policy objectives and the budget through prioritization of public investment in line with their NDP.

Monetary and exchange rate policies

13. My authorities' monetary policy will continue supporting their macroeconomic framework through maintaining sufficient liquidity in the financial system, and low and stable inflation. They will remain vigilant of the inflation pressures arising from the resurgence of global commodity prices and domestic supply shocks. To achieve the objective of anchoring its monetary policy on low and stable inflation, the BoU will further bolster its open market operations, maintain a flexible exchange rate policy, rely on foreign exchange sales for sterilization of liquidity, and continue to improve liquidity forecasting. Meanwhile, they are improving their inflation-specific analytical and forecasting tools, and envisage migrating to an inflation targeting lite framework over the medium-term. The BoU will also continue to review performance of monetary aggregates against their quantitative targets on a monthly basis. They stand ready to intervene regularly with repos and reverse repos to ensure stability in the money markets.

14. The BoU is committed to maintain the transparency of its monetary policy stance and promote orderly financial markets. The authorities will also seek to make progress in the preparation for and negotiations of the East African Monetary Union. To that end, targeted support by the Fund in key relevant areas will be greatly appreciated by the EAC partners.

15. On exchange rate, the BoU remains committed to a flexible exchange rate regime and continue to see this as the first line of defense against external shocks. The BoU will remain vigilant and only intervene occasionally to smooth out excessive volatility. The authorities will also seek to accumulate a high level of international reserves from the current 3.6 months of import cover to the 6 months cover target consistent with the East African Monetary Union convergence criteria over the medium-term.

Financial sector

16. The BoU will continue to enhance its supervisory and regulatory services to the financial institutions to stem further exposure to the new challenges emanating from mobile banking and avert future resurgence of NPLs. Building on the operationalization of the credit reference bureau and the recent increase in capital requirements, the authorities intend to strengthen the regulatory framework for financial institutions to be fully consistent with Basel 1 Capital Accord, and to update the Financial Institutions Act to allow banks to offer additional products. 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.

Structural reforms

17. My Ugandan authorities' commitment to the implementation of a wide range of reforms underpins the NDP objectives. Improving the stock and quality of infrastructure—from road and rail networks to energy and telecommunications and regional infrastructure projects—is a priority with the aim of enhancing productivity in the primary sectors and competitiveness of the country as a whole, and strengthening regional markets. Additionally, the authorities' pursuit of detailed fiscal management reforms should help create the needed fiscal space to undertake their ambitious investment program including that in the oil sector.

Conclusion

18. The authorities' macroeconomic fundamentals and continued commitment to strong policies helped the economy restore its growth momentum faster than earlier envisaged. They are aware of the reemerging risks in addition to the regional security threats and are, therefore, prepared to take appropriate measures to protect the gains in the country's macroeconomic stability. In the near term, and notwithstanding the need for fiscal consolidation, the authorities are determined to ensure that the program focuses on sustaining macroeconomic stability, enhancing domestic resource mobilization, promoting broad-based and pro-poor growth, and increasing investment in infrastructure, primary sectors and core MDG clusters. They are aware of the future opportunities and challenges arising from the imminent exploitation of the oil and gas resources. They, therefore, request 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 attainment of the MDGs.