INTERNATIONAL MONETARY FUND

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UGANDA

July 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UGANDA

In the context of the Staff Report for the 2015 Article IV Consultation and the Fourth Review Under the Policy Support Instrument, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its June 29, 2015 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 29, 2015, following discussions that ended on May 14, 2015, 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 12, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- 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

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INTERNATIONAL MONETARY FUND
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Press Release No. 15/305
FOR IMMEDIATE RELEASE
June 29, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth PSI Review for Uganda and Concludes 2015 Article IV Consultation

The Executive Board of the International Monetary Fund today completed the fourth review of Uganda's economic performance under the program supported by the Policy Support Instrument (PSI)[1] and also concluded the 2015 Article IV consultation[2] with Uganda.

The PSI for Uganda was approved by the Executive Board on June 28, 2013 (see Press Release No: 13/239).

Following the Board discussion, Min Zhu, Deputy Managing Director and Acting Chair, made the following statement:

"Economic performance has been positive, underpinned by sound policies and strong implementation of the program supported by the Policy Support Instrument. In particular, tax revenue has been higher than expected; inflation has remained low despite global and regional shocks; and exchange rate flexibility has been preserved. GDP growth is picking up, the financial sector remains sound, and international reserves and public debt remain at comfortable levels.

"The economic policy mix is expected to remain focused on attaining growth and inflation objectives. The authorities are urged to maintain fiscal discipline in the pre-electoral period, by adhering to a budget that contains large infrastructure investment and higher tax collections, while keeping domestic financing at a moderate level. The Bank of Uganda is

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[1] 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. 02/145).

[2] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

encouraged to remain firmly focused on the maintenance of price stability. Preserving the banking system's soundness and promoting financial deepening and access would contribute to economic growth.

"Further increasing tax revenue collection; ensuring that the infrastructure investment program is well sequenced, with project selection based on commercial viability; enhancing regional integration; and strengthening social protection are important steps to attain medium-term inclusive growth and poverty reduction.

"The authorities are to be commended for the progress achieved on the structural front. The Public Financial Management (PFM) Act was adopted, the accounting and payments systems upgraded, the stock of domestic arrears reduced, and the inflation targeting framework improved. Enacting regulations to implement the new PFM Act and a charter of fiscal responsibility, and improving cash management are critical remaining reforms. Amending the Bank of Uganda Act and enacting financial institutions legislation are key steps to further enhance central bank independence and strengthen financial resilience. Reforms are also needed to strengthen the business climate and public institutions in order to promote diversified, inclusive growth through enhanced competitiveness, foreign investment, and regional integration."

The Executive Board also completed the 2015 Article IV Consultation with Uganda.

Uganda's recent economic performance has been favorable. Real GDP growth is projected at 5¼ percent for FY2014/15 supported by a fiscal stimulus and a recovery in private consumption. Annual core inflation increased to 4¾ percent in May, from very depressed levels, mainly fueled by the shilling depreciation pass-through. The current account deficit is set to widen to about 9 percent of GDP reflecting increasing capital goods imports, but international reserves remain adequate. A sound banking system resumed lending to finance trade and construction activities.

Economic policies in FY2014/15 have supported growth and stability objectives. The fiscal deficit is estimated at 4½ percent of GDP, below previous projections, on account of a sharp tax revenue increase (the package in force is expected to yield 1 percent of GDP compared to a target of ½ percent), savings from improvements in the payment and payroll systems, and delays in the implementation of infrastructure projects. Following the recent large depreciation—driven by the dollar strengthening, subdued exports, and profit repatriations—the Bank of Uganda tightened the monetary policy stance to keep inflation low. Risk-based supervision has kept bank vulnerabilities low.

The outlook is promising. Growth is estimated at 5¾ percent in FY2015/16 and an average 6¼ percent over the medium-term, driven by scaled-up public investment and a rebound in private demand. Core inflation is projected to remain within the 5 percent medium-term target range. Despite the planned ambitious infrastructure investment package, total debt is expected to remain at low risk of distress and reserves to remain at comfortable levels. Risks to the outlook emanate from regional geo-political uncertainties and potential unbudgeted election-related spending.

Executive Board Assessment[3]

Directors commended Uganda's positive economic performance supported by sound policies amid a challenging external environment. Growth has rebounded, inflation has remained moderate, policy buffers are adequate, and the banking system remains sound. Directors stressed the importance of continued strong policies to foster resilience and competitiveness, maintain macroeconomic stability, and promote diversified, inclusive growth.

Directors endorsed the authorities' fiscal policy stance focused on enhanced revenue mobilization and public spending efficiency, to create room for priority social and infrastructure investment. They welcomed the tax reform package, and endorsed plans to extend the tax net to the informal sector, strengthen tax compliance and enforcement, and eliminate discretionary tax exemptions. Directors stressed the need for continued fiscal discipline in the pre-electoral environment, and recommended strengthened communication with the markets.

Directors supported the authorities' plans to scale up infrastructure spending, underpinned by new public investment management guidelines. They stressed the importance of ensuring the consistency of infrastructure investment with absorptive and implementation capacity; transparent selection of projects that are commercially viable; and contracting debt on favorable terms. Well-designed public-private partnerships should help to curtail contingent liabilities. Fund technical assistance would be helpful in supporting the authorities' efforts in these areas.

Directors welcomed the adoption of the Public Financial Management Act, and advised prompt enactment of its regulations. They looked forward to the adoption of the Charter of Fiscal Responsibility, and recommended sustained efforts to reduce domestic arrears.

Directors considered the tight monetary stance appropriate, in view of recent price and exchange rate developments and rising domestic spending. They welcomed the strengthened inflation targeting framework, and called for further efforts to improve monetary policy transmission and coordination. Interventions in the foreign exchange market should continue to be limited to smoothing excessive volatility. Directors encouraged measures to enhance

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[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

the central banks' independence, including timely passage of amendments to the Bank of Uganda Act and the central bank's continued recapitalization.

Directors noted that the financial sector is well capitalized and profitable. To further enhance financial stability, they advised enactment of the financial institutions legislation, and strengthening the risk assessment of foreign currency lending and credit concentration. Directors supported efforts to promote financial inclusion and deepening, including the strengthening of financial literacy. They welcomed the recent passage of the Anti-Terrorism Amendment Bill, and encouraged the authorities to address remaining deficiencies in the AML/CFT framework.

Directors commended the significant progress on structural reforms, and recommended sustained efforts to strengthen the business climate and public institutions in order to enhance competitiveness and promote diversified, inclusive growth. Efforts are needed to attract foreign investment and enhance regional integration, while a stronger social protection system should contribute to reducing poverty and inequality.

Uganda: Selected Economic and Financial Indicators, FY2011/12–2019/20[1,2]

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
			Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
Output, prices, and exchange rate								
Real GDP	3.3	4.5	5.3	5.8	5.9	6.4	6.7	6.8
GDP deflator	4.1	2.4	4.4	5.1	4.7	4.3	4.1	4.2
CPI (period average)	5.8	6.7	2.7	5.5	5.8	5.0	5.0	5.0
CPI (end of period)	3.6	5.0	5.6	6.4	5.2	5.0	5.0	5.0
Core inflation (end of period)	5.7	2.9	6.1	6.7	5.5	5.0	5.0	5.0
Terms of trade (deterioration, -)	-8.2	2.5	3.3	0.9	-2.5	-1.5	-1.0	-0.6
Money and credit								
Broad money (M3)	6.6	17.4	14.2	16.3	15.7	12.6	14.6	15.8
Credit to non-government sector	6.4	13.9	15.7	15.0	15.5	15.9	15.7	15.3
Bank of Uganda policy rate[3]	11.0	11.0	…	…	…	…	…	…
M3/GDP (percent)	18.9	20.7	21.5	22.5	23.4	23.8	24.6	25.6
NPLs (percent of total loans)	4.0	5.8	…	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)							
General government budget								
Revenue and grants	12.9	13.0	14.1	15.1	15.1	15.5	15.7	16.1
of which: grants	1.5	1.0	1.1	1.6	1.1	0.9	0.6	0.6
Expenditure	16.5	16.7	18.6	22.1	22.0	22.4	21.8	20.6
Current	9.1	9.8	10.0	10.4	10.2	10.1	10.5	10.6
Capital[4]	6.6	7.0	7.9	11.3	10.9	11.8	10.7	9.5
Primary balance	-2.2	-2.4	-2.9	-5.0	-4.7	-4.6	-3.5	-1.7
Overall balance	-3.6	-3.8	-4.5	-7.0	-6.9	-7.0	-6.1	-4.5
Excluding grants	-5.0	-4.8	-5.6	-8.6	-7.9	-7.8	-6.7	-5.0
Public debt								
Public gross nominal debt	26.2	28.9	31.9	36.0	39.7	43.0	45.5	46.0
of which: external public debt[5]	15.2	16.1	18.2	21.8	25.5	29.7	32.3	32.7
Investment and savings								
Investment	29.5	28.9	31.4	35.3	35.5	37.1	36.8	37.1
Savings	21.6	20.7	22.1	24.1	22.8	23.7	22.8	22.8
External sector								
Exports (goods and services)	20.2	19.2	19.7	20.5	20.6	22.1	21.9	21.9
Imports (goods and services)	30.5	28.7	29.8	32.1	33.4	34.8	34.8	34.8
Current account balance (incl. grants)	-7.6	-7.9	-8.9	-11.0	-12.4	-13.1	-13.8	-14.0
Current account balance (excl.	-7.9	-8.2	-9.3	-11.3	-12.7	-13.4	-14.0	-14.2
Gross international reserves								
In billions of US$	2.9	3.4	2.9	3.2	3.6	3.9	4.4	4.7
In months of next year imports	4.5	5.1	4.0	3.9	4.0	4.0	4.1	4.4
Memorandum items:								
GDP at current market prices								
Billion of Ugandan Shillings	63,905	68,407	75,183	83,596	92,668	102,782	114,129	126,92
GDP per capita (Nominal US$)	670	709	682	668	703	729	770	811

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.
[2] All figures are based on the rebased GDP.
[3] The CBR was introduced following the start of Inflation Targeting in July 2011. End of year CBR.
[4] Capital expenditures include net lending and investment on hydropower projects.
[5] The public external debt is different from the Public and Publicly Guaranteed Debt reflected in the DSA, which also covers publicly guaranteed

INTERNATIONAL MONETARY FUND

UGANDA

June 12, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT

KEY ISSUES

Backed by sound policies, economic performance since the 2013 Article IV Consultation has been positive. In response to fiscal stimuli and credit recovery, growth is picking up from the low levels that followed the credit-boom-and-bust-cycle. Careful central bank policies kept inflation low and the financial sector stable, despite shilling volatility. Lower export demand and high infrastructure-related imports widened the current account deficit, but reserves and debt remain at comfortable levels.

Performance under the PSI is on track. All end-December 2014 quantitative assessment criteria and most indicative targets and structural benchmarks were met. Key highlights include an exceptionally strong revenue performance and progress in public financial management. The inflation targeting mechanism triggered consultations with staff as average core inflation fell below the inner limit of the band. Risks to the program stem from the upcoming election, regional unrest, and capacity constraints.

The envisaged policy mix should achieve further economic gains in the fiscal year starting in July. Despite the election, the authorities are committed to keeping fiscal policy within a budget that favors large infrastructure investment and sustains tax revenue collections in the context of low inflation. They also intend to closely oversee the spillovers and feedback loops between the real economy and the financial sector.[1]

The planned oil production, infrastructure upgrades, and regional integration bring encouraging medium-term prospects for growth and employment. The strategy will be supported by foreign direct investment; enhanced domestic revenue mobilization through additional tax collection and efforts to improve access to bank services; and increased borrowing at non-concessional but favorable terms.

Staff recommends conclusion of the 2015 Article IV Consultation and supports the authorities' request to complete the fourth PSI review. It also supports the authorities' decision to modify two end-June 2015 ACs and to increase the continuous ceiling on the contracting or guaranteeing of new nonconcessional debt.

[1] Since Uganda is a pilot on the mainstreaming financial sector surveillance initiative, this report highlights the macro-financial links throughout its analysis.

Approved By

Roger Nord (AFR) and Masato Miyazaki (SPR)

IMF team: A. L. Coronel (head, senior resident representative), A. Aisen, C. Mira, and B. Raisi (all AFR), J. Danforth (FAD), H. Wang (MCM), and F. Narita (SPR). C. Ntumwa (local office economist) supported the mission, and G. Gasasira-Manzi (OED) attended some official meetings.

Discussions: Held in Kampala during April 29-May 14, 2015. The mission met with economic authorities, senior government officials and representatives of the financial, business and international communities, civil society, and the media.

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CONTEXT

1. **A challenging geo-political situation over the last two years has not disrupted economic and financial stability.** Security concerns following unrest in neighboring countries and terrorist attacks in the region have weighed on Uganda's spending needs, exports, and remittances. Declining donor support in reaction to concerns about governance and human rights and reduced development partners' aid budgets have spurred domestic borrowing requirements. Moreover, the proximity of the February 2016 presidential and parliamentary elections has generated uncertainty. Despite these challenges, the authorities have succeeded in preserving economic and financial stability, helped by a resilient economy—characterized by low inflation, sustainable debt, and ample international reserves.

2. **Economic developments and performance under the PSI have been positive.** During a period of moderate growth, inflation has come down significantly from its 33 percent peak in 2011; and despite a decline in international reserves and a pickup in public debt, both remain at comfortable levels. Policies have strongly responded to the last Article IV recommendations (Box 1). Recent program performance has been positive, with all end-December 2014 quantitative assessment criteria (QAC) met. However, the lower inner limit of the inflation consultation clause was breached triggering consultations with staff. The indicative target (IT) on tax revenue was met by a substantial margin. The reduction in the stock of domestic arrears was smaller than targeted reflecting a decision to backload intra-year repayments, but the annual target is expected to be met. Contracting of nonconcessional borrowing (NCB) for hydropower plants (HPPs), roads, and electrification was within the $2.2 billion limit. Most end-March ITs were met.

3. **Structural reforms have progressed steadily.** The approval of the Public Financial Management (PFM) Act in November 2014 was a major milestone, and structural benchmarks on finalizing preparation on its regulations and the Charter of Fiscal Responsibility (CFR) were observed. The Treasury Single Account (TSA) set-up has laid the stage for improved cash management although more time will be needed to eliminate movements of cash and incorporate donor accounts in the system. The submission to parliament of amendments to the Bank of Uganda (BoU) Act was postponed.

4. **Over the medium term, the government is committed to boosting sustainable growth to generate employment.** This will require bolstering public and private investment with a more targeted focus on inclusiveness. To this end, the government has started the implementation of an ambitious investment package aimed at narrowing the infrastructure gap, enhancing regional integration, and preparing for oil production. The acceleration of private investment is expected to entail PPP schemes for strategic projects; and reforms to deepen financial markets, encourage credit growth, and make bank credit more accessible and affordable. Improvements in governance and the business environment are set to support this framework.

Box 1. Response to 2013 Article IV Consultation's Key Recommendations

Preserving macroeconomic stability. Moderate growth, low inflation, and comfortable reserves have underpinned favorable economic conditions.

Strengthening public financial management. The legal framework for improving budget credibility and execution, and a TSA to boost cash controls were set up. Payment and payroll systems were upgraded. Domestic arrears are declining.

Enhancing tax revenue. The authorities eliminated many tax exemptions, and efforts are ongoing to modernize tax administration. Additional action is needed to raise tax collection.

Refining the inflation targeting framework. With the use of better forecasting techniques, monetary policy formulation has improved. The government has recapitalized the BoU with marketable securities reinforcing its instrument independence. Further operational and institutional reforms are being considered.

Improving the business environment to better prepare the economy for oil production. Public sector operations are more transparent. Clearer tax and licensing rules bring favorable oil production prospects. Shortcomings in doing business and governance indicators remain.

Strengthening implementation capacity. Capacity constraints still limit execution of public investment projects, and delays are frequent. Guidelines to improve investment decisions are being prepared.

Deepening the financial sector and making it more inclusive. The system is sound and dominated by banks. Private sector credit has recovered, but a structurally low deposit base is insufficient to contribute to development financing.

RECENT DEVELOPMENTS

5. In the context of moderate growth and exchange rate depreciation, inflation is coming up from depressed levels:

- According to rebased estimates (Box 2), ***real GDP growth*** was 4½ percent in FY2013/14, driven by services, trade, construction, and manufacturing—below the estimated potential of about 6 percent.[2] More recently, economic activity is picking up, led by public investment and a recovery in private consumption driven by higher real incomes and stronger credit growth.

- The ***nominal exchange rate*** against the US dollar appreciated by 7 percent in the year through February 2014, and since then depreciated by 20-25 percent. Sharp pressures were felt in early 2015 reflecting 1) a portfolio rebalancing in response to the dollar appreciation; 2) increased foreign exchange demand from corporations to repatriate their profits; 3) lower exports to and remittances from South Sudan; 4) some decline in FDI linked to oil

[2] Potential growth is estimated on the basis of the rebased series using HP filters and a Kalman filter applied to a simple semi-structural model. However, given that growth prior to FY2009/10 was not revised when the rebasing took place, results should be taken with caution.

investment plan deferrals; and 5) election-related market nervousness as memories of the 2011 elections—when rapid credit expansion and expenditure overruns drove inflation out of control—reverberated. The real effective exchange rate appreciated by about 4 percent in 2014, mainly reflecting the weakening of Uganda's main trading partners' currencies, and it is close to the level implied by the estimated current account norm (Annex I).

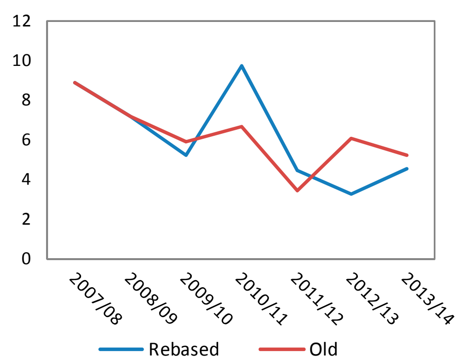
- ***Inflation*** has been contained in the context of declining food crops and oil prices, the 2013 shilling appreciation, and moderate economic activity. Nonetheless, the recent exchange rate depreciation has started to pass through to core inflation despite the mitigating impact of declining fuel prices (Box 3). Annual core inflation fell to 2.7 percent in December 2014 and rebounded to 4.8 percent in May 2015.

Box 2. Effects of Rebasing Gross Domestic Product

The rebasing exercise. In November 2014, the Uganda Bureau of Statistics rebased the GDP series from calendar year 2002 to FY2009/10 to better reflect the dynamism of economic activity and improve the quality of statistics. The new estimates incorporate more comprehensive survey data; compile production by industry supply and use tables; and introduce methodological changes to improve accuracy and coverage (e.g. compilation of intermediate consumption, and inclusion of the informal sector and non-profit institutions in the national accounts). GDP was revised upwards by 17¼ percent in FY2009/10, the base year. The services sector and to a lesser extent the agricultural sector increased their share in GDP, while the share of industry and construction declined.

Implications for economic analysis. Some indicators experienced significant change, including the debt-to-GDP ratio, almost 4 percentage points lower, at 29 percent in FY2013/14; and the tax-to GDP ratio, about 1 percentage point lower, at 11½ percent. There are also implications for policy analysis. The impact of the credit boom-and-bust cycle that started in 2011, for example, looks now more pronounced, with GDP growing by almost 10 percent in FY2010/11 (6½ percent estimated earlier) and decelerating more significantly in the following years. The slower economic recovery looks now more consistent with the behavior of banks' nonperforming loans (NPLs) and tax collections of the past two years.

Real GDP Growth
(percent)



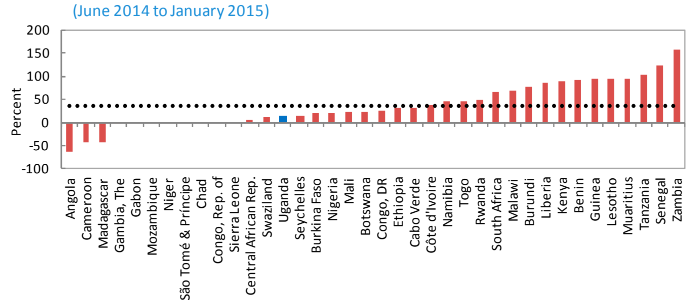
Source: Uganda Authorities

Box 3. Impact of the Decline in International Oil Prices

In the short term. Lower oil prices represent a positive supply shock, resulting in foreign exchange savings and a slight growth stimulus. A one percent reduction in international oil prices is estimated to lead to a 0.2 percent decline in total nominal imports in US dollars, implying that the expected average price for the current fiscal year would lead to a 10 percent reduction in the total import bill. With pump prices fully liberalized, lower prices allow consumers to divert income to other purposes. In the absence of fuel subsidies, the fiscal impact is also positive, as the government saves in the energy bill and collects slightly higher excise taxes (which are based on quantities and not prices). In the first nine months of the fiscal year, revenue from petroleum duties increased by around 18 percent compared to the same period in the previous year. The decline in oil prices is also expected to feed into lower electricity prices.

Short-term benefits of the oil price decline have been less pronounced in Uganda than in other countries in the region.[1] In the past nine months, petrol average pump prices have declined by 10 percent in domestic currency (21 percent in US dollar terms) on account of the shilling depreciation; the taxation modality; the oligopolistic nature of suppliers; and the lags between purchases and distribution.

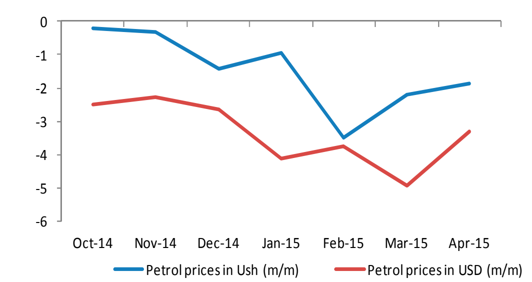
Pass-through of Changes in International Fuel Prices
(June 2014 to January 2015)



Sources: Country authorities; and IMF staff calculations.

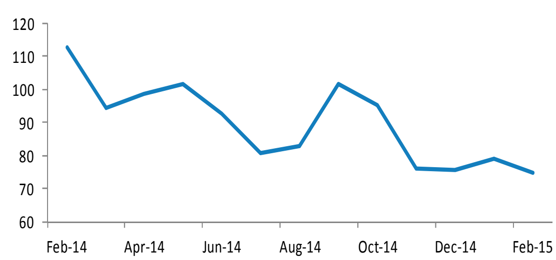
In the medium term. The impact would likely be less benign. Oil investments might be delayed in the context of lower profitability. Moreover, many interrelated investment decisions are dependent on the oil price, including granting production licenses; signing commercial and financial arrangements; developing engineering, procurement and construction plans; and agreeing on transnational infrastructure works.

Monthly Variation of Petrol Prices (USD and Ush)[1]



1. Average in 8 locations.
Source: Uganda Bureau of Statistics.

Imports of Petroleum Products (in millions of US$)



Source: Bank of Uganda (preliminary data the most recent)

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[1]According to standardized calculations for the whole sub-Saharan region, the pass-through from the oil price decline to pump prices in Uganda was about 14 percent, compared to a regional average of about 36 percent (IMF Sub-Saharan Africa Regional Economic Outlook, Spring 2015).

6. International reserves declined reflecting the spike in dollar demand for financial transactions in the context of depressed exports, but continue to be adequate. The current account deficit remained large owing to structurally high trade deficits. Imports of capital goods and petroleum products are increasing, while both coffee and non-coffee exports have stagnated since mid-2013 reflecting depressed food exports to South Sudan. Temporarily, strong travel receipts partially offset the impact of the large trade deficit. FDI, loans, and portfolio inflows have financed the deficit. However, since late 2014 total net financial inflows have slowed down.

7. Recent indicators show that the banking sector remains sound. Banks are well capitalized, liquid, and profitable. As of March-2015, the core capital-to-asset ratio averaged 20.8 percent, well above the minimum requirement of 8 percent. At over 29 percent, the statutory liquidity requirement (minimum 20 percent) was met. Consistent with the rebound in private sector activity, NPLs declined from the March 2014 peak of 6.2 percent to 4.2 percent of total loans in March 2015—getting closer to the 5-year historical average of 3.8 percent—boosting average profitability. Credit and liquidity risks related to loan quality and currency mismatches remained low.

8. Private sector credit recovered as lending rates declined and credit risks dissipated. The strong monetary tightening that followed the 2011 credit boom led to a sharp decline in credit and growth as lending rates picked up with a short lag. Once inflation stabilized, the significant drop in the central bank rate (CBR) in 2013 led to a similar fall in interbank rates (reflecting the functioning first stage in the interest rate transmission mechanism), although the decline in lending rates was more sluggish, revealing a longer lag in monetary transmission than in the tightening period, leading to a gradual credit recovery. The monetary policy transmission asymmetry is explained by the banks' cautious focus on loan recovery and their high operating costs, coupled with some crowding out effects as government's domestic borrowing requirements increased at that time. Now at 16 percent year on year, credit growth—mainly to manufacturing, trade and construction—is significantly higher than the 10 percent average of the previous two years, reflecting an improvement in the bank lending monetary transmission channel. However, lending rates remain relatively high.

Text Table 1. Key Interest Rates (percent)

	Jul-11	Jul-12	Jul-13	Jul-14	Sep-14	Dec-14	Apr-15
Central Bank Rate	13.0	19.0	11.0	11.0	11.0	11.0	12.0
7-day interbank market	15.3	18.5	11.0	11.0	11.0	11.0	12.3
Deposit (Uganda shillings)[1]	2.8	3.6	2.9	2.8	2.5	3.0	2.7
Time Deposit (Uganda shillings)[1]	13.0	17.8	11.7	10.4	10.0	10.5	9.8
Lending (Uganda shillings)[1]	21.7	26.9	23.2	21.6	21.2	20.7	20.1
Treasury bill yields							
91-day	14.2	18.7	9.9	9.6	10.0	11.3	14.2
182-day	15.0	18.6	11.6	11.2	10.9	13.6	15.5
364-day	15.3	17.5	13.2	12.0	11.3	13.8	16.7

1. Data from Mar-15 used when Apr-15 unavailable.

Source: Bank of Uganda

9. Despite significant banking sector growth, financial intermediation is limited and access to bank services low. The number of commercial banks has increased from 14 to 25 with a large influx of foreign banks, which currently hold 80 percent of assets. However, the system is small (total assets equal 27 percent of GDP) and highly concentrated, with the three largest banks holding 50 percent of assets. In a cash-based economy that suffers from a low savings rate, the deposit base (about 18 percent of GDP) is limited, and credit to the private sector stands at just 14 percent of GDP. Financial access is low with only 28 percent of adults owning a formal bank account.

10. Over the last year, economic policies had to respond to volatile foreign exchange flows, declining commodity prices, and the complex geopolitical environment.

- **On monetary policy,** the BoU kept a tight policy stance, holding the CBR constant at 11 percent from June 2014 to April 2015, and then raising it to 12 percent, on account of global developments and the ongoing and expected exchange rate pass-through. The BoU's intervention in the foreign exchange market has been focused on its program of announced dollar purchases for reserve build-up, but in the last few months it has been intervening on the sale side to smooth the fast-paced shilling depreciation. This intervention, along with increased infrastructure-related government imports, drove reserves down from $3.2 billion in end-December to $2.9 billion in mid-May (about 4 months of imports).

- **Regarding the financial sector,** to shield banks' balance sheets from the impact of ongoing shocks and mitigate short-term liquidity risks, the BoU further integrated risk-based analysis into its supervision work; introduced a liquidity coverage ratio to ensure that banks hold sufficient high quality liquid assets to cover 100 percent of net cash flows over a 30-day period (well above international standards); and advanced efforts to improve regulation of mobile money payments and financial literacy.

- **On fiscal policy,** in FY2014/15 the authorities embarked on an ambitious revenue enhancing program that yielded tax revenue beyond expectations, and kept expenditures below the budget level due to delays in external disbursements for HPPs. A supplementary budget, needed to reallocate resources, did not add expenses to the budget, but together with the delays in HPPs, tilted it towards current spending.

Text Table 2. Uganda: Fiscal Operations of the Central Government, FY2012/13–2015/16

(Percent of GDP[1])

	2012/13	2013/14	2014/15	2014/15	2014/15	2015/16
			3rd Review Old GDP	3rd Review New GDP	Proj.	Proj.
Total revenue and grants	12.9	13.0	15.1	14.1	14.1	15.1
Revenue	11.4	11.9	13.6	12.7	13.0	13.6
Tax	11.0	11.4	13.1	12.1	12.5	12.9
Expenditures and net lending	16.5	16.7	22.0	20.4	18.6	22.1
Current expenditures	9.1	9.8	10.5	9.7	10.0	10.4
Development expenditures	6.6	6.9	7.5	6.9	6.5	8.6
Other spending[2]	0.1	0.0	0.3	0.2	0.3	0.2
Net lending and investment	0.6	0.0	3.8	3.5	1.8	3.0
HPP projects	0.0	0.0	3.4	3.2	1.5	2.7
Bank of Uganda recapitalization	0.6	0.0	0.4	0.3	0.3	0.2
Overall balance	-3.6	-3.8	-6.8	-6.4	-4.5	-7.0
Financing	3.3	3.6	6.8	6.4	4.5	7.0
External financing (net)	2.2	1.3	2.8	2.6	1.1	5.0
Domestic financing (net)	1.0	2.3	4.0	3.8	3.4	2.0
Errors and omissions	-0.3	-0.2	0.0	0.0	0.0	0.0
Memorandum item						
Overall deficit excluding large infrastructure projects financed by non-concessional external borrowing and BoU recapitalization[3]	-2.9	-3.7	-3.1	-2.9	-2.7	-2.9

Sources: Ugandan authorities and IMF staff estimates and projections.

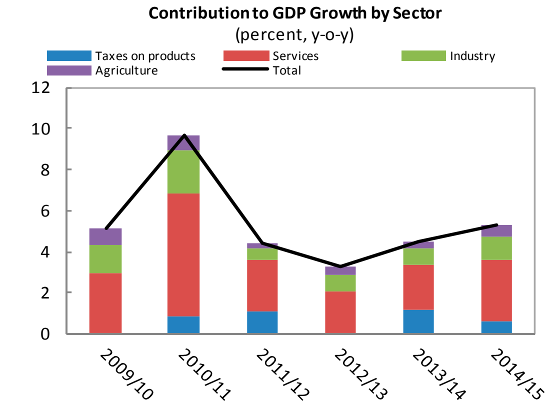
[1] All figures are based on the rebased GDP, except the 3rd review "old GDP" column.

[2] Other spending includes contingency reserve and repayment of domestic arrears.

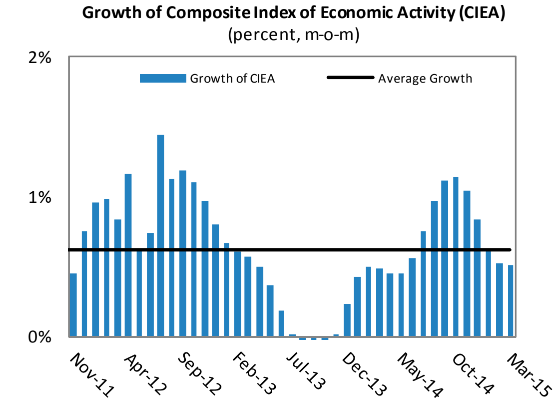
[3] The authorities follow this definition to better assess the impact of the fiscal stance on domestic demand.

Figure 1. Uganda: Recent Economic Developments

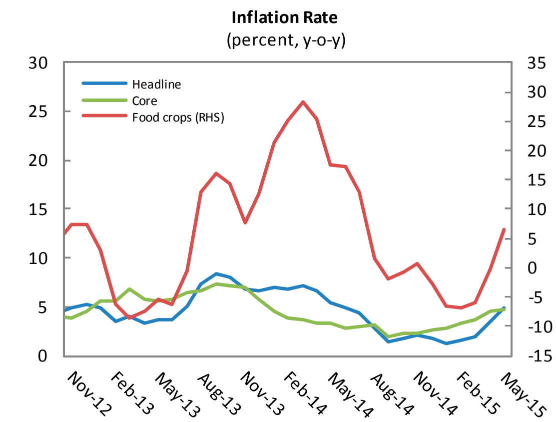
Economic growth has been moderate led by the service sector...



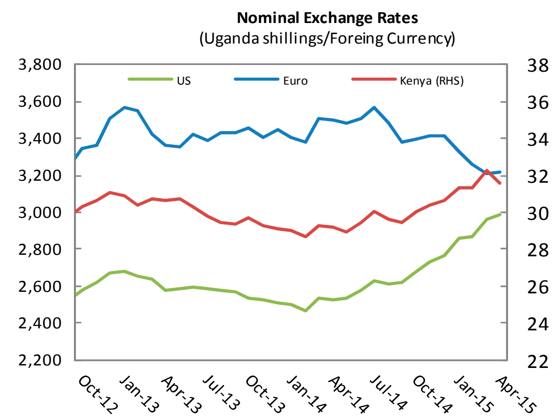
...in line with leading indicators



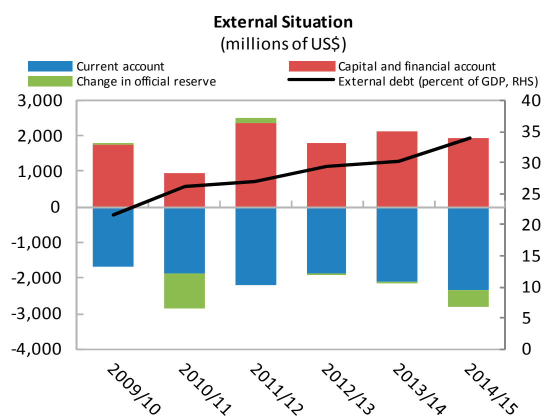
Inflation has been declining helped by falling food crops' prices but is now rebounding...



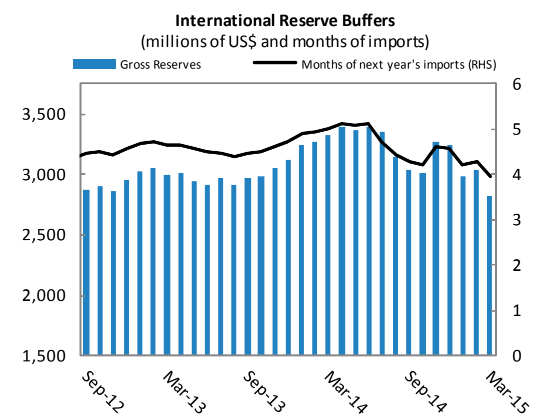
...in line with the recent exchange rate depreciation.



The current account deficit is widening...



...but international reserves coverage remains adequate.

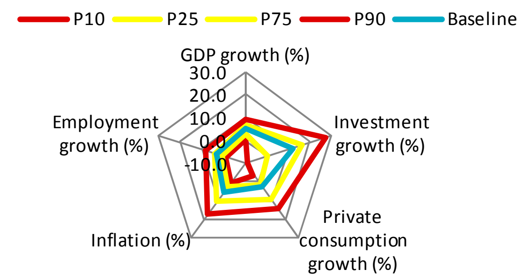


Sources: Bank of Uganda, World Bank, and IMF staff calculations.

ECONOMIC OUTLOOK AND RISKS

11. **The outlook is broadly favorable underpinned by consistent macro-financial policies.** Real GDP growth is projected at 5¼ percent in FY2014/15, 5¾ percent in FY2015/16, and an average 6¼ percent over the medium term, driven by scaled-up public investment and a rebound in private sector demand. Public investment financing, alongside weaker exports and tourism receipts, will drive the current account deficit up while preserving reserves at 4 months of imports. The rebound in private activity will be supported by an expected expansion in credit to the private sector of about 10 percent per year in real terms—gradually boosting the credit-to-GDP ratio to about 17 percent by FY2019/20. This pace—expected to prevent a reoccurrence of credit boom-and-bust cycles and preserve economic stability—is consistent with real GDP, consumption, and investment growth estimates, as judged by observed trends in other low-income countries.[3] Low consumer prices—with average core inflation projected to remain within the PSI consultation inner band at 3½ and 6¼ percent for end FY2014/15 and FY2015/16—will underpin the encouraging outlook.

Distribution of Macroeconomic Outcomes
(percent)



Source: IMF Staff Calculations

Text Table 3. Macroeconomic Outlook

	FY 2011/12	FY 2012/13	FY 2013/14	FY 2014/15	FY 2015/16	FY 2016/17
			(Percent)			
Real GDP growth	4.4	3.3	4.5	5.3	5.8	5.9
Headline CPI inflation, period average	23.5	5.8	6.7	2.7	5.5	5.8
Core CPI inflation, period average	24.6	6.6	5.2	3.5	6.3	6.1
			(Percent of GDP, unless otherwise specified)			
External current account balance	-9.5	-7.1	-6.8	-8.9	-11.0	-12.4
International reserves (stock, months of imports)	4.2	4.5	5.1	4.0	3.9	4.0
Overall balance	-2.5	-3.6	-3.8	-4.5	-7.0	-6.9
Overall deficit excluding large infrastructure projects financed by non-concessional external borrowing and BoU recapitalization[1]	-3.3	-2.9	-3.7	-2.7	-2.9	-2.8
Policy rate (end of period)	20.0	11.0	11.0			
Credit to the private sector (annual growth, percent)	11.2	6.6	13.9	15.7	15.1	15.6

[1] The authorities follow this definition to better assess the impact of the fiscal stance on domestic demand.
Sources: Ministry of Finance, Planning and Economic Development of Uganda, Bank of Uganda, and IMF staff calculations.

[3] This conclusion is based on the use of an excel-based toolkit to assess consistency between real sector and financial sector forecasts.

12. Risks to the outlook reflect economic and political vulnerabilities. Uganda has ample buffers and a flexible policy framework to respond to potential shocks—including low inflation, healthy international reserves, low levels of debt, a resilient financial system, a flexible exchange rate, and an improved PFM system. Nonetheless, the economy is vulnerable and risks are tilted to the downside. In the short run, expenditure overruns could materialize in the pre-electoral environment, potentially leading to a hike in inflation or to tight domestic credit conditions that could crowd out the private sector, affect banks' balance sheets, and hamper growth. Slower growth in key trading partners and further spillovers from lower global liquidity could trigger capital outflows, squeezing liquidity and generating currency mismatches for banks and corporations. In the medium term, the complex commercial and legal aspects surrounding FDI in the oil sector could delay the planned investments. Other risks stem from postponements or cost overruns in the planned infrastructure projects. Security issues in the region pose additional challenges (Annexes II and III).

SUPPORTING MEDIUM-TERM GROWTH

13. The authorities are committed to supporting sustainable growth and socioeconomic transformation. Key objectives of their medium-term development plan include enhancing sustainable production and productivity; strengthening public service delivery; improving education and health; and reducing the infrastructure deficit to strengthen competitiveness. The latter has been at the center of the authorities' economic agenda as infrastructure investments of around $11 billion—including PPPs—are expected over the next ten years (Box 4). Discussions centered on policies to support the medium-term strategy, including by preserving the hard-won price and financial sector stability; increasing revenue collection; improving spending efficiency; enhancing financial intermediation and access to bank services; and ensuring a stable regulatory environment, in which contracts and medium-term commitments are fully honored and procurement rules are transparently observed.

14. Oil production will be an important component of the medium-term economic horizon. With recoverable crude oil reserves of 1.7 billion barrels out of potential reserves of 6.5 billion, oil production would start in FY2020/21 under a model that entails a crude export pipeline and a domestic refinery. While the government has identified a lead investor for the refinery, decisions on the pipeline's route are still subject to economic and geopolitical considerations. Significant steps have been taken to speed-up investments in the sector including (i) granting one of the production licenses; (ii) announcing a bidding process for operations in six new blocks; (iii) starting to set up the institutions that will govern oil operations; and (iv) proposing parliament to remove the value-added tax (VAT) on capital equipment used in exploration and production activities. Despite the oil price decline, companies remain optimistic about the medium-term prospects. While operations will be largely externally financed, their domestic content is expected to have positive spillovers on employment and domestic banks' operations.

Box 4. Developing Infrastructure

Overview. In line with the National Development Plan (NDP II), the government has embarked on an ambitious infrastructure investment program to revamp the transport network and alleviate bottlenecks emanating from electricity shortfalls. The program will be gradually implemented during the next 10 years; financed through NCB, PPPs, and use of government savings (the oil, energy, and infrastructure funds): and accompanied by capacity building in project preparation, appraisal, monitoring, and execution. Key projects include:

- *Electricity projects*. A total of $4.6 billion is estimated. Besides the Karuma and Isimba dams and related substations—already under construction and financed by China's Export Import Bank with government's contributions—other plans include the construction of smaller HPPs and several transmission lines for rural electrification.
- *Oil and oil-related infrastructure.* The plan includes the construction of the Hoima oil refinery and a product pipeline to Kampala to be run as a PPP, and the Albertine region airport and roads, with a total investment of $1.8 billion. The crude oil pipeline is not included in these estimates, as it is expected to be privately financed.
- *Transport infrastructure.* Projects, worth $4.7 billion, include (i) the Kampala-Jinja highway and several other roads serving the Greater Kampala area under PPP arrangements; (ii) the upgraded Entebbe International Airport, financed by China's Export Import Bank; and (iii) the initial phase of the standard gauge railway from Kampala to the Kenyan border.

Economic Impact.

- A multiplier analysis points to a positive impact on growth during construction—about 1½ percent over the next five years—and an increase in potential output once projects come on stream.
- The projects are expected to have an import component of about 80 percent, thus limiting their impact on aggregate demand and inflation.
- Private sector credit growth will not be compromised because current spending and domestic borrowing will remain constrained, providing space for credit expansion.
- Capital spending is set to pick up by an average 4¼ percent of GDP during the period.
- Imports are expected to rise by about 3½ percent of GDP per year, leading to an equal expansion of the current account deficit over the period.
- The impact on reserves is determined by the domestic component of the financing, which amounts to $515 million over the construction period.
- The total impact on external debt will be about 14 percent of GDP.

15. Progress towards East African Community (EAC) regional integration is gradually taking place and has the potential to further enhance trade and structural transformation. Uganda ratified the Monetary Union Protocol, and has been actively participating in work to establish EAC regional institutions and to create a fiscal surveillance process. The Ugandan authorities plan to achieve greater integration by continuing progress towards the reduction of non-tariff barriers; implementing common-market agreements; integrating payment systems; and harmonizing policies in the context of the medium-term convergence program. These improvements would allow Uganda to reap its comparative advantages and maximize efficiency of production, raising prospects for attracting investors.

16. Financing the medium-term development strategy requires domestic revenue mobilization and external borrowing.

- ***Domestic revenue mobilization will entail gains in public and private savings.***

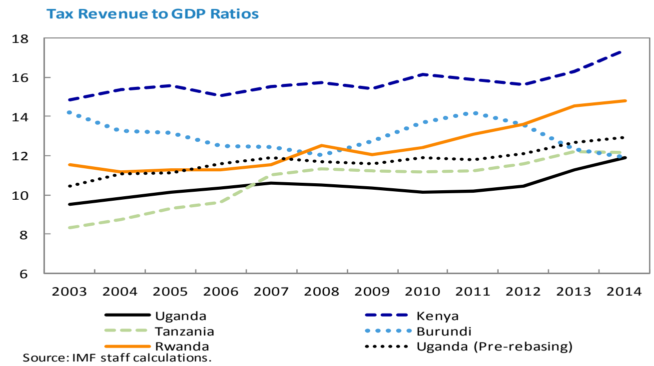
  ✓ ***On the public sector side,*** the government plans to use savings in the oil an energy funds to finance part of the infrastructure program. Bold action is needed, however, to raise tax revenue as this is the most sustainable and reliable source of development financing. Welcome steps are being taken by the Uganda Revenue Authority (URA) to improve enforcement and compliance, but a sustained increase in the ratio will require incorporating the large informal sector into the tax-paying portion of the economy and ensuring that large taxpayers comply with their obligations—no simple task. Although many statutory tax exemptions were removed, loopholes remain on the policy front. Taxpayer-specific exemptions still exist, and the government is under near constant pressure to provide tax breaks (Box 5). Continued diligence is required to resist these pressures and create a tax system that is efficient and fair for everyone.

  ✓ ***On the private sector side,*** deepening the financial sector and improving bank access are essential for making private sector credit an engine for growth. Sustainable financial deepening will largely rely on making steady progress on financial inclusion, which will in turn depend on actions to boost the bank deposit base; enhance the intermediation role of non-bank financial institutions, including the National Social Security Fund (NSSF); and develop the money and capital markets. To this end, there is scope for simplifying procedures to open bank accounts, locating outlets in remote areas, upgrading trading and settlement systems, improving investors' literacy, and leveraging regional opportunities for the local stock exchange. The current massive use of mobile money is a clear demonstration of the population's demand to move away from cash transactions (Annex IV). FDI flows will add to domestic credit within this financing strategy.

- ***External borrowing will complement the financing needs.*** With insufficient domestic savings and ample space for borrowing, external financing is a key requirement. The authorities remain committed to pursuing concessional loans as the preferred means of financing, when available. For infrastructure projects, however, they have started to secure NCB, still on favorable terms, within levels that would allow total debt to remain at low risk of distress. Staff's debt sustainability analysis, which includes the infrastructure package as a whole, concludes that the public and publicly guaranteed external debt-to-GDP ratio in net present value (NPV) terms would peak at about 25 percent in FY2020/21. Even combined with domestic borrowing plans, total public debt would remain well below the benchmark associated with heightened vulnerabilities. Nonetheless, the relatively short average maturity of domestic debt and the high debt service-to-revenue ratio are matters of concern (Debt Sustainability Analysis).

Box 5. Enhancing Tax Revenue

Weak tax performance. The tax-to-GDP ratio in Uganda was one of the lowest in the region prior to the GDP rebasing and is definitely the lowest afterward. Over the past ten years the ratio only increased by 0.2 percentage points per year, on average. This weak performance was due to a combination of ineffective tax policy and poor compliance. On the policy front, the Income and VAT Acts contained many exemptions. On the administrative side, a VAT gap analysis showed that 60 percent of the gap was due to compliance, partly related to deficiencies in data integrity and operational weaknesses in tax administration.



Successful concerted efforts. Many statutory VAT and income tax exemptions were eliminated in FY2014/15, and improvements in coordination between the URA and local governments have paid off. As a result, the tax-to-GDP ratio is projected to increase substantially. An additional increase is expected next year as focus begins to shift from tax policy changes to tax administration improvements. Planned improvements include URA's efforts to assess income from rental properties and identify businesses that are accessing local services but not filing national tax returns. Use of enhanced controls and creation of a single central processing center for all customs clearances should boost customs revenue.

Changing the tax-paying culture. As part of the EAC convergence criteria, Uganda has targeted a tax-to-GDP ratio of 25 percent by 2021. Although some of the increase is expected to come from oil revenues, an effort far beyond what has been achieved in the last ten years is needed. While URA's audit and enforcement efforts—an expensive way to collect taxes—will bear fruit, sustained improvement in tax collections will only be possible if the citizens of Uganda pay tax voluntarily. For this to happen, they need to be convinced that their tax payments are being put to good use and that corruption is being eliminated.

17. **Strengthening social protection is another key ingredient for accomplishing the medium-term development agenda.** Although progress on poverty reduction has been significant, inequality remains high, suggesting that investments in infrastructure and service delivery are not sufficient for attaining inclusive growth. While there is evidence that fiscal policy has played a key role in boosting growth and addressing inequality, there is a clear need for enhancing the social support system (Box 6 and Annex V).

Box 6. Strengthening Social Protection

Poverty and vulnerability. Uganda has made impressive progress on poverty reduction over the past two decades, with poverty declining from 56 percent in the early 1990s to 19.7 percent in 2013, allowing for early achievement of the Millennium Development Goal (MDG) of halving poverty by 2015. However, vulnerability remains widespread, rural and urban inequality has increased, and still about 7 million Ugandans live below the poverty line. While accelerating growth and upgrading infrastructure will contribute to further reductions of poverty and vulnerability, the most vulnerable segments of the population are not likely to fully share the benefits. Furthermore, the traditional social protection system (family support and other community self-help initiatives) has weakened in the last few decades.

Benefits of well-targeted protection. Experience in other countries in the world and the region show that the establishment of a comprehensive, well-targeted, and well-defined social protection system can improve productivity through health and education enhancements; function as a shock-absorber to various forms of economic instability; benefit the wider local economy; and contribute to achieving inclusive growth, creating employment, and building community assets. Social protection systems do not have to be costly. Average spending in safety nets in low income countries in Africa is 1.1 percent of GDP, and 2.8 when considering social protection in a broader sense[1]. Donors finance almost 75 percent of social safety nets in low income Africa.

Revamping social protection in Uganda. Social protection in Uganda is entrenched in the Constitution, Vision 2040 and the NDP II. Interventions have nonetheless been limited and fragmented—with only 0.4 percent of GDP a year devoted to direct income support and 1.2 percent of GDP to total social protection—and donors played an important role. A new policy framework is being developed to scale up interventions, covering the areas of direct income support, contributory social assistance, and social care services.

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[1] Monchuk, Victoria (2013). "Reducing Poverty and Investing in People: The New Role of Safety Nets in Africa". Directions in Development. Washington, DC, World Bank.

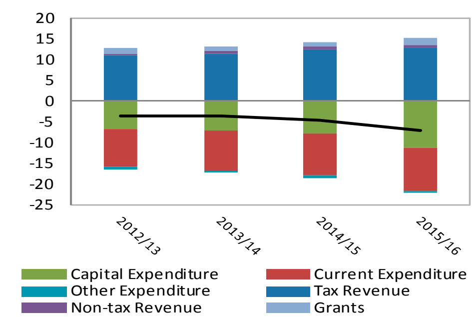
MAINTAINING FISCAL RESTRAINT WHILE RAISING PUBLIC INVESTMENT

18. In the last few years, the fiscal deficit has widened and has been largely domestically financed. The overall deficit increased by 2 percent of GDP between FY2011/12 and FY2014/15. While grants declined by ¾ percentage points, tax and non-tax revenue picked up by 1¾ percentage points, and total spending by 3 percentage points (with significantly larger increases in capital than current outlays). Given the substantial decline in concessionally financed external loans, the deficit was financed almost exclusively from domestic sources, mainly through issuances of securities in the market and use of government savings. This illustrates the falling importance of external support in deficit financing. Only 12 percent of total expenditure and net lending is expected to be financed by loans and grants this year, compared to 45-50 percent a decade earlier.

19. Over the medium term, the deficit is set to expand further, with spending tilted more towards capital outlays, and the bulk of financing coming from external sources. The overall deficit is projected to increase by an additional 2½ percentage points by FY2017/18 fueled by a continued expansion in capital spending (3¾ percentage points) and a small increase in current spending (¼ percentage point), and curtailed by a further improvement in revenues of at least ½ percent of GDP each year. Financing of the deficit is expected to pivot away from domestic sources towards external borrowing on non-concessional but favorable terms. Staff welcomed the changing deficit structure and financing, which will result in a higher fiscal multiplier, and will create space for private sector credit growth.

20. For FY2014/15, buoyant revenues, savings from the elimination of ghost workers, and delays in HPP implementation should keep the overall deficit well below the budget limit. The strong revenue measures, alongside tax administration enhancements, are likely to result in a 1 percent increase in the tax-to-GDP ratio (½ percent in the program), a significantly better than expected outcome. At the same time, spending on HPPs was almost 2 percent of GDP lower than originally anticipated, as delays in negotiating loan repayment mechanisms slowed progress. Against this backdrop, the supplementary budget used part of the windfall revenue and expenditure savings to cover operational shortfalls at several ministries, and Electoral Commission outlays, among other pressing needs. All in all, the overall fiscal deficit is now projected to reach 4½ percent of GDP (6¾ percent in the program) and issuances of securities in the domestic market should remain within the target.[4] While supporting efforts to keep domestic financing contained, staff expressed concern about investment delays, which can be costly, and about reallocating spending away from development expenditure. The authorities indicated that more time was needed to get assurances on the commercial viability of the projects, and committed to preserving spending in social sectors in the future.

Fiscal Revenue and Expenditure
(percent of GDP)



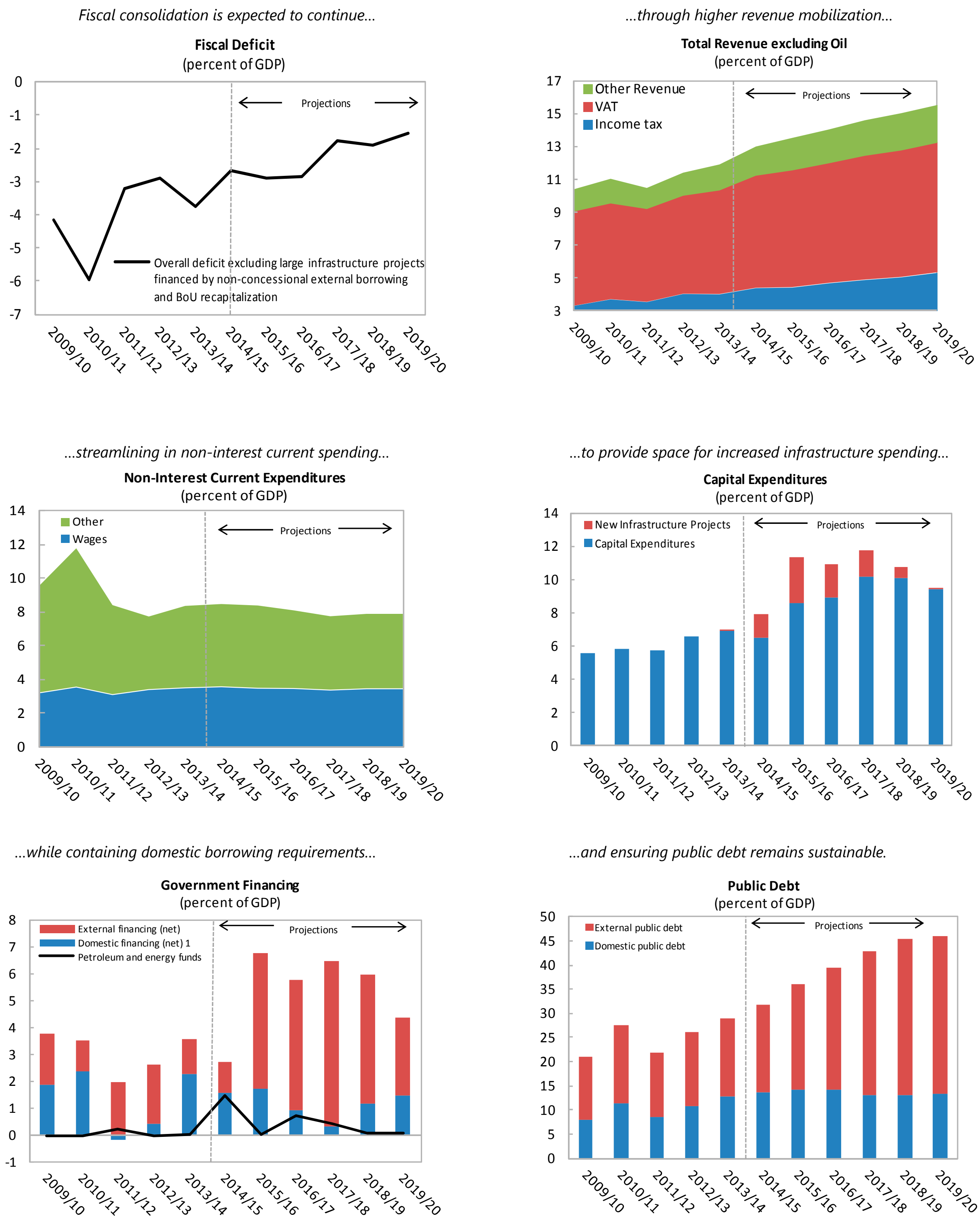
*Other expenditure includes net lending minus HPP projects. Capital Expenditure includes HPP projects.

Source: Bank of Uganda and IMF Staff Calculations

21. The FY2015/16 budget will increase the overall fiscal deficit to 7 percent of GDP, largely financed by NCB on favorable terms. The budget was approved on May 30 in line with the provisions of the PFM Act that call for approval before the fiscal year starts. The deficit expansion is explained by the boost in public investment, mainly for infrastructure financed by NCB with a grant element of about 11½ percent, and an increase in interest payments, partially offset by additional tax revenue gains. The revenue-to-GDP ratio is set to rise by 0.6 percentage points through policy measures and efficiency gains, including an increase in excise taxes (0.2 percent); an expansion in the scope of withholding taxes (0.1 percent); the imposition of the VAT on discounted taxable supply of services at fair market value (0.1 percent); an increase in fees and stamp duties (0.1 percent), and improved use of compliance data and better collaboration among ministries and the private sector (0.1 percent).

[4] If HPPs and BoU recapitalization outlays are excluded, the deficit at 2¾ percent of GDP will be 1 percent of GDP lower than last year's.

Figure 2. Uganda: Fiscal Developments and Outlook



[1]Domestic financing excludes withdrawal of petroleum funds and energy funds and issuance of government securities for the recapitalization of Bank of Uganda.

Sources: Bank of Uganda and IMF staff calculations.

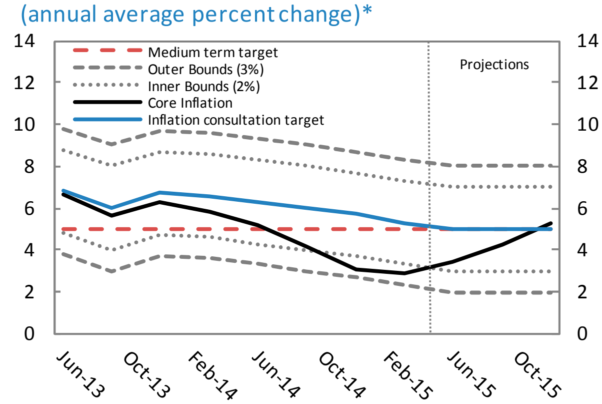
22. Staff urged the authorities to resist current spending pressures and implement infrastructure investment efficiently. The FY2015/16 budget is consistent with program objectives, but its successful implementation would require strong efforts to keep current expenditures within the budgeted amounts and proceed without further delays with the infrastructure plan. The contingency provision was reduced by 0.2 percent of GDP at the time of budget approval to facilitate one-off spending on police activities linked to the election and allowances to parliamentarians, leaving little budget flexibility and requiring prudent execution in the year ahead. The authorities agreed that the projected deficit expansion will be contingent on the materialization of the planned infrastructure projects, and committed to refrain from substituting them by other types of spending in case of delays. On the infrastructure program, staff reiterated the need to properly sequence projects while ensuring that they are selected on the basis of commercial viability and with awareness of implementation constraints. The authorities agreed and are developing new public investment management guidelines and procedures for this purpose.

PROTECTING THE INFLATION OBJECTIVE

23. The inflation targeting framework has been successful, although a few challenges need to be addressed to ensure its long-term efficiency. Underpinned by a strong commitment to the inflation target, clear arrangements for monetary policy formulation, revamped policy instruments, and continuous learning from past experiences, the framework has been effective in keeping inflation low. The monetary transmission has worked well in spite of the shallowness of financial markets. Nonetheless, some challenges remain, including insufficient institutional arrangements to prevent government's use of deposits in BoU accounts beyond agreed levels, and shortcomings in inflation forecasting capabilities and fiscal-monetary policy coordination (Annex VI). The authorities have committed to taking action to address these shortcomings, including by agreeing on a floor below which the balances in the Uganda Consolidated Fund—the main government's account—would not decline, and upgrading the BoU's technical capacity. Both will result in improved decision making.

24. Recent inflation volatility has complicated monetary policy decisions. Inflation and inflation expectations have fluctuated over the last 18 months in response to sharp variations in the shilling (a fast depreciation following a significant appreciation); the food price evolution (not only seasonal but also related to weather conditions), and fiscal uncertainties. This volatility generated an understandable monetary tightening bias. Staff conducted consultations with the BoU on the factors behind the fall of average core inflation (3.1 percent in December 2014) below the inner band of the inflation consultation clause (3.7 percent). The authorities explained that prospects for loosening the

Core Inflation Forecast
(annual average percent change)*



*This is calculated as the 12-month average of the y-o-y percent change of Core CPI
Sources: Bank of Uganda and IMF Staff Calculations

stance in the first half of 2014 were constrained by (i) the start of a shilling depreciation trend that threatened to persist in the context of weakening trade; (ii) an expected increase of food prices; and (iii) unclear fiscal prospects amid mounting spending promises by politicians.

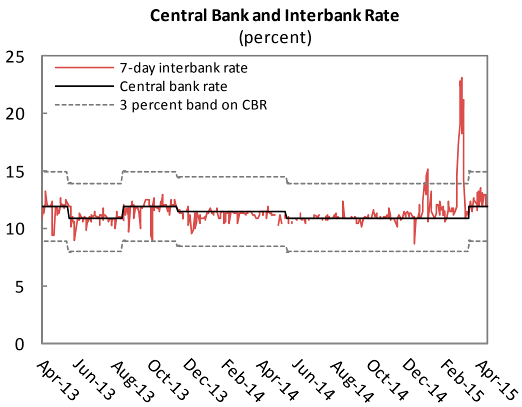
25. The depreciation risk materialized, at higher-than-anticipated rates, driving the BoU's decision to tighten the stance by 100 basis points in April. Given the high share of imported goods in the CPI, import prices play a key role in inflation behavior, with an estimated pass-through factor of 0.4–0.5. In view of this and of the narrowing output gap, the authorities' decision to tighten the stance was appropriate. Staff inquired whether some monetary easing last year could have possibly helped reduce inflation volatility and limit the interest rate hike given the monetary transmission lags. The authorities indicated their preference not to allow for swings in the policy stance, as frequent changes could jeopardize signaling and confuse the markets. Going forward, the BoU intends to continue to adapt monetary policy to evolving conditions to ensure that core inflation remains within the target range.

26. The BoU has managed the tradeoffs between interest rates and exchange rate behavior well, but has faced difficulties in times of market turbulence. Since the adoption of inflation targeting, the BoU has let the shilling find its market price while preserving international reserves. Foreign exchange interventions have been limited to smoothing excessive variations that would generate unfounded nervousness or threaten the inflation objective, and have been sterilized. In mid-March, however, the BoU intervened strongly on the sale side (gross sales amounted to $375 million in the first quarter of 2015 compared to around $10 million in 2013 and $140 million in 2014). In doing so, the BoU was successful in calming the markets, but to stop speculation, it intentionally allowed a liquidity shortage for a few days (by incomplete sterilization), temporarily pushing the 7-day interbank rate above the upper 3 percent band around the CBR, and forcing banks to borrow needed liquidity (through the Lombard facility) at high rates. Staff recommended dealing with speculation by building policy credibility rather than by allowing discrepancies between the CBR and the 7-day interbank rate. Fully sterilizing all market interventions will provide clear monetary policy signals, while ensuring that price stability remains the BoU's primary objective.

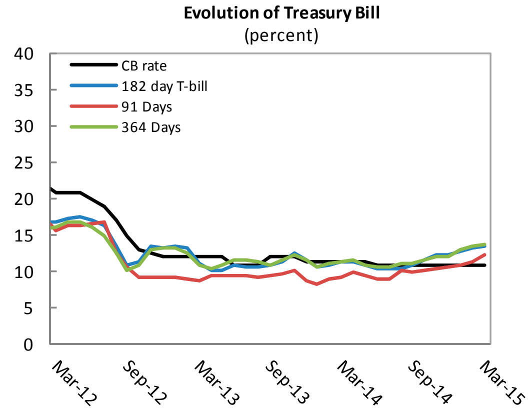
27. The authorities' program of foreign exchange reserve build up will continue albeit with a different modality. Relatively high FDI and portfolio inflows, partly related to the presence of foreign-owned businesses in Uganda's banking, telecommunications and retail sectors, allow for continued reserve accumulation in preparation for the expected rise in government's import needs. Until April, the BoU carried out a program of pre-announced BoU purchases through daily auctions, which was only interrupted during days when the BoU intervened on the sale side. More recently the BoU reached agreement with seven banks to buy a fixed daily amount from each of them. Staff expressed preference for market-based competitive foreign exchange auctions to allow for clarity of objectives, promote market deepening, and prevent market distortions. The authorities explained that the new system is well understood by all parties, introduces predictability, and is being used on a pilot basis to assess its effectiveness.

Figure 3. Uganda: Monetary Sector Developments and Outlook

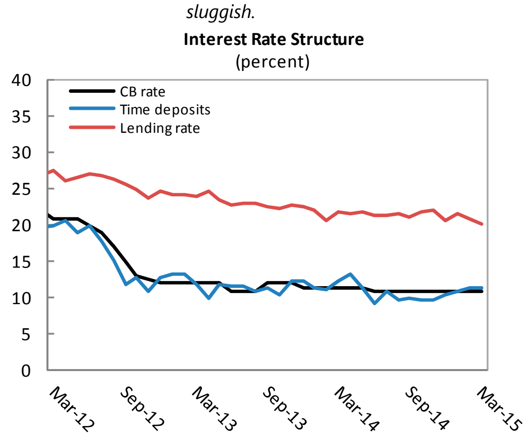
The interbank rate has been broadly aligned with the policy rate except for isolated episodes...



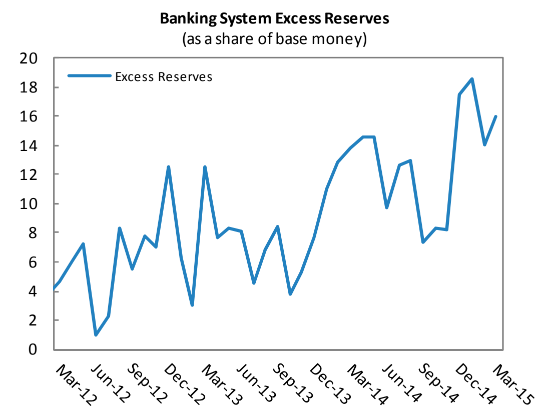
...as have been the Treasury bill rates...



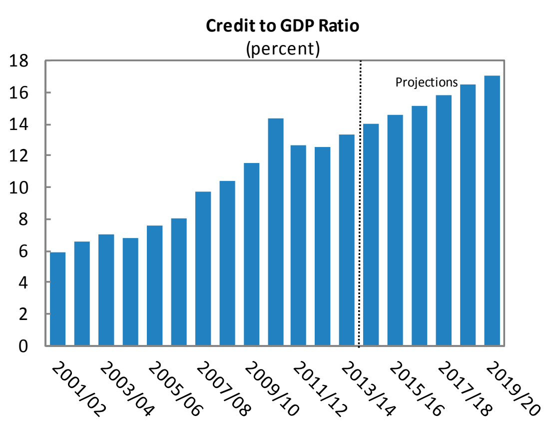
...but the transmission to lending rates has been more sluggish.



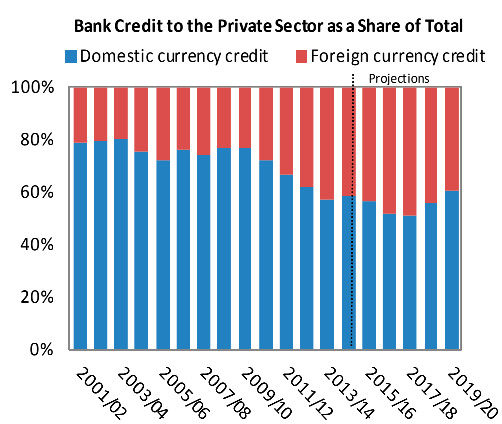
Excess reserves in the banking system have remained elevated.



Credit is gradually growing...



...and dollarization remains high.



Sources: Bank of Uganda, Bloomberg and IMF staff calculations.

28. Several actions to improve monetary policy effectiveness are underway. The BoU has taken steps to reduce volatility in overnight market rates by allowing all banks (previously only primary dealers) to access BoU operations. It is also strengthening its inflation forecasting skills, institutionalizing procedures to improve the decision making process, and studying the possibility of rearranging the reserve requirement cycle to smooth liquidity conditions. The latter would enhance operational effectiveness, potentially reducing speculation exacerbated by insufficient BoU short-term liquidity management facilities.

SECURING A MORE EFFECTIVE CONTRIBUTION OF THE FINANCIAL SECTOR TO GROWTH

29. The banking sector is broadly resilient to key adverse shocks. Stress tests regularly conducted by the BoU and those carried out with staff—including one to assess resilience to a combination of shocks—confirm the banking sector's relative strength. Specifically, the system can tolerate shocks such as increased NPLs, deposit withdrawals, and a large shilling depreciation, suggesting that credit, liquidity, and foreign exchange risks are well contained (Box 7). The BoU does not stress test banks' resilience to lending rate hikes because of insufficient data availability. Staff welcomed ongoing efforts to collect granular data on interest bearing assets and liabilities classified by maturity buckets, which would allow better measurement of the impact of interest rates changes on banks' solvency.

30. Despite bank stability reassurances, there are some sources of vulnerability that call for caution. Staff acknowledged that existing prudential requirements and risk-based supervision provide assurances of banks' strength to deal with shocks. Noting that stress test results usually mask diverse impacts on individual banks, the authorities agreed that further efforts to deter any negative impact of real sector developments on bank balance sheets—mainly due to potential interest rate and exchange rate volatility—are needed. Discussions covered the following issues:

- *High dollarization*. 37 percent of deposits and 43 percent of loans are denominated in foreign currency. These shares have increased, possibly reflecting depositors' inclination to protect the real value of their funds and borrowers' preference for lower financing costs. Regulations in place—banks' required net open position in foreign currency is 25 percent of capital; foreign exchange loans are mainly granted to hedged borrowers; and an 80 percent loan-to-deposit ratio is in place for operations in foreign currency—mitigate risks associated with foreign currency operations. Staff acknowledged that liquidity risks from banks' balance sheet mismatches seem to be contained, but called for guarding against credit risks associated with possible currency mismatches in borrowers' balance sheets. To complement current assessments on the effects of shilling depreciation on banks' net open positions and transaction costs, it would be advisable to revamp on-site inspections to examine more closely the quality of foreign currency loans.

- *Concentration and related-party risks. Gi*ven that the largest borrowers operate with all systemic banks, their default would seriously harm the system's capital. There is a need to strengthen data verification and monitoring, and ensure strict compliance with the regulations to avoid the risks posed by credit concentration.

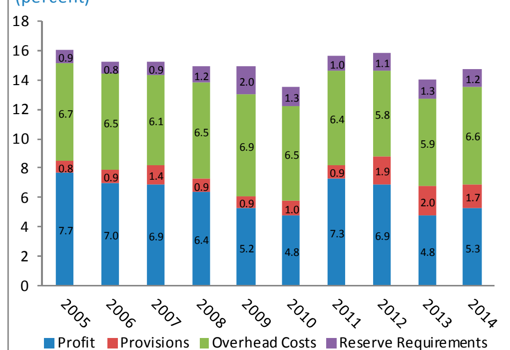
- *Provisioning of bad loans*. Provisions as a share of NPLs stand at 55 percent, and the general provisioning ratio for watch loans—those that have been past due for 30 to 89 days—at 1 percent. While the loan write-off and collateral policies are strict, staff encouraged the authorities to consider an increase in the general provisioning ratio for watch loans as recommended in the 2011 FSAP update.

- *Cross–border transactions*. The dominant presence of subsidiaries of foreign banks in the system involves transactions with nonresidents. While risks of cross-border flow reversals do not seem too high—a sudden withdrawal of nonresident funds would only affect 1.5 percent of bank liabilities—more detailed monitoring of offshore investor activities is warranted.

- *Consolidated supervision*. Cooperation with foreign regulators through supervisory colleges with regional presence is gradually enhancing the quality of consolidated supervision. Nonetheless, further efforts are needed to exchange information, address financial group issues more systematically, and prevent regulatory arbitrage.

31. While financially sound, the banking system's role in credit intermediation is weak, hampered by high operational costs, insufficient competition, and low policy credibility. The recent recovery in credit is welcome and its sectoral distribution does not raise credit risk. However, at about 11 percent, spreads between time deposit and lending rates in domestic currency are high by international standards. The low deposit base and elevated overhead costs (40 percent of income) hinder economies of scale gains in bank operations. Profits are high suggesting insufficient competition.[5] Moreover, banks' business models, with a large share of assets devoted to investments in Treasury bills, reflect cautious risk taking, as well as curtailed policy predictability given the large swings in interest rates, thus jeopardizing credit growth. Although there is some evidence that the lending channel is functioning well, improved bank efficiency and competition would result in better monetary policy transmission.

Decomposition of Bank Interest Rate Spreads
(percent)



Source: Bank of Uganda

32. The BoU has made progress in implementing the FSAP update recommendations, but many are waiting for the approval of supporting legislation (Text Table 4). Reforms contained in the Financial Institutions Act (FIA), currently before parliament, (i) require banks to maintain a capital buffer in addition to the minimum capital requirements; (ii) allow for agent banking (licenses to carry out financial institutions business through an agent); and (iii) permit operations of Islamic banking (license to operate financial businesses under Islamic procedures).

[5] An exercise to decompose spreads confirms that high operating costs and profits are the main drivers of high spreads in Uganda (Mugume, A. Apaa, J. and Ojwiya, C. "Interest Spreads in Uganda: Bank Specific Characteristics or Policy Changes?" Bank of Uganda Staff Papers, vol 3. No.2, 2009).

Box 7. Uganda: Banking Sector Stress Tests

Based on the Cihak model, the BoU regularly conducts stress tests (STs) to measure credit and liquidity risks on the banking sector and publishes the results annually. In its most recent STs exercise, the BoU assessed sensitivity to single-factor shocks on the basis of end-2014 bank-by-bank data. In addition, BoU and IMF staff carried up ad-hoc STs to assess foreign exchange risk and to test the system's sensitivity to a combined set of shocks.

On credit risk, the BoU assesses the impact on the core-tier-1 capital adequacy ratio (CAR) of a deterioration in loan quality by applying:

- A uniform shock to total performing loans: a "breaking point" approach is used to find the NPL ratio that would trigger a large bank to fail CAR compliance. The trigger is then applied to all other banks.
- A uniform shock to sectoral performing loans: the same "breaking point" approach is used to find the NPL ratio that would trigger a large bank to stop complying with the CAR due to the portfolio deterioration of business sectors exceeding 25 percent of the total loan portfolio.
- A proportional increase in NPLs to large borrowers (concentration risk): to measure the impact on the CAR of the default of three or the five largest borrowers of each bank.

Results suggest that the first large bank's CAR would fall below the required level when 19.6 percent of its loans become nonperforming. A total of seven banks would get undercapitalized, with the system's CAR falling from 19.7 percent to 12.6 percent. When the five largest borrowers of each bank default, the system's capital would fall to 11.6 percent. In both cases, the CAR would remain above the threshold.

On liquidity risk, BoU's simulations to measure the impact on the liquidity ratio include:

- A bank run with daily deposit withdrawals of 6 percent of total deposits for five consecutive days.
- A sudden withdrawal of all deposits of the NSSF, a big player in the market.
- A sudden withdrawal of all funds held by offshore clients.

Results suggest that the liquidity ratio would decline from 43 percent to 26, 41, and 37 percent, respectively, as a result of each of the above shocks. Therefore, the system as a whole would continue to meet the threshold of 20 percent even though for a few banks, the ratio would fall below the floor.

On foreign exchange (FX) risk, BoU and IMF staff analyzed the impact on the net open foreign exchange position from:

- A depreciation of the shilling against US dollar by up to 50 percent.

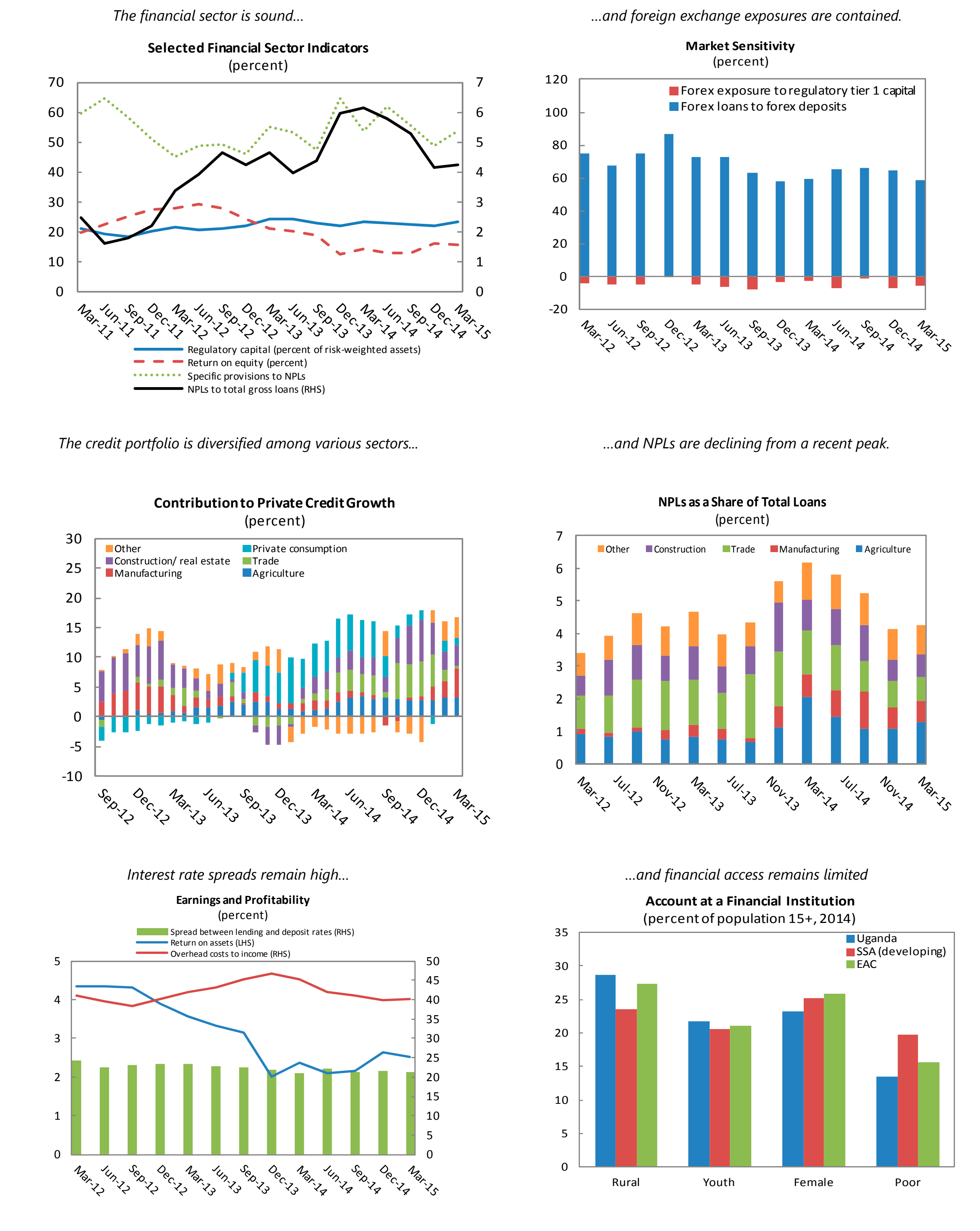
Results show that both the net open position in foreign currency and the system's CAR would remain within the required thresholds after the shock.

On combined credit, liquidity, and FX risks, BoU and IMF staff measured the impact on solvency and liquidity of:

- The NPL ratio rising to 19.6 percent (consistent with the trigger to assess credit risk) combined with 50 percent depreciation, and 3-day successive withdrawals of 6 percent of deposits.

Results show that banks' capital is vulnerable to multiple risks. The system's core CAR would fall to 11.9 percent with seven undercapitalized banks presenting a capital shortfall equivalent to 1.8 percent of GDP. Further, the system's liquid asset ratio would fall to 18.2 percent (below the regulatory requirement of 20 percent), and five banks would suffer liquidity shortages.

Figure 4. Uganda: Financial Sector Developments



Sources: Bank of Uganda, World Bank, and IMF staff calculations.

BUILDING INSTITUTIONS AND IMPROVING THE BUSINESS ENVIRONMENT

33. **Progress on PFM reforms has been strong and is set to continue.** The reduction of the stock of domestic arrears to a projected ½ percent of GDP by the end of the current fiscal year—about a third of the June 2013 level—is welcome. The new PFM Act incorporates good budget practices; prepares the economy for oil revenue management; and institutionalizes the preparation of a fiscal risks statement and the CFR (Box 8). Staff urged progress on issuing the PFM Act regulations and eliminating cash movements within the TSA sub-account structure.

Box 8. Enacting the Charter of Fiscal Responsibility

The authorities are working on the enactment of the CFR, which in line with the PFM Act needs to be published at the start of each new parliamentary cycle. The CFR has the following main features:

Core fiscal targets. These targets are based on the EAC convergence criteria, and consist of an overall deficit target of 3 percent of GDP by FY2020/21 and an annual debt ceiling of 50 percent of GDP in NPV terms. The targets enjoy political support; are clear and simple; are achievable under the current medium-term framework; and provide ample scope for avoiding pro-cyclicality. Pursuing a gradual and sustainable convergence path will be important to avoid the need for unrealistic adjustments to meet the targets.

Interim targets. To counterbalance the need for flexibility with the risk of unsustainable deficit and debt paths, potential interim targets will be introduced, including on the tax-to-GDP ratio and net domestic financing.

Deviations from fiscal objectives. Although the PFM Act specifies circumstances under which the government can deviate from fiscal objectives, the CFR will establish strict and transparent procedures for when these ‘escape clauses’ can be used and how objectives will be reestablished afterwards.

Management of oil revenues. Fiscal objectives should govern outflows from the oil fund and their use. This would require building capacity in oil revenue forecasting and public investment management.

Fiscal reporting requirements. To strengthen the budget process, the CFR will provide definitions and data sources for key fiscal objectives and establish robust and transparent forecasting practices including the provision of a fiscal risk statement.

34. **The completion and approval of several pieces of legislation will be crucial in moving reforms forward.** The submission to parliament of the planned amendments to the BoU Act to improve central bank governance and independence has been delayed, but the authorities are confident they will be able to do so immediately after the election. Similarly, the FIA and the Microfinance Development Institutions (MDI) Act, which allow for important improvements in supervision of financial institutions and create the legal framework for development of non-banks, have been before parliament for a long period. Staff encouraged their prompt approval.

35. Staff called for strengthened communications between the Ministry of Finance, Planning and Economic Development (MoFPED) and the BoU and with market players. Aware that policies have been misunderstood by economic agents and opinion makers, MoFPED authorities agreed to overhaul their communication strategy to better influence economic expectations, and prevent market confusion or misperceptions. They also agreed to coordinate policies more closely with the BoU, so that messages from the fiscal authorities and central bank policy statements are better aligned. While credibility will be strengthened by continuous sound policy implementation, better communication would facilitate closer alignment of banks' and households' behavior with the economic incentives.

36. The authorities need to take further steps to address Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) shortcomings. The Financial Action Task Force has included Uganda in its list of jurisdictions with serious deficiencies in the AML/CFT framework and placed the country under its review process. The authorities have designed an action plan to address deficiencies, but its implementation has been slow, posing risks to Uganda's business climate. The Board of Directors of the Financial Intelligence Unit has been constituted, which will allow its functioning, and procedures to secure approval of the Anti-Terrorism Act (ATA) are being advanced. Further actions to be taken include (i) compelling financial institutions to file suspicious transaction reports (a stipulation to this end is included in the FIA); (ii) properly criminalizing terrorist financing (a provision for this included in the ATA before parliament); and (iii) enforcing adequate and effective AML/CFT supervisory and oversight program for all financial sector institutions.

37. Further upgrades of statistics compilation and dissemination remain a critical objective. On the real sector, staff discussed planned efforts to improve the quality and coverage of surveys—including compiling GDP from the expenditure side and on a quarterly basis. In the fiscal area, staff emphasized the importance of overcoming the coordination difficulties that prevent the straightforward collection and dissemination of arrears data.

STAFF APPRAISAL

38. Supported by comfortable buffers and a sound policy mix, Uganda's economic performance over the last two years has been favorable. Real GDP growth has gradually rebounded from a low of 3.3 percent in FY2012/13 slowly narrowing the output gap. The BoU has reigned in inflation while keeping a comfortable international reserve level, preserving financial sector stability, and encouraging credit recovery. Nonetheless, the external current account deficit has widened reflecting stubbornly high negative trade positions. Fiscal policy has stimulated growth with an emphasis on public investment, unprecedented action to boost tax collections, and maintenance of debt at low risk of distress. Monetary policy formulation and implementation have noticeably matured with improved forecasting techniques, revamped policy instruments, and more professional policy signaling.

39. Program performance has been positive. Key program objectives have been accomplished, notably by maintaining inflation within the outer bands of the consultation mechanism; eliminating many tax exemptions and improving tax administration; prudently managing domestic debt issuances; and reducing domestic arrears. Progress in PFM has been impressive and is already bearing fruit. The upgrade in payments and payroll systems and the TSA set-up are generating savings through the elimination of ghost workers and pensioners and better cash controls. The authorities are to be commended for these achievements.

40. Maintaining fiscal discipline in the pre-electoral period will be essential. The expected growth recovery is critically contingent on the maintenance of price stability, which is being threatened not only by the decline in the shilling and possible increases in food prices, but by unanchored expectations related to perceived election-related spending. Reassuring the markets soon—through an overhauled communication strategy—that fiscal policy decisions will be strictly aligned to the budget is essential to influencing banks', corporations', and households' behavior. Even more critical, however, is that policy implementation adheres to the budget to build a track record of fiscal discipline during pre-electoral periods and preserve the economic objectives. The authorities are therefore urged to keep the overall deficit and domestic financing within the planned limits, find savings to replenish the upfront appropriation of the contingency provision, and refrain from reallocating expenses to less productive activities.

41. Monetary policy needs to remain vigilant of evolving conditions. Against the backdrop of the dollar appreciation, depressed exports and remittances, and impaired policy credibility, the BoU was effective in calming the markets and preserving low inflation by tightening policies and stepping up interventions. Nonetheless, the associated decline in international reserves to deal with this temporary shock was sizeable. A build up of this critical buffer is ongoing, and should help address the projected government import needs. Preserving low and stable inflation will require a monetary policy stance that continues to carefully calibrate trade-offs between interest rates and exchange rates, and allows the shilling to reflect market conditions. The inflation targeting framework, which has been successful to date, should support these efforts. The approval of the amendments to the BoU Act; and additional operational and institutional improvements to upgrade the inflation forecasting quality, enhance policy coordination with the government and fully insulate the BoU against fiscal dominance, and further improve the monetary transmission mechanism are critical actions to improve the inflation targeting framework.

42. The banking system's stability needs to be maintained, while increasing its contribution to growth. The credit-to-GDP ratio needs to increase over the medium term by improved bank efficiency and higher access of the population to bank services. An expanded deposit base along with lower operational costs, and enhanced policy credibility will be necessary to achieve the needed contraction in bank spreads and lending rates, and foster financial deepening. Bank regulation and supervision have been effective, and would be further enhanced by the prompt approval of the FIA and MDI Act. To deal with ongoing vulnerabilities while preserving bank soundness, the BoU is encouraged to further strengthen its risk assessment of foreign currency lending and credit concentration, and revamp its loan provisioning policy. Interest rates and exchange rates are subject to volatility in Uganda—as in any small and open economy with large current account deficits and a focus on targeting inflation—and their impact on banks' balance sheets should be continuously assessed.

43. Sustaining recent gains in domestic revenue mobilization and PFM reform and securing efficient infrastructure spending will be critical priorities. Despite an increase of 1½ percent of GDP in the past two years, the tax-to-GDP ratio remains low by international and regional standards. Its further improvement critically depends on securing the political will for removing the remaining discretionary tax exemptions, ensuring taxpayer compliance, and bolstering government efforts to enforce obligations. PFM reforms need to be complemented by the enactment of regulations to implement the new law, improvements in cash management, enactment of a CFR, and continued reductions in the stock of arrears. The infrastructure investment program needs to be based on good project selection to ensure commercial viability, and efficient implementation to avoid overheating or cost overruns.

44. Supported by oil production, infrastructure upgrades, and regional integration, medium-term growth prospects are encouraging. The weak export performance in the context of structurally large external current account deficits is a matter of concern, and needs to be addressed by improvements in productivity and competitiveness. Future oil production, infrastructure upgrades, and regional integration will support these efforts, particularly if accompanied by stronger governance, improvements in conditions for doing business, addressing AML/CFT shortcomings, and a decisive fight against poverty and inequality. Financing of the development strategy comprises higher domestic revenue mobilization and prudent borrowing. A more targeted focus on employment creation and inclusiveness, including by strengthening social protection, would raise policy efficacy.

45. Staff recommends completing the fourth review under the PSI-supported program. The attached LoI and MEFP outline policies for the rest of FY2014/15 and propose alignment of program conditionality with the updated macroeconomic framework. In particular, the authorities propose reductions in the end-June 2015 ceiling on net domestic financing of the central government in line with the lower-than-projected deficit, and in the reserve accumulation target to take account of the impact of shocks, which staff support. The planned start of a few key infrastructure projects—including the Entebbe Airport rehabilitation, the purchase of road construction equipments, and other electricity and rural electrification projects—underpins the request to raise the NCB ceiling from $2.2 to $3.0 billion. Finally, the authorities also request incorporating a new overall deficit IT in preparation for the transition to the application of the new debt limits policy expected at the time of the fifth PSI review.

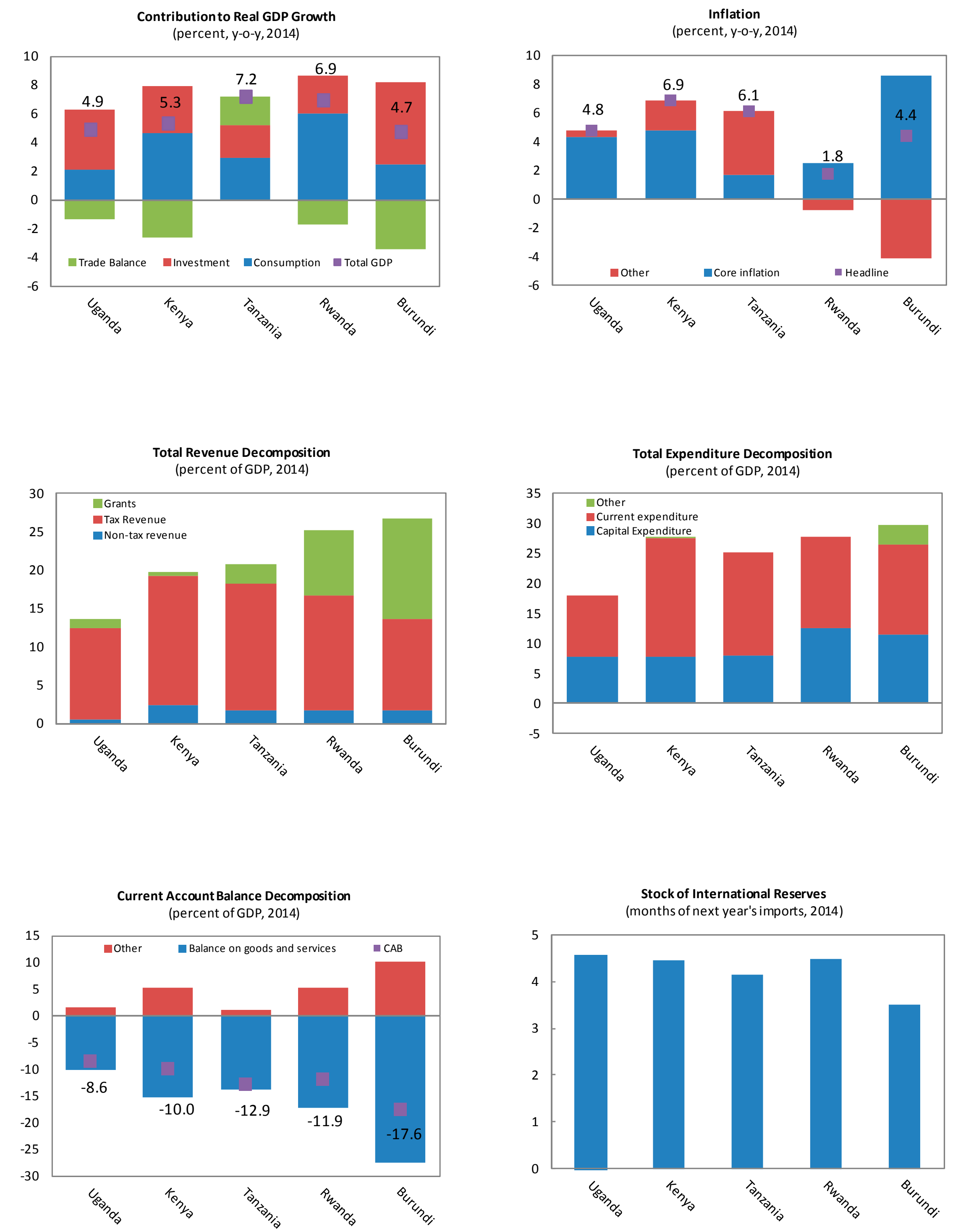
46. It is proposed that the next Article IV Consultation be held in accordance with Decision No. 14747, as amended.

Text Table 4. Uganda: Implementation of 2011 FSAP Recommendations (April 2015)	
Recommendations	**Current Status**
A. Banking Structure and Stability	
1. Refocus bank licensing strategy and merger/acquisition review based on the quality, market segment, and viability of the business models of potential entrants/merged banks.	Implemented
2. Issue agent banking regulations and consider instituting an end date for exclusivity agreements with agents.	Work in progress
3. Develop options for increasing the supply of long term finance to dilute the dominant position of NSSF.	Work in progress
B. Regulatory Framework for Banking	
1. Enact the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Bill.	Work in progress
2. Institute a program of formal annual communication with the home supervisor.	Work in progress
3. Develop measures to monitor possible contagion from operations in other jurisdictions.	Not implemented
4. Amend regulatory requirements on classification and provisioning in respect of "watch loans."	Not implemented
C. Systemic Liquidity and Crisis Management	
1. Improve capacity for liquidity forecasting and enhance collaboration between MoFPED and BoU.	Not implemented
2. Accelerate the upgrade of the Central Securities Depository (CSD) to enable electronic trading and settlement of government securities transactions.	Work in progress
3. Monitor closely the compliance with risk concentration limits and prudential regulation regarding inter-bank lending.	Implemented
4. Operationalize a financial crisis management framework.	Implemented
5. Analyze emergency scenarios and develop plans for providing liquidity on an emergency basis.	Work in progress
6. Provide training to market participants on the pricing and trading of securities including repo operations	Implemented
7. The Uganda Bankers' Association, in cooperation with BoU, should consider devising predetermined rediscount asset categories for collateral, and develop standards for prearranged common crisis response protocols.	Work in progress
D. Payments, Remittances and Securities Settlement Systems	
1. Draft a comprehensive National Payment Systems (NPS) bill taking into consideration recent market and infrastructure developments.	Work in progress
2. Issue interim regulation to further strengthen BoU's oversight and regulatory actions.	Not implemented
3. Create within BoU a small department or division—independent of the operational side— to be responsible for the NPS oversight and regulation.	Implemented
4. Establish an NPS Council.	Work in progress
5. Design participation of Micro-Financial Institutions and cooperatives in the payments system by allowing for functionalities relevant to the sector.	Not implemented
6. Dematerialize private sector securities and interlink the Uganda Stock Exchange (USE), CSD and the Uganda National Interbank Settlement System to allow full Delivery versus Payment.	Work in progress

Text Table 4. Uganda: Implementation of 2011 FSAP Recommendations (April 2015) (concluded)	
7. Revise the current settlement agent arrangement for the USE and CSD.	Work in progress
8. USE should adopt an electronic trading system to reduce settlement time and BoU should finalize the implementation of its electronic trading system.	Work in progress
9. Develop a comprehensive and clear framework for nonbank correspondents providing banking related and payments services.	Work in progress
10. Issue an overarching regulation to govern mobile payments and e-money issuance.	Work in progress
11. Agree with Uganda Communications Commission on coordinating the review and audit of systems deployed by mobile network operators for effecting mobile payments.	Work in progress
E. Access to Finance	
12. Suspend the government's program for forming new Savings and Credit Cooperatives (SACCOs), and restrict government lending to SACCOs. Support the development of a smaller number of self-formed SACCO unions.	Work in progress
13. Allow Microfinance Deposit-Taking to use "Microfinance Bank" in their names.	Work in progress
F. Housing Finance	
1. Develop underwriting guidelines for use by providers of mortgages for housing purposes.	Not implemented
2. Institute alternative methods of valuing properties for stamp duty, to relieve the burden on the Office of the Government Value and accelerate the settlement process.	Implemented
G. Capital Markets	
1. Prepare and implement a post-assessment plan to enhance compliance with the International Organization of Securities Commissions (IOSCO) principles.	Work in progress
2. Evaluate options for the automation of trading at the USE in anticipation of regional integration.	Work in progress
3. Demutualize the USE.	Work in progress
4. Expand the number of settlement banks and link with the real-time gross settlement (RTGS) system.	Not implemented
H. Insurance	
1. Consider plans to establish the Uganda Reinsurance Company and suggest whether NSSF ought to have a controlling interest in it.	Implemented
2. Participate in the preparation of the single EAC Act on insurance in line with principles aligned to the International Association of Insurance Supervisors.	Implemented
3. Staff the Uganda Insurance Regulatory Authority.	Implemented
4. Recent amendments to the insurance Act have facilitated banc assurance but require some complementary amendments to FIA to permit arrangements to operate.	Work in progress
I. Pensions	
1. Appoint the Board of URBRA and prepare licensing requirements.	Not implemented
2. Form the National Pensions Policy Group to include representatives of all relevant stakeholders.	Work in progress
3. Prepare an actuarial review of the Armed Forces Pension Scheme.	Not implemented

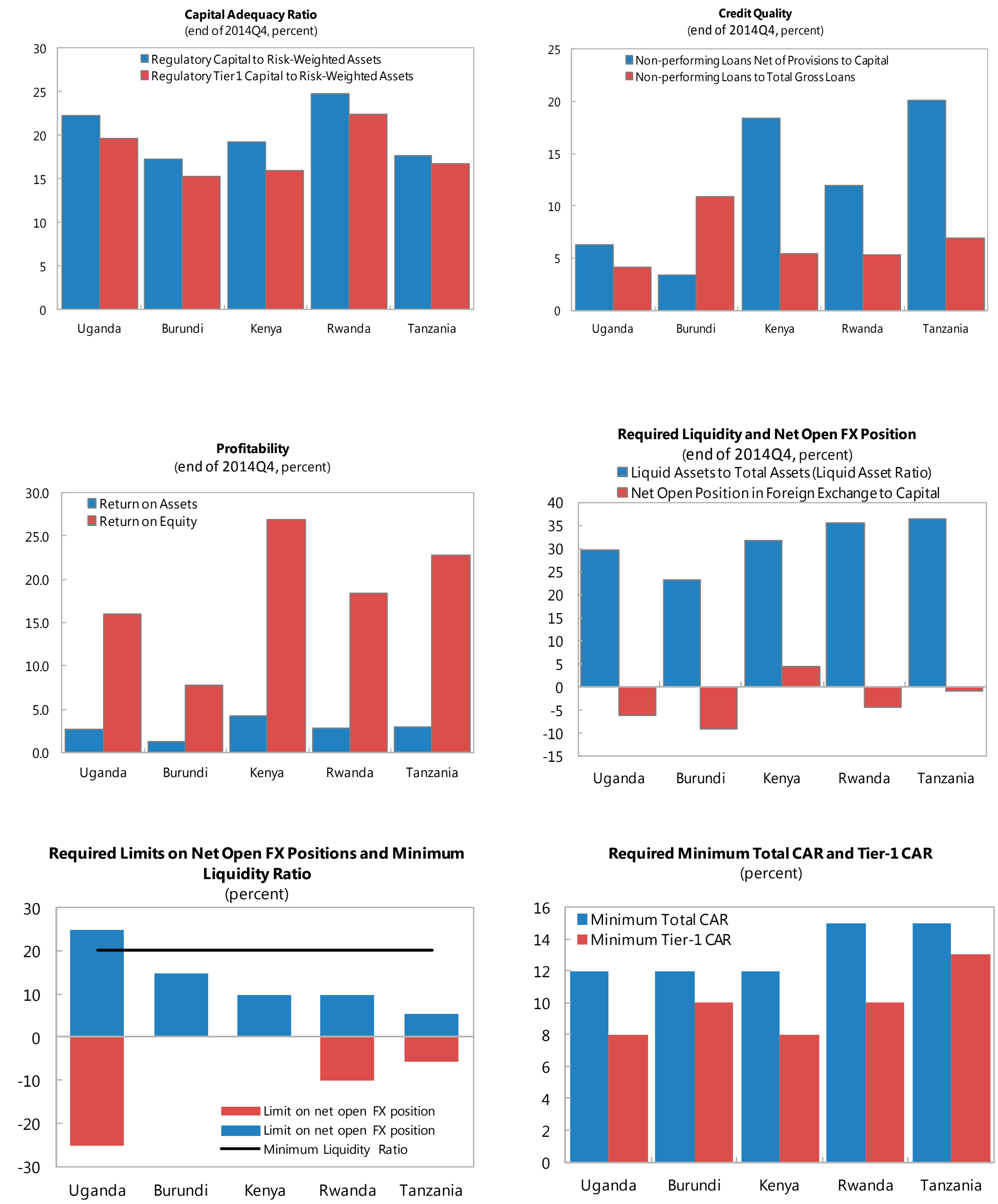
Sources: Bank of Uganda and IMF staff.

Figure 5. Economic Indicators in EAC Countries



Sources: Bank of Uganda and IMF staff calculations.

Figure 6. Financial Sector Indicators and Prudential Requirements in EAC Countries



Sources: Bank of Uganda and IMF staff calculations.

Table 1. Uganda: Selected Economic and Financial Indicators, FY2011/12–2019/20[1,2]

(Annual percentage change, unless otherwise indicated)

	2011/12	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18	2018/19	2019/20
				3rd Rev	Proj.	3rd Rev	Proj.	Proj.	Proj.	Proj	Proj.
				(Annual percentage change, unless otherwise indicated)							
Output, prices, and exchange rate											
Real GDP	4.4	3.3	4.5	6.1	5.3	6.2	5.8	5.9	6.4	6.7	6.8
GDP deflator	20.9	4.1	2.4	5.7	4.4	4.9	5.1	4.7	4.3	4.1	4.2
CPI (period average)	23.5	5.8	6.7	5.0	2.7	5.0	5.5	5.8	5.0	5.0	5.0
CPI (end of period)	18.0	3.6	5.0	6.0	5.6	5.0	6.4	5.2	5.0	5.0	5.0
Core inflation (end of period)	19.6	5.7	2.9	5.7	6.1	5.0	6.7	5.5	5.0	5.0	5.0
Core inflation (period average)	24.6	6.6	5.2	4.5	3.5	5.0	6.3	6.1	5.0	5.0	5.0
Terms of trade (deterioration, -)	3.5	-8.2	2.5	0.0	3.3	-0.4	0.9	-2.5	-1.5	-1.0	-0.6
Exchange Rate (Ugandan Shilling/US$)	10.1	1.3	-2.0	...	...	...	...	...	...	...	...
Real effective exchange rate (depreciation, -)	-19.9	2.2	-2.4	...	...	...	...	...	...	...	...
Money and credit											
Broad money (M3)	7.2	6.6	17.4	17.5	14.2	17.5	16.3	15.7	12.6	14.6	15.8
Credit to non-government sector	11.5	6.4	13.9	15.6	15.7	15.6	15.0	15.5	15.9	15.7	15.3
Bank of Uganda policy rate [3]	20.0	11.0	11.0	...	...	...	...	...	...	...	...
M3/GDP (percent)	19.0	18.9	20.7	23.8	21.5	25.1	22.5	23.4	23.8	24.6	25.6
NPLs (percent of total loans)	3.9	4.0	5.8	...	...	...	...	...	...	...	...
				(Percent of GDP, unless otherwise indicated)							
Central government budget											
Revenue and grants	13.1	12.9	13.0	15.1	14.1	15.2	15.1	15.1	15.5	15.7	16.1
Of which: grants	1.9	1.5	1.0	1.5	1.1	1.1	1.6	1.1	0.9	0.6	0.6
Expenditure	15.6	16.5	16.7	22.0	18.6	20.7	22.1	22.0	22.4	21.8	20.6
Current	9.4	9.1	9.8	10.5	10.0	10.7	10.4	10.2	10.1	10.5	10.6
Capital [4]	5.8	6.6	7.0	10.9	7.9	9.4	11.3	10.9	11.8	10.7	9.5
Primary balance	-1.5	-2.2	-2.4	-5.0	-2.9	-3.4	-5.0	-4.7	-4.6	-3.5	-1.7
Overall balance	-2.5	-3.6	-3.8	-6.8	-4.5	-5.5	-7.0	-6.9	-7.0	-6.1	-4.5
Excluding grants	-4.5	-5.0	-4.8	-8.3	-5.6	-6.6	-8.6	-7.9	-7.8	-6.7	-5.0
Net domestic borrowing	0.0	1.0	2.3	4.0	3.4	2.0	2.0	2.0	0.8	1.3	1.5
Public debt											
Public gross nominal debt	22.0	26.2	28.9	33.7	31.9	37.0	36.0	39.7	43.0	45.5	46.0
of which: external public debt [5]	13.2	15.2	16.1	18.9	18.2	21.6	21.8	25.5	29.7	32.3	32.7
Investment and savings											
Investment	28.2	29.5	28.9	27.1	31.4	26.1	35.3	35.5	37.1	36.8	37.1
Public	6.7	7.0	5.6	8.6	6.3	7.7	9.1	8.9	9.6	8.8	7.8
Private	21.5	22.5	23.4	18.5	25.1	18.5	26.2	26.5	27.5	28.0	29.3
Savings	17.7	21.6	20.7	16.5	22.1	16.4	24.1	22.8	23.7	22.8	22.8
Public	2.4	3.1	1.5	1.4	1.4	1.8	1.8	1.7	2.4	2.4	3.1
Private	15.3	18.5	19.2	15.1	20.7	14.6	22.3	21.1	21.3	20.4	19.7
External sector											
Exports (goods and services)	20.2	20.2	19.2	21.0	19.7	22.1	20.5	20.6	22.1	21.9	21.9
Imports (goods and services)	33.0	30.5	28.7	33.2	29.8	33.3	32.1	33.4	34.8	34.8	34.8
Current account balance (including grants)	-9.5	-7.6	-7.9	-10.3	-8.9	-9.4	-11.0	-12.4	-13.1	-13.8	-14.0
Current account balance (excluding grants)	-10.5	-7.9	-8.2	-10.6	-9.3	-9.7	-11.3	-12.7	-13.4	-14.0	-14.2
Gross international reserves											
In billions of US$	2.6	2.9	3.4	3.2	2.9	3.4	3.2	3.6	3.9	4.4	4.7
In months of next year imports	4.2	4.5	5.1	4.1	4.0	4.1	3.9	4.0	4.0	4.1	4.4
Memorandum items:											
GDP at current market prices											
Billion of Ugandan shillings	59,420	63,905	68,407	69,962	75,183	77,921	83,596	92,668	102,782	114,129	126,925
US$ million	23,237	24,663	26,953	...	...	...	...	...	...	...	...
GDP per capita (Nominal US$)	652	670	709	669	682	676	668	703	729	770	811
Population (million)	35.1	36.2	37.4	...	...	...	...	...	...	...	...
Share of population below poverty line (percent)	...	19.7	...	...	...	...	...	...	...	...	...

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

[3] The CBR was introduced following the start of Inflation Targeting in July 2011. End of year CBR.

[4] Capital expenditures include net lending and investment on hydropower projects.

[5] The public external debt is different from the Public and Publicly Guaranteed Debt reflected in the DSA, which covers also publicly guaranteed debt.

Table 2a. Uganda: Fiscal Operations of the Central Government, FY2011/12–2019/20[1,2]

(Billions of Uganda shillings)

	2011/12	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18	2018/19	2019/20
				3rd Rev	Proj.	3rd Rev	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	7,771	8,245	8,874	10,569	10,618	11,872	12,631	14,009	15,914	17,881	20,477
Revenue	6,634	7,309	8,165	9,547	9,799	11,048	11,333	13,033	15,033	17,180	19,744
Tax	5,983	7,005	7,831	9,132	9,397	10,544	10,814	12,428	14,325	16,398	18,879
International trade taxes	503	599	747	845	879	1,020	1,073	1,226	1,426	1,700	1,945
Income taxes	2,112	2,588	2,756	3,243	3,314	3,654	3,719	4,362	5,047	5,789	6,793
Excises	1,446	1,466	1,757	2,098	2,025	2,439	2,397	2,791	3,101	3,449	3,952
Value-added tax	1,921	2,353	2,570	2,946	3,118	3,432	3,556	3,968	4,656	5,353	6,071
Infrastructure levy	…	…	…	…	60	…	68	81	95	107	117
Nontax	259	304	334	416	402	504	519	605	708	783	865
Oil revenue	392	0	0	0	0	0	0	0	0	0	0
Grants	1,137	936	709	1,022	819	824	1,299	976	881	701	734
Budget support[3]	581	199	215	222	260	256	253	272	241	262	269
Project grants	556	738	494	800	559	568	1,046	704	640	439	465
Expenditures and net lending[4]	9,281	10,523	11,456	15,358	13,988	16,156	18,503	20,390	23,062	24,854	26,130
Current expenditures	5,585	5,813	6,675	7,324	7,550	8,332	8,681	9,471	10,370	11,943	13,489
Wages and salaries	1,832	2,160	2,384	2,654	2,668	2,991	2,894	3,190	3,445	3,919	4,358
Interest payments	603	890	970	1,277	1,199	1,614	1,688	1,992	2,433	2,968	3,503
Other current	3,150	2,763	3,321	3,392	3,682	3,727	4,099	4,289	4,492	5,057	5,628
Development expenditures	3,458	4,237	4,740	5,225	4,881	5,477	7,177	8,284	10,500	11,566	11,925
Externally-financed projects	1,701	2,163	1,674	1,902	1,652	1,764	3,361	3,735	5,787	5,647	4,624
Of which: Non-concessional borrowing							989	1,535	3,640	3,988	3,573
Government of Uganda investment	1,756	2,074	3,066	3,323	3,229	3,713	3,816	4,550	4,713	5,918	7,302
Net lending and investment[5]	-39	409	21	2,629	1,346	2,017	2,472	2,204	1,687	791	86
Hydro-power projects	0	0	21	2,379	1,096	1,817	2,272	1,854	1,587	691	86
Of which: Non-concessional borrowing	0	0	0	1,148	0	1,817	2,229	1,840	1,587	691	86
Bank of Uganda recapitalization	0	410	0	250	250	200	200	350	100	100	0
Other spending	278	63	20	180	212	330	173	430	505	555	630
Clearance of domestic arrears	278	63	20	80	212	80	80	80	80	80	80
Contingency	0	0	0	100	0	250	93	350	425	475	550
Overall balance	-1,510	-2,277	-2,582	-4,789	-3,371	-4,284	-5,872	-6,381	-7,148	-6,973	-5,652
Financing	1,191	2,084	2,455	4,789	3,371	4,284	5,872	6,381	7,148	6,973	5,653
External financing (net)	1,171	1,418	879	1,957	845	2,698	4,203	4,505	6,321	5,456	3,725
Disbursement	1,374	1,628	1,120	2,251	1,093	3,013	4,545	4,870	6,734	5,899	4,245
Budget support	126	324	0	0	0	0	0	0	0	0	0
Concessional project loans	1,056	1,303	1,120	1,102	1,093	1,196	1,326	1,495	1,508	1,220	586
Non-concessional borrowing	192	0	0	1,148	0	1,817	3,219	3,375	5,227	4,679	3,659
Amortization (–)	-193	-200	-212	-275	-235	-295	-327	-354	-413	-443	-520
Exceptional financing	-10	-10	-30	-19	-13	-20	-15	-11	0	0	0
Domestic financing (net)	20	666	1,576	2,832	2,526	1,585	1,669	1,875	827	1,517	1,928
Bank financing	-1,242	508	647	2,083	1,526	863	982	1,409	628	825	1,039
Bank of Uganda[6]	-1,182	-77	-198	1,334	1,140	200	284	949	435	143	159
Of which: Petroleum fund withdrawals	0	0	-1	482	347	0	43	680	429	108	108
Of which: Energy fund withdrawals	122	0	21	748	748	0	0	0	0	0	0
Of which: Government Securities[5]	0	410	0	250	250	200	200	350	100	100	0
Commercial banks	-60	585	845	749	386	663	698	460	193	682	880
Nonbank financing	1,262	158	930	749	1,000	722	687	466	199	692	889
Errors and omissions/financing gap (- is gap, + is surplus)	-319	-193	-127	0	0	0	0	0	0	0	0
Memorandum Items:											
Overall deficit excluding large infrastructure projects financed by non-concessional external borrowing and BoU recapitalization	-1,942	-1,868	-2,561	-2,160	-2,025	-2,267	-2,410	-2,641	-1,821	-2,194	-1,993
Petroleum revenues (Ush billions)											
Inflows (including interest)	405	4	0	15	0	13	0	0	0	0	0
Valuation adjustment	156	-58	4	91	109	69	0	0	0	108	108
Withdrawals	0	0	-1	482	347	0	43	680	429	108	108
Stock at end period	1,682	1,628	1,632	1,284	1,394	1,366	1,351	671	241	241	241
Public domestic debt[7]	5,206	7,033	8,798	10,400	10,288	11,985	11,872	13,148	13,640	15,114	16,883

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

[3] Include mainly HIPC-related grants from FY 2013/14 onwards.

[4] Expenditure categories in FY2013/14 include clearance of arrears totaling Shs. 544 billion, mainly in Government of Uganda investment and other current spending.

[5] Reflects actual and projected issuances for the recapitalization of Bank of Uganda.

[6] Net financing from the Bank of Uganda includes resources freed by MDRI relief.

[7] Public domestic debt has been revised following methodological discussions, and new information, on intra-public sector transactions.

Table 2b. Uganda: Fiscal Operations of the Central Government, FY2011/12–2019/20[1,2]

(Percent of GDP)

	2011/12	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18	2018/19	2019/20
				3rd Rev	Proj.	3rd Rev	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	13.1	12.9	13.0	15.1	14.1	15.2	15.1	15.1	15.5	15.7	16.1
Revenue	11.2	11.4	11.9	13.6	13.0	14.2	13.6	14.1	14.6	15.1	15.6
Tax	10.1	11.0	11.4	13.1	12.5	13.5	12.9	13.4	13.9	14.4	14.9
International trade taxes	0.8	0.9	1.1	1.2	1.2	1.3	1.3	1.3	1.4	1.5	1.5
Income taxes	3.6	4.0	4.0	4.6	4.4	4.7	4.4	4.7	4.9	5.1	5.4
Excises	2.4	2.3	2.6	3.0	2.7	3.1	2.9	3.0	3.0	3.0	3.1
Value-added tax	3.2	3.7	3.8	4.2	4.1	4.4	4.3	4.3	4.5	4.7	4.8
Infrastructure levy	…	…	…	…	0.1	…	0.1	0.1	0.1	0.1	0.1
Nontax	0.4	0.5	0.5	0.6	0.5	0.6	0.6	0.7	0.7	0.7	0.7
Oil revenue	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	1.9	1.5	1.0	1.5	1.1	1.1	1.6	1.1	0.9	0.6	0.6
Budget support[3]	1.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Project grants	0.9	1.2	0.7	1.1	0.7	0.7	1.3	0.8	0.6	0.4	0.4
Expenditures and net lending[4]	15.6	16.5	16.7	22.0	18.6	20.7	22.1	22.0	22.4	21.8	20.6
Current expenditures	9.4	9.1	9.8	10.5	10.0	10.7	10.4	10.2	10.1	10.5	10.6
Wages and salaries	3.1	3.4	3.5	3.8	3.5	3.8	3.5	3.4	3.4	3.4	3.4
Interest payments	1.0	1.4	1.4	1.8	1.6	2.1	2.0	2.1	2.4	2.6	2.8
Other current	5.3	4.3	4.9	4.8	4.9	4.8	4.9	4.6	4.4	4.4	4.4
Development expenditures	5.8	6.6	6.9	7.5	6.5	7.0	8.6	8.9	10.2	10.1	9.4
Externally-financed projects	2.9	3.4	2.4	2.7	2.2	2.3	4.0	4.0	5.6	4.9	3.6
Of which: Non-concessional borrowing							1.2	1.7	3.5	3.5	2.8
Government of Uganda investment	3.0	3.2	4.5	4.7	4.3	4.8	4.6	4.9	4.6	5.2	5.8
Net lending and investment	-0.1	0.6	0.0	3.8	1.8	2.6	3.0	2.4	1.6	0.7	0.1
Hydro-power projects	0.0	0.0	0.0	3.4	1.5	2.3	2.7	2.0	1.5	0.6	0.1
Of which: Non-concessional borrowing	0.0	0.0	0.0	1.6	0.0	2.3	2.7	2.0	1.5	0.6	0.1
Bank of Uganda recapitalization[5]	0.0	0.6	0.0	0.4	0.3	0.3	0.2	0.4	0.1	0.1	0.0
Other spending	0.5	0.1	0.0	0.3	0.3	0.4	0.2	0.5	0.5	0.5	0.5
Clearance of domestic arrears	0.5	0.1	0.0	0.1	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Contingency	0.0	0.0	0.0	0.1	0.0	0.3	0.1	0.4	0.4	0.4	0.4
Overall balance	-2.5	-3.6	-3.8	-6.8	-4.5	-5.5	-7.0	-6.9	-7.0	-6.1	-4.5
Financing	2.0	3.3	3.6	6.8	4.5	5.5	7.0	6.9	7.0	6.1	4.5
External financing (net)	2.0	2.2	1.3	2.8	1.1	3.5	5.0	4.9	6.1	4.8	2.9
Disbursement	2.3	2.5	1.6	3.2	1.5	3.9	5.4	5.3	6.6	5.2	3.3
Budget support	0.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Concessional project loans	1.8	2.0	1.6	1.6	1.5	1.5	1.6	1.6	1.5	1.1	0.5
Non-concessional borrowing	0.3	0.0	0.0	1.6	0.0	2.3	3.9	3.6	5.1	4.1	2.9
Amortization (–)	-0.3	-0.3	-0.3	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing (net)	0.0	1.0	2.3	4.0	3.4	2.0	2.0	2.0	0.8	1.3	1.5
Bank financing	-2.1	0.8	0.9	3.0	2.0	1.1	1.2	1.5	0.6	0.7	0.8
Bank of Uganda[6]	-2.0	-0.1	-0.3	1.9	1.5	0.3	0.3	1.0	0.4	0.1	0.1
Of which: Petroleum fund withdrawals	0.0	0.0	0.0	0.7	0.5	0.0	0.1	0.7	0.4	0.1	0.1
Of which: Energy fund withdrawals	0.2	0.0	0.0	1.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Government Securities[5]	0.0	0.6	0.0	0.4	0.3	0.3	0.2	0.4	0.1	0.1	0.0
Commercial banks	-0.1	0.9	1.2	1.1	0.5	0.9	0.8	0.5	0.2	0.6	0.7
Nonbank financing	2.1	0.2	1.4	1.1	1.3	0.9	0.8	0.5	0.2	0.6	0.7
Errors and omissions/financing gap (- is gap, + is surplus)	-0.5	-0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:											
Overall deficit excluding large infrastructure projects financed by non-concessional external borrowing and BoU recapitalization	-3.3	-2.9	-3.7	-3.1	-2.7	-2.9	-2.9	-2.8	-1.8	-1.9	-1.6
Petroleum revenues (Ush billions)											
Inflows (including interest)	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation adjustment	0.3	-0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.1	0.1
Withdrawals	0.0	0.0	0.0	0.7	0.5	0.0	0.1	0.7	0.4	0.1	0.1
Stock at end period	2.8	2.5	2.4	1.8	1.9	1.8	1.6	0.7	0.2	0.2	0.2
Public domestic debt[7]	8.8	11.0	12.9	14.9	13.7	15.4	14.2	14.2	13.3	13.2	13.3

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

[3] Include mainly HIPC-related grants from FY 2013/14 onwards.

[4] Expenditure categories in FY2013/14 include clearance of arrears totaling 0.8 percent of GDP, mainly in Government of Uganda investment and other current spending.

[5] Reflects actual and projected issuances for the recapitalization of Bank of Uganda.

[6] Net financing from the Bank of Uganda includes resources freed by MDRI relief.

[7] Public domestic debt has been revised following methodological discussions, and new information, on intra-public sector transactions.

Table 2c. Uganda: Quarterly Fiscal Operations of the Central Government, FY2014/15–2015/16[1,2]

(Billions of Uganda shillings)

	2014/15					2015/16				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	2,369	2,890	2,563	2,796	10,618	2,794	3,509	2,953	3,375	12,631
Revenue	2,150	2,550	2,416	2,683	9,799	2,552	2,908	2,747	3,125	11,333
Tax	2,050	2,432	2,312	2,603	9,397	2,441	2,758	2,624	2,991	10,814
International trade taxes	195	218	205	261	879	255	267	254	298	1,073
Income taxes	648	925	722	1,019	3,314	752	1,024	792	1,151	3,719
Excises	475	519	545	487	2,025	560	586	651	600	2,397
Value-added tax	717	755	825	821	3,118	857	864	910	925	3,556
Infrastructure levy	15	15	15	15	60	17	17	17	17	68
Nontax	99	118	104	80	402	111	151	123	134	519
Oil revenue	0	0	0	0	0	0	0	0	0	0
Grants	219	340	147	113	819	242	600	207	250	1,299
Budget support[3]	63	104	53	40	260	80	58	71	44	253
Project grants	156	236	94	73	559	162	543	136	205	1,046
Expenditures and net lending	3,868	3,475	2,990	3,656	13,988	4,477	5,041	4,218	4,767	18,503
Current expenditures	1,691	1,891	1,875	2,092	7,550	2,011	2,105	2,109	2,456	8,681
Wages and salaries	642	681	685	661	2,668	702	712	717	762	2,894
Interest payments	279	299	306	316	1,199	424	384	433	447	1,688
Other current	771	911	885	1,116	3,682	885	1,008	960	1,246	4,099
Development expenditures	1,261	1,262	1,047	1,312	4,881	1,414	2,137	1,572	2,053	7,177
Externally-financed projects	468	525	349	309	1,652	387	941	430	615	3,361
Of which: Non-concessional borrowing						128	189	157	516	989
Government of Uganda investment	793	736	698	1,002	3,229	900	1,008	985	922	3,816
Net lending and investment	902	248	0	196	1,346	971	719	456	326	2,472
Other spending	13	75	68	55	212	80	80	80	-67	173
Overall balance	-1,499	-585	-427	-860	-3,371	-1,682	-1,532	-1,265	-1,392	-5,872
Overall deficit excluding large infrastructure projects financed by non-concessional external borrowing and BoU recapitalization	-597	-337	-427	-663	-2,025	-584	-625	-651	-551	-2,410
Financing	1,654	465	505	747	3,371	1,682	1,532	1,265	1,392	5,872
External financing (net)	240	230	179	196	845	1,036	1,258	905	1,004	4,203
Disbursement	313	289	255	236	1,093	1,128	1,352	976	1,089	4,545
Concessional project loans	313	289	255	236	1,093	225	398	294	409	1,326
Non-concessional borrowing	0	0	0	0	0	903	954	681	680	3,219
Amortization (–)	-66	-60	-69	-40	-235	-84	-96	-71	-77	-327
Exceptional financing	-6	1	-7	0	-13	-8	2	0	-9	-15
Domestic financing (net)	1,414	235	326	551	2,526	647	274	359	389	1,669
Bank financing	1,122	-78	-39	520	1,526	445	153	180	204	982
Bank of Uganda	666	67	-34	441	1,140	245	2	10	27	284
Commercial banks	456	-144	-5	79	386	200	151	170	177	698
Nonbank financing	292	312	365	31	1,000	202	121	179	184	687
Errors and omissions/financing gap (- is gap, + is surplus)	155	-120	78	-113	0	0	0	0	0	0

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

[3] Include mainly HIPC-related grants from FY 2014/15 onwards.

Table 3. Uganda: Monetary Accounts, FY2011/12–2019/20[1,2]

(Billions of Uganda shillings unless otherwise indicated)

	2011/12	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18	2018/19	2019/20
				3rd Rev	Proj.	3rd Rev	Proj.	Proj.	Proj.	Proj.	Proj.
					Depository Corporations Survey[3]						
Net foreign assets	7,901	8,427	8,851	8,509	9,319	9,554	9,768	10,559	10,835	11,432	12,271
Bank of Uganda	6,845	8,305	9,455	8,855	9,411	10,059	10,340	11,586	12,536	14,228	15,660
Commercial banks	1,056	122	-604	-346	-91	-504	-572	-1,028	-1,700	-2,795	-3,389
Net domestic assets	3,395	3,621	5,291	8,109	6,824	9,970	9,015	11,166	13,633	16,605	20,185
Claims on public sector (net)[4]	-496	-17	623	2,798	2,171	3,662	3,153	4,562	5,190	6,016	7,054
Claims on central government (net)	-569	-105	539	2,722	2,073	3,586	3,055	4,464	5,092	5,918	6,956
Claims on the private sector	7,532	8,011	9,124	10,547	10,553	12,191	12,141	14,023	16,249	18,792	21,675
Other items (net)[5,6]	-3,641	-4,373	-4,456	-5,228	-5,900	-5,876	-6,279	-7,420	-7,806	-8,203	-8,544
Money and quasi-money (M3)	11,296	12,047	14,142	16,618	16,144	19,524	18,783	21,724	24,468	28,037	32,457
Broad money (M2)	7,721	8,932	10,195	11,822	11,348	13,974	13,569	15,509	17,713	21,979	26,742
Foreign exchange deposits	3,575	3,115	3,947	4,796	4,796	5,551	5,214	6,215	6,755	6,058	5,715
						Bank of Uganda					
Net foreign assets	6,845	8,305	9,455	8,855	9,411	10,059	10,340	11,586	12,536	14,228	15,660
Net domestic assets	-3,832	-4,760	-5,363	-4,127	-4,727	-4,627	-4,968	-5,382	-5,558	-6,243	-6,431
Claims on public sector (net)[4]	-2,749	-2,858	-3,059	-1,725	-1,919	-1,525	-1,634	-685	-251	-107	51
Claims on central government (net)	-2,750	-2,858	-3,059	-1,725	-1,919	-1,525	-1,634	-685	-251	-107	51
Claims on commercial banks	-1	-518	-889	-582	-638	-601	-774	-975	-1,187	-1,607	-1,600
Other items (net)[5,6]	-1,082	-1,383	-1,415	-1,828	-2,170	-2,509	-2,560	-3,721	-4,120	-4,529	-4,882
Base money	3,013	3,545	4,092	4,728	4,684	5,431	5,372	6,204	6,978	7,984	9,230
Currency in circulation	2,204	2,453	2,746	3,179	2,997	3,757	3,584	4,097	4,679	5,493	6,683
Commercial bank deposits[7]	808	1,092	1,346	1,549	1,686	1,674	1,788	2,107	2,299	2,491	2,547
						Other Depository Corporations					
Net foreign assets	1,056	122	-604	-346	-91	-504	-572	-1,028	-1,700	-2,795	-3,389
Net domestic assets	8,318	9,805	12,432	14,248	13,685	16,818	16,306	19,267	22,189	26,223	30,238
Of which Claims on central government (net)	2,168	2,753	3,598	4,447	3,992	5,111	4,690	5,150	5,343	6,025	6,905
Of which Claims on private sector	7,471	7,964	9,069	10,488	10,490	12,132	12,078	13,960	16,186	18,729	21,612
Deposit liabilities to the non-bank public	9,373	9,927	11,828	13,902	13,594	16,314	15,734	18,239	20,488	23,428	26,849
Shilling deposits	5,798	6,812	7,881	9,106	8,798	10,764	10,520	12,024	13,733	17,370	21,134
Foreign exchange accounts	3,575	3,115	3,947	4,796	4,796	5,551	5,214	6,215	6,755	6,058	5,715
Memorandum items:											
(Annual percentage change)											
Base money	1.5	17.7	15.4	15.6	14.5	14.9	14.7	15.5	12.5	14.4	15.6
M3	7.2	6.6	17.4	17.5	14.2	17.5	16.3	15.7	12.6	14.6	15.8
Credit to the private sector	11.5	6.4	13.9	15.6	15.7	15.6	15.0	15.5	15.9	15.7	15.3
Memorandum items:											
Base money-to-GDP ratio (percent)	5.1	5.5	6.0	6.8	6.2	7.0	6.4	6.7	6.8	7.0	7.3
M3-to-GDP ratio (percent)	19.0	18.9	20.7	23.8	21.5	25.1	22.5	23.4	23.8	24.6	25.6
Base money multiplier (M2/base money)	2.6	2.5	2.5	2.5	2.4	2.6	2.5	2.5	2.5	2.8	2.9
Credit to the private sector (percent of GDP)	12.7	12.5	13.3	15.1	14.0	15.6	14.5	15.1	15.8	16.5	17.1
Gross reserves of BoU (US$ millions)	2,644	2,912	3,394	3,158	2,912	3,408	3,162	3,621	3,947	4,389	4,701.1
Velocity (M3)	5.3	5.3	4.8	4.2	4.7	4.0	4.5	4.3	4.2	4.1	3.9
Exchange rate (Ush/US$, eop)	2,472	2,593	2,600	...	...	...	...	...	...	...	...

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

[3] Starting on June 2013, the Bank of Uganda expanded the reporting coverage from Monetary Survey to Depository Corporations Survey.

[4] The public sector includes the central government, public enterprises, other financial corporations and local governments.

[5] Including valuation effects, the Bank of Uganda's claims on the private sector and Claims on Other Financial Corporations.

[6] Reflects actual and projected issuances for the recapitalization of Bank of Uganda.

[7] Inclusive of foreign currency clearing balances.

Table 4. Uganda: Balance of Payments, FY2011/12–2019/20[1,2]

(Millions of US dollars unless otherwise indicated)

	2011/12	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18	2018/19	2019/20
				3rd Rev	Proj.	3rd Rev	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-2,218	-1,878	-2,134	-2,700	-2,385	-2,581	-2,958	-3,624	-4,101	-4,686	-5,168
Trade balance	-2,581	-2,123	-2,332	-2,536	-2,198	-2,512	-2,504	-3,018	-3,033	-3,338	-3,654
Exports, f.o.b.	2,660	2,912	2,709	3,051	2,794	3,343	2,920	3,220	3,886	4,221	4,603
Of which: coffee	444	423	404	415	402	423	400	440	469	495	522
Imports, f.o.b.	-5,241	-5,035	-5,040	-5,588	-4,991	-5,855	-5,424	-6,237	-6,919	-7,559	-8,257
Of which: oil	-947	-1,028	-1,074	-1,052	-905	-1,133	-785	-910	-999	-1,075	-1,150
Of which: government, infrastructure related	-304	-359	-301	-419	-356	-416	-506	-564	-581	-598	-768
Services (net)	-404	-416	-242	-664	-484	-584	-610	-736	-926	-1,049	-1,118
Income (net)	-471	-539	-639	-665	-722	-758	-864	-935	-1,240	-1,446	-1,581
Of which: interest on public debt	-35	-39	-49	-49	-44	-100	-102	-130	-229	-346	-432
Transfers	1,238	1,199	1,079	1,165	1,018	1,273	1,020	1,065	1,098	1,146	1,184
Private transfers	838	1,121	989	1,082	915	1,183	929	969	1,014	1,058	1,106
Of which: workers' remittances (inflows)	584	807	686	933	613	1,029	624	651	681	711	743
Official transfers	400	79	90	83	102	90	91	96	83	88	78
Of which: budget support (including HIPC)	224	71	83	83	92	90	81	86	73	78	78
capital gains tax	176	7	7	0	10	0	10	10	10	10	0
Capital and financial account	2,357	1,793	2,116	2,472	1,911	2,838	3,215	4,087	4,427	5,128	5,480
Capital account	194	297	206	301	199	200	338	175	97	103	91
Of which: project grants	194	297	206	301	199	200	338	175	97	103	91
Financial account	2,163	1,496	1,910	2,171	1,712	2,638	2,877	3,912	4,330	5,025	5,389
Foreign direct investment	1,244	940	1,225	1,376	1,186	1,691	1,204	1,946	2,807	3,676	4,226
Portfolio investment	277	-46	6	-3	-45	-100	23	139	141	155	183
Other investment	642	602	679	798	571	1,046	1,650	1,826	1,382	1,194	980
Of which:											
Public sector (net)	745	534	303	914	447	958	1,350	1,424	1,921	1,621	1,072
SDR allocation	0	0	0	0	0	0	0	0	0	0	0
Build-up (-)/drawdown (+) of petroleum fund	273	-7	-7	172	162	0	-10	0	0	0	0
Loan disbursements	546	617	403	846	388	1,061	1,467	1,537	2,047	1,757	1,235
Project support (loans)	392	497	322	414	388	421	428	472	458	363	170
Budget support (loans)	49	120	0	0	0	0	0	0	0	0	0
Non-concessional borrowing	105	0	81	432	0	640	1,039	1,065	1,589	1,394	1,064
Amortization due	-75	-76	-93	-104	-104	-104	-107	-113	-126	-136	-162
Commercial banks (net)	-240	380	279	-107	-202	48	154	133	195	310	151
Other private (net)	414	-312	96	-10	326	41	146	269	-734	-737	-244
Errors and omissions	620	422	394	0	0	0	0	0	0	0	0
Overall balance	759	337	377	-229	-475	257	257	462	326	442	312
Financing	-759	-337	-377	229	475	-257	-257	-462	-326	-442	-312
Of which:											
Central bank net reserves (increase = –)	-755	-333	-372	236	482	-250	-250	-459	-326	-442	-312
Of which: SDR allocation	0	0	0	0	0	0	0	0	0	0	0
Use of Fund credit	-2	-2	-2	-1	-1	0	0	0	0	0	0
Memorandum items:											
Gross offical reserves	2,644	2,912	3,394	3,158	2,912	3,408	3,162	3,621	3,947	4,389	4,701.1
Months of imports of goods and services	4.2	4.5	5.1	4.1	4.0	4.1	3.9	4.0	4.0	4.1	4.4
Donor support											
Of which: Budget support (loans and grants)	273	191	83	83	92	90	81	86	73	78	78
Project support (loans and grants)	586	794	529	715	587	622	765	647	556	466	262
Current account balance (percent of GDP)	-9.5	-7.6	-7.9	-10.3	-8.9	-9.4	-11.0	-12.4	-13.1	-13.8	-14.0
Current account balance (excluding grants)	-10.5	-7.9	-8.2	-10.6	-9.3	-9.7	-11.3	-12.7	-13.4	-14.0	-14.2
Trade balance (percent of GDP)	-11.1	-8.6	-8.7	-9.6	-8.2	-9.2	-9.3	-10.3	-9.7	-9.8	-9.9
Exports of goods (percent of GDP)	11.4	11.8	10.0	11.6	10.5	12.2	10.8	11.0	12.4	12.4	12.5
Imports of goods (percent of GDP)	22.6	20.4	18.7	21.2	18.7	21.3	20.1	21.3	22.1	22.2	22.4

Sources: Ugandan authorities and IMF staff estimates and projections.

[1] Fiscal year runs from July 1 to June 30.

[2] All figures are based on the rebased GDP, except 3rd PSI review figures.

Table 5. Uganda: Banking Sector Indicators, March 2010–March 2015
(Percent)

	2010				2011				2012				2013				2014				2015
	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Capital adequacy																					
Regulatory capital to risk-weighted assets	22.7	21.7	21.2	20.2	21.2	19.3	18.3	20.3	21.8	20.7	20.9	21.9	24.5	24.3	23.1	22.1	23.6	22.8	22.5	22.2	23.2
Regulatory tier 1 capital to risk-weighted assets	19.9	19.2	18.8	17.5	18.9	17.3	16.2	17.9	19.0	18.3	18.5	18.8	21.4	21.2	20.3	19.1	20.9	20.3	19.9	19.7	20.8
Asset quality																					
NPLs to total gross loans	3.7	3.3	2.8	2.1	2.5	1.6	1.8	2.2	3.4	3.9	4.7	4.2	4.7	4.0	4.4	6.0	6.2	5.8	5.3	4.1	4.2
NPLs to total deposits	2.5	2.1	1.8	1.4	1.7	1.1	1.4	1.7	2.6	2.9	3.4	3.1	3.5	2.9	3.2	4.3	4.2	4.1	3.7	2.9	3.1
Specific provisions to NPLs	65.4	58.8	70.5	65.0	59.7	64.4	58.1	50.9	45.2	48.7	49.0	45.9	55.1	53.1	47.3	64.8	53.9	62.1	55.4	48.9	53.7
Earning assets to total assets	82.4	74.9	76.7	77.1	73.6	74.8	74.3	74.0	74.7	72.0	71.9	71.3	69.6	70.0	70.7	69.6	69.3	68.9	71.5	71.5	70.4
Large exposures to gross loans	41.0	35.4	35.5	35.7	38.6	41.7	38.3	34.6	33.7	34.6	34.6	34.6	34.8	36.0	35.4	37.9	33.6	32.3	37.2	38.3	35.2
Large exposures to total capital	123.9	112.8	116.1	124.4	129.8	156.2	145.4	120.8	109.4	111.5	104.2	104.7	95.4	103.4	102.2	113.6	97.7	96.4	109.7	113.2	104.5
Earnings and profitability																					
Return on assets	2.4	2.3	2.4	2.7	2.9	3.1	3.6	4.0	4.4	4.4	4.3	3.9	3.6	3.3	3.2	2.0	2.4	2.1	2.2	2.6	2.5
Return on equity	15.5	16.1	16.2	18.0	19.6	22.4	25.4	27.4	28.1	29.5	27.9	24.2	21.0	20.4	18.9	12.4	14.2	12.8	13.1	16.0	15.6
Net interest margin	10.0	9.9	10.0	10.0	10.1	10.5	11.0	11.7	12.5	12.8	12.9	12.8	12.5	12.2	11.8	11.6	11.4	11.5	11.3	11.0	11.0
Cost of deposits	3.5	3.3	3.2	2.9	2.7	2.5	2.8	3.2	3.4	3.6	4.0	4.1	4.3	4.1	3.9	3.7	3.6	3.7	3.7	3.5	3.4
Cost to income	78.9	79.2	78.7	75.7	73.5	71.2	68.8	68.2	67.5	68.1	68.8	70.9	72.0	72.4	73.2	80.1	76.6	75.8	74.8	68.7	68.7
Overhead to income	53.0	53.7	54.0	53.1	52.5	50.4	47.5	43.9	40.9	39.6	38.5	40.1	41.9	43.2	45.3	46.7	45.4	41.9	41.1	40.0	40.1
Liquidity																					
Liquid assets to total deposits	45.5	41.6	40.5	39.8	40.5	35.6	36.2	37.6	37.5	38.9	42.5	42.0	42.7	41.1	40.6	42.5	45.4	46.5	41.8	44.0	44.2
Market sensitivity																					
Foreign currency exposure to regulatory tier 1 capital	-3.0	-3.5	-11.8	-1.6	-2.1	-0.9	-3.4	-3.6	-4.1	-5.2	-5.2	-0.6	-5.1	-6.7	-8.2	-3.2	-2.6	-6.7	-1.4	-6.9	-5.4
Foreign currency loans to foreign currency deposits	59.2	52.1	54.4	65.2	63.4	68.6	66.8	67.9	74.7	67.1	74.8	87.0	72.3	72.8	63.0	57.6	73.7	65.0	64.3	64.5	58.8
Foreign currency assets to foreign currency liabilities	101.1	98.4	96.3	98.0	98.1	100.1	98.1	100.2	103.2	103.4	100.7	105.0	104.8	104.9	100.6	97.3	100.8	95.4	95.2	97.1	102.9

Source: Bank of Uganda.

Table 6. Uganda: Millennium Development Goals Indicators

	1990	1995	2000	2005	2010	2011	2012	2013
Goal 1: Eradicate extreme poverty and hunger								
Employment to population ratio, 15+, total (%) (modeled ILO estimate)		80	79	77	75	74	74	75
Employment to population ratio, ages 15-24, total (%) (modeled ILO estimate)		62	62	59	56	55	55	55
Income share held by lowest 20%				6			6	
Malnutrition prevalence, weight for age (% of children under 5)		22	19					
Poverty headcount ratio at national poverty lines (% of population)			34	31			20	
Poverty headcount ratio at $1.25 a day (PPP) (% of population)				52			38	
Goal 2: Achieve universal primary education								
Literacy rate, youth total (% of people ages 15-24)					87			
Primary completion rate, total (% of relevant age group)				56	55	53		54
School enrollment, primary (% net)					88	91		91
Goal 3: Promote gender equality and empower women								
Proportion of seats held by women in national parliaments (%)	12		18	24	31	35	35	35
Ratio of female to male primary enrollment (%)	80	84	94	99	101	102		102
Ratio of female to male secondary enrollment (%)	58		77	80	86	85		87
Ratio of female to male tertiary enrollment (%)	39	48	51		79	78		
Goal 4: Reduce child mortality								
Immunization, measles (% of children ages 12-23 months)	52	57	57	68	73	75	82	82
Mortality rate, infant (per 1,000 live births)	107	99	89	68	51	49	45	44
Mortality rate, under-5 (per 1,000 live births)	179	165	147	109	78	74	69	66
Goal 5: Improve maternal health								
Births attended by skilled health staff (% of total)		38				57		
Contraceptive prevalence (% of women ages 15-49)		15		20		30		
Maternal mortality ratio (modeled estimate, per 100,000 live births)	780	740	650	510	410			360
Pregnant women receiving prenatal care (%)		91				93		
Goal 6: Combat HIV/AIDS, malaria, and other diseases								
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)						65		
Incidence of tuberculosis (per 100,000 people)	625	543	427	304	209	193	179	166
Prevalence of HIV, total (% of population ages 15-49)	12	11	7	6	7	7	7	7
Tuberculosis case detection rate (%, all forms)	13	22	29	47	60	68	69	73
Tuberculosis treatment success rate (% of new cases)		44	63	73	68	73	77	
Goal 7: Ensure environmental sustainability								
Forest area (% of land area)	24	22	19	17	15	15	14	
Improved sanitation facilities (% of population with access)	26	28	30	32	33	34	34	
Improved water source (% of population with access)	42	49	57	64	72	73	75	
Terrestrial protected areas (% of total land area)	8	9	9	10	11		11	
Goal 8: Develop a global partnership for development								
Net ODA received per capita (current US$)	38	40	35	42	51	45	46	45
Internet users (per 100 people)	0	0	0	2	13	13	15	16
Mobile cellular subscriptions (per 100 people)	0	0	1	5	38	48	45	44
Telephone Lines (per 100 people)				4	13	15		

Sources: World Development Indicators, Millennium Development Goals Report for Uganda 2013.

Annex I. Uganda: External Stability Assessment

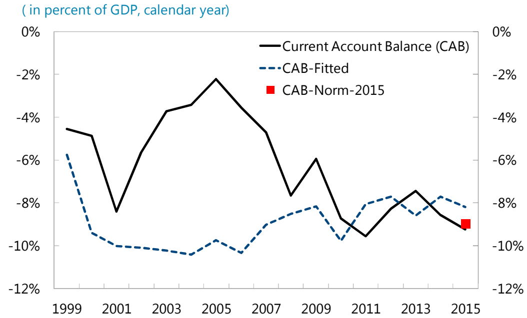
Current Account Sustainability and Exchange Rate Assessment

Uganda's high external current account deficits reflect structural factors. Ongoing economic development requires large investment-related imports, which alongside a narrow export base leads to structurally negative trade deficits. High deficits also reflect a slower pace of aging in the population and higher aid flows than the rest of the world. The deficits are mostly financed by foreign direct investment (FDI), public loans and use of government savings. Increased portfolio investment flows provide an additional source of foreign exchange.

An estimated current account norm indicates no need for adjustment in the real effective exchange rate in the near term. The norm is estimated at a deficit of 9.0 percent of GDP for CY2015, which reflects the above-mentioned Uganda's fundamentals and the rest of the world's fiscal expansion relative to its desirable level (Chart 1).[1] The estimated gap implies a slight overvaluation of 1.1 percent in the real effective exchange rate that is not likely to create difficulties in the near term because imports related to large infrastructure projects are associated with identified external financing. The evolution of the real effective exchange rate does not indicate any misalignment (Chart 2).

Chart 1. Uganda: Current Account Balance Estimates

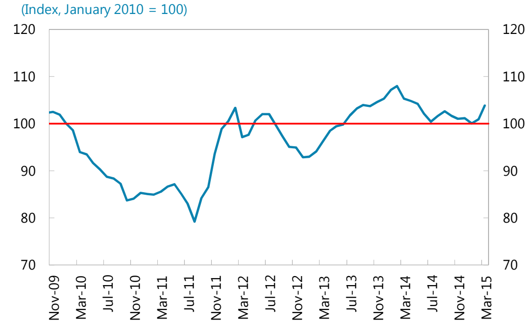
(in percent of GDP, calendar year)



Sources: Ugandan authorities, WDI, and IMF Staff estimates.

Chart 2. Uganda: Real Effective Exchange Rate

(Index, January 2010 = 100)



Sources: Ugandan authorities and IMF staff calculation

Nonetheless, the high current account deficit warrants adjustment over the medium to long term. The deficit is projected to widen during the period when the expected oil-related and public investment scale-up takes place, and will continue to be financed by FDI and external loans. Thereafter, the envisaged oil production would help narrow the deficit by 2½ percent of GDP on average, although there is uncertainty stemming from oil price fluctuations. The weak performance of exports is a matter of concern that needs to be addressed over the medium term through structural transformation to increase economic productivity and competitiveness, and improve the quality of domestic production to partly substitute imports. The new hydropower plants will generate a welcome electricity surplus that can be exported to neighboring countries.

[1] These calculations are based on the External Balance Assessment (EBA-lite) methodology (IMF Working Paper, WP/13/272), and assume an elasticity of 0.22 of the current account balance to the exchange rate (IMF Working Paper, WP/10/180). The results do not differ from those obtained by using other methodologies, such as the Macroeconomic Balance Approach and the External Sustainability Approach.

Adequacy of International Reserves

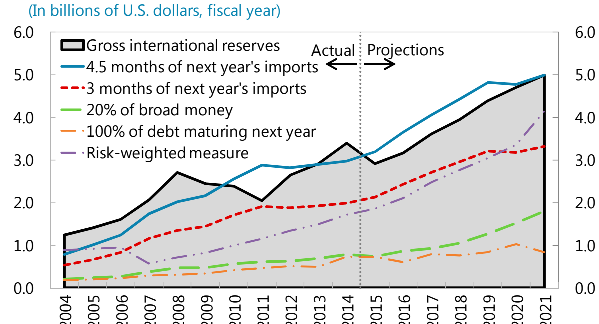
Despite the recent decline, international reserves keep their comfortable levels. Since FY2012/13, strong financial inflows had allowed for a significant reserve accumulation, with its level reaching 5 months of imports at end-FY2013/14. This provided a welcome cushion when the demand for foreign exchange spiked in late 2014. The Bank of Uganda intervened only when the exchange rate showed excessive volatility, allowing for exchange rate adjustment to fundamentals. Reserves at end-FY2014/15 are still projected at 4 months of next year's imports, over 70 percent of broad money (M2), and 350 percent of debt maturing in the next year.

The adequate level of reserves for Uganda is estimated at 3½ to 4 months of next year's imports, considering precautionary and non-precautionary motives for holding reserves. First, a level of 1.2-2.5 months of next year's imports will be adequate for precautionary motives to prevent and mitigate crises, taking into account the high costs of holding reserves in the range of 5.3-10.6 percent. These costs include the external financing cost, sterilization cost, and marginal product from foregone physical investment.[2] The optimal reserve level would be somewhat higher —up to ½ months of next year's imports—over the medium term considering the increasing fiscal deficits in the coming years. Second, non-precautionary motives justify further reserve accumulation, including dealing with volatile capital flows, preparing for import payment needs for public and private investment projects, and ensuring intergenerational equity by managing the proceeds from the country's non-renewable resources such as prospective oil revenues. Such considerations lead to an estimate of 0.8 months of next year's imports of additional reserve holding, implying that a level about 3½ to 4 months of next year's imports is adequate overall.

Staff projections indicate that international reserves will remain adequate over the medium term (Chart 3). Reserves are projected to be higher than required by traditional adequacy measures and on track to fulfill commitments under the EAC convergence criteria. The traditional import cover measurement of reserves fluctuates over the medium term as high imports related to large investment projects fade out. In fact, this measurement may understate reserve adequacy because increased imports are tied to external financing and hence are not likely to cause payment difficulties. Based on Uganda's open capital account and increased portfolio flows, the ratios of reserves to broad money and to short-term maturity debt are becoming more relevant as they capture potential capital flight risks. On average, reserves are estimated to be 69 percent of broad money and 511 percent of short-term debt over the medium term.

Chart 3. Uganda: Gross international reserves[1]

(In billions of U.S. dollars, fiscal year)



Sources: Ugandan authorities and IMF staff calculations

[1] Risk-weighted measure follows the IMF Policy Paper, "Assessing Reserve Adequacy-Specific Proposals" (2014).

[2] IMF Policy Paper, 2014, "Assessing Reserve Adequacy—Specific Proposals."

Annex II. Uganda: Risk Assessment Matrix (RAM)[1]

	Sources of Risk	Relative Likelihood	Impact if Realized	Staff advice on policy response[2]
Global Risks				
Short-term	***Uncertain global financial conditions***			
	A surge in financial volatility following slow and uneven global growth, asymmetric monetary exit, or poor market liquidity	**High**	**Medium** Rising foreign interest rates could reduce financial flows to Uganda. This would accentuate shilling depreciation pressures, push up interest rates, generate inflation, and dampen GDP growth.	Maintain fiscal and monetary policies consistent with the growth and inflation objectives to reassure investors. Find a delicate balance between ensuring low inflation, protecting reserve adequacy, and preventing undue market volatility.
	Protracted growth slowdown in main trading partners			
	Weak demand in advanced economies and continued slower growth in emerging markets, including due to maturing of the commodities' cycle	**High**	**Medium** Lower consumption and investment abroad could hurt demand for Ugandan exports, including commodities, whose prices might also decline. This would undermine the country's external and fiscal positions and result in additional borrowing requirements.	Design contingent policies that would allow quick adjustment to the changing environment. Improve the efficiency of spending to spur growth while maintaining social protection. Focus on regional trade and financial links in the context of EAC integration, to partially compensate declining demand in the rest of the world.
Medium-term	***Declining energy prices***			
	Persistently low oil prices triggered by supply factors and weaker global demand	**Medium**	**Medium** Lower oil prices could delay oil-related investment decisions and complicate negotiations of oil companies with the government given the early stage of production.	Maintain a business-friendly environment and clear rules of the game, to reassure investors.

Regional and Domestic Risks				
Short-term	***National elections***			
	Rising election-related spending pressures that could result in large fiscal slippages	**Medium**	**High** An unduly high fiscal deficit would require unplanned financing, pushing interest rates up and slowing down growth. An increase in public consumption could fuel inflation expectations and reverse the hard-won price stability.	Resist spending pressures and adhere to a budget framework and borrowing plan consistent with the economic program. If expenditure is inevitable, streamline other outlays (preserving social outlays) or generate revenue with a view of using only the available fiscal space.
	Delays in public investment			
	Implementation capacity constraints that could delay public investment plans	**High**	**Medium** Lower public investment would raise construction costs, and delay growth recovery and the other benefits of closing the infrastructure gap.	Continue to develop sound public investment guidelines and improve financial management practices to build capacity to implement projects efficiently.
Medium-term	***Regional security issues***			
	Deteriorating security situation in the region that could generate strong spillover effects	**Medium**	**Medium** Instability in neighboring countries would dampen trade, investment, remittances, and tourism, and would generate spending needs. This would hurt growth and employment, and generate a loss of confidence in the economy.	Accommodate policies to support growth, by using existing fiscal space and borrowing capacity.

[1]The RAM shows events that could materially alter the baseline path—the scenario most likely to materialize in staff's view. The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities.

[2]The policy response assumes other things unchanged. For a combination of shocks, policy responses would need to be tailored to avoid potential conflicting advice.

Annex III. Uganda: Economic Resilience Analysis[1]

An analysis of the resilience of the Ugandan economy to a pre-identified set of external and domestic shocks, based on impulse-response functions, finds that the economy can withstand the impact of the shocks relatively well.[2] A prolonged slowdown in growth in main trading partners would have a strong impact on growth in Uganda. Importantly, a lax fiscal policy stance could compromise fiscal sustainability and medium-term growth in Uganda.

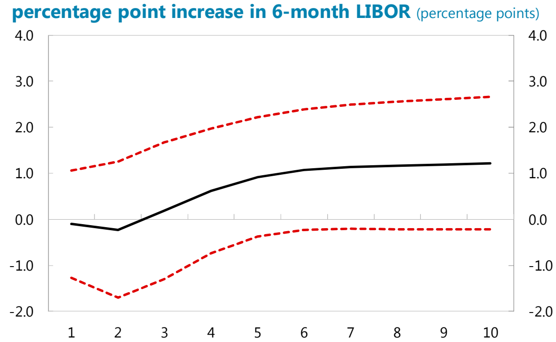
A. External Shocks

Global liquidity shock

Hypothesis: Higher-than-anticipated foreign interest rates would curtail portfolio and possibly FDI flows to Uganda—a small and open economy—driving a shilling depreciation and fueling inflation and inflationary expectations. Heightened country risk and inflation pressures would push interest rates up as the BoU responds with monetary tightening. Increases in domestic prices and the cost of credit would hurt private investment and consumption, and would impact banks', companies' and households' balance sheets.

Results: Staff econometric estimates show that high foreign interest rates (as measured by the 6-month LIBOR) would raise domestic inflation and reduce GDP growth in Uganda, although the impact was not found statistically significant at the 5 percent confidence level (Chart 1).

Chart 1. Uganda: Impulse response of growth to a one percentage point increase in 6-month LIBOR (percentage points)



Sources: Ugandan authorities, IFS, and IMF staff calculation

This benign results suggest that the economy would cope relatively well with a global liquidity shock supported by (i) its strong external buffer with international reserves covering over 70 percent of broad money; and (ii) the relative low foreign holdings of government securities (about 13 percent of total securities or 13¼ percent of international reserves). However, results

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[1] Prepared by Ari Aisen and Futoshi Narita. Edited by Ana Lucía Coronel.

[2] The shocks are consistent with those identified in the Risk Assessment Matrix. The analysis is based on the estimation of vector auto regressions (VARs) using quarterly data from 1997 to 2014. Separate models were used to assess the impact of each shock on growth, inflation and the exchange rate. The number of selected lags, guided by standard statistical inference, is two for all models, except for the oil price shock where the number of lags is five.

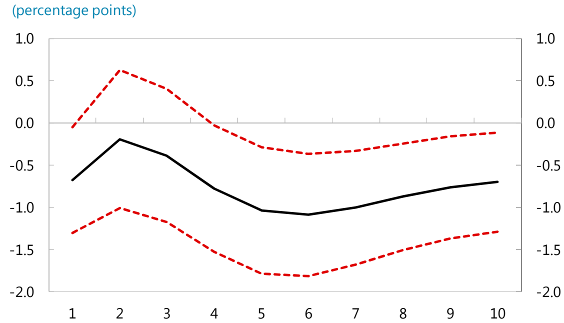
are driven by historical data that do not reflect the increasing importance of FDI and portfolio flows. Therefore, a potential negative impact of foreign exchange flow volatility on growth and inflation cannot be ruled out, particularly considering the recent increase in deposit and swap operations in foreign currency and the large profits of foreign firms operating in Uganda. With a shallow foreign exchange market and low daily turnover (about $50 million), a sharp unwinding of households' or corporates' foreign exchange positions or unusually large profit repatriation could have a significant impact on the exchange rate and pose risks to banks, which would see their open position widen and their credit quality deteriorate.

Protracted slow economic growth in main trading partners

Hypothesis: Slower-than-expected growth in economies trading with Uganda would hurt exports and widen the trade deficit, hampering economic growth and posing threats to BoP financing. The impact on inflation would be ambiguous as depreciation forces would push domestic prices up, but lower exports would weaken aggregate demand mitigating an eventual exchange rate pass-through.

Results: A one percentage point decline in main trading partners' growth would result in a 0.7 percentage reduction in Ugandan GDP growth (Chart 2). The impact on inflation is muted. Regarding BOP financing needs, a severe shock on neighboring countries that would wipe out their demand for Ugandan exports would result in a significant decline in international reserves if these exports would not find alternative destinations. Given that about 20 percent of Ugandan exports are directed to neighboring countries a severe shock would result in a shortage in export earnings of 4 percent of GDP that would require additional financing, with an impact on international reserves of about $1.1 billion.

Chart 2. Uganda: Impulse response of GDP growth to a one percentage point decline in trade partners' GDP growth
(percentage points)



Sources: Ugandan authorities, IFS, and IMF staff calculation

Oil price shock

Hypothesis: A reduction in oil prices would improve the trade balance by reducing imports, and given that domestic fuel prices are liberalized, the shock would push prices down. The impact on growth would be ambiguous depending on the interaction of supply-side cost savings and possible exchange rate appreciation that could hurt exports.

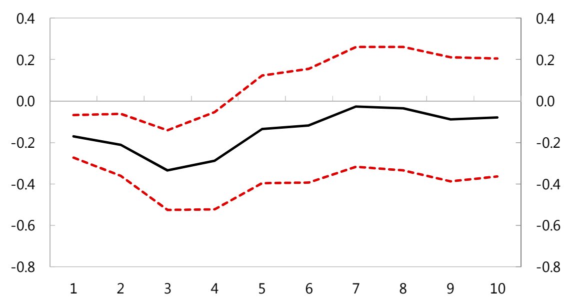
Results: A one percentage point decline of international oil prices would reduce nominal import growth by 0.2 percentage points since oil imports are inelastic on impact (Chart 3). The effects on growth and inflation are not statistically significant. Econometric estimates suggest that a reduction in oil prices is associated with exchange rate depreciation in Uganda, possibly reflecting a general worsening of BoP flows from oil producing neighboring countries (exports and remittances). The depreciation may mitigate the effect of oil prices on core inflation. With no impact on inflation, real incomes are virtually unchanged without pronounced effect on private consumption and growth.

B. Domestic Shocks

Food price shock

Hypothesis: Large increases in food prices could raise core inflation through second round effects. The impact on growth would be ambiguous as higher food prices would reduce disposable income, negatively affecting households' consumption, but agricultural production could benefit. Since Uganda is a net food exporter, exports could increase and the exchange rate could appreciate.

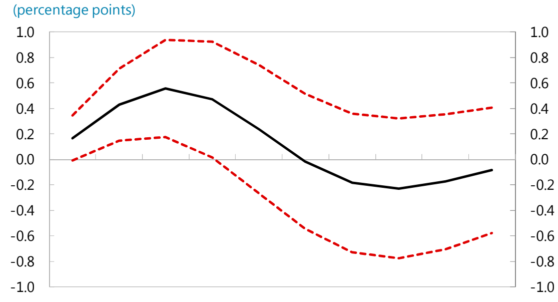
Chart 3. Uganda: Impulse response of import growth to one percent decline in international oil prices
(percentage points)



Sources: Ugandan authorities, IFS, and IMF staff calculation

Results: A one percentage point increase in food inflation would raise core inflation by 0.2 percentage points on impact and by 0.5 percentage points after 6 to 9 months (Chart 4). The effects on growth are not statistically significant.

Chart 4. Uganda: Impulse response of core inflation to a one percentage point increase in food inflation
(percentage points)



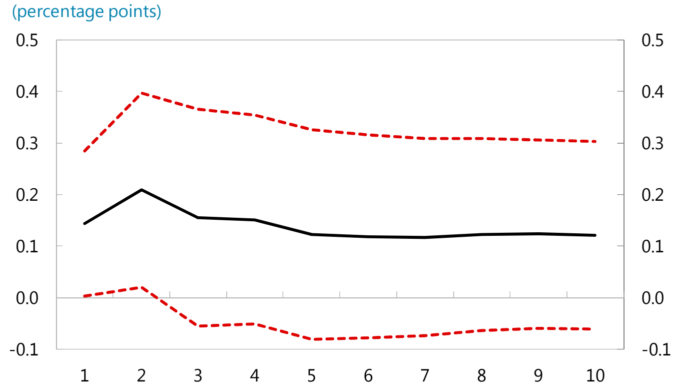
Sources: Ugandan authorities, IFS, and IMF staff calculation

Lax fiscal policy shock

Hypothesis: The impact on growth of a laxer than anticipated fiscal policy would depend on the nature of the expansion. Ceteris paribus, higher capital expenditures would have a stronger impact on growth than higher current expenditures.[3] The impact on inflation would depend on the cyclical position of the economy prior to the fiscal boost and the potential crowding out effects on private activity due to higher interest rates or appreciated exchange rate (exports).

Results: One dollar increase in real fiscal expenditure would raise real GDP by $0.15 a year, in line with fiscal multipliers observed, on average, for low-income countries (Chart 5).[4] While a lax fiscal policy could benefit growth in the short run, it could compromise fiscal sustainability given that the fiscal expansion would be over and above current projections. If a fiscal consolidation is later required, any short term positive impact on growth would quickly dissipate. The boost to aggregate demand would not raise core inflation immediately but with a lag of about 5 quarters.

Chart 5. Uganda: Impulse response of real GDP to one dollar increase in real fiscal expenditure (fiscal multiplier)
(percentage points)



Sources: Ugandan authorities, IFS, and IMF staff calculation

[3] The impact of current and capital expenditures on growth was explored separately, but the results were inconsistent mainly because capital expenditure data are highly volatile.

[4] See the "2013 Low-income countries global risks and vulnerability report" for a summary of fiscal multipliers estimates found in the literature.

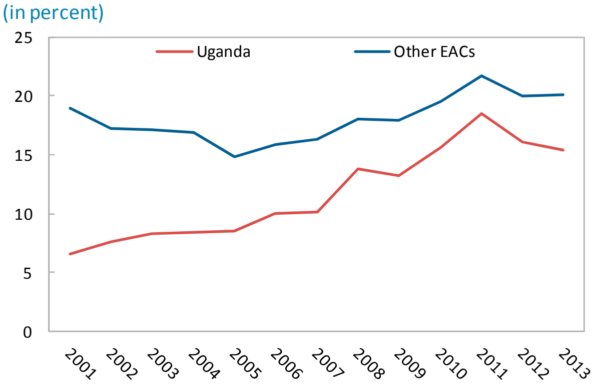
Annex IV. Uganda: Achieving Financial Deepening and Financial Inclusion[1]

Uganda has significantly developed its banking sector over the past decade. Nonetheless, the degree of financial depth and financial access remains low. Further efforts are needed to boost credit expansion and efficiently allocate domestic savings to activities that support economic growth. It is critical, however, to ensure that credit expansion occurs at a gradual and sustainable pace to avoid risking financial stability. To fully harvest the economic benefits of financial deepening, an increase in financial access is needed through improvements in financial literacy, consumer protection, and well-regulated financial innovations.

A. Financial Deepening: A Shallow System

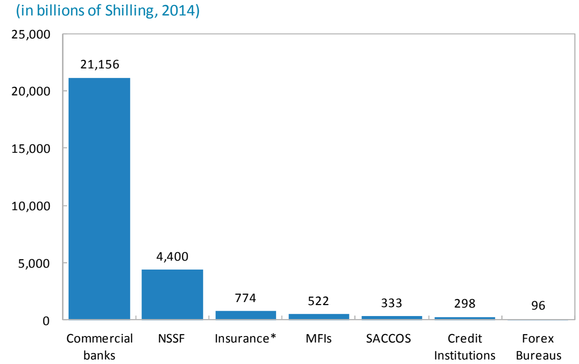
The banking sector has achieved significant deepening in the past years, but still remains relatively shallow.[2] Total bank assets have increased from 22 percent of GDP in 2001 to 31 percent in 2014. The increase has been driven both by an expansion in credit and by robust economic growth. The private sector credit-to-GDP ratio has doubled from 6½ percent in 2001 to 13¼ percent in 2014, with a setback from its 2011 peak of 18½ percent at a time of a credit boom. Although this increase has taken place at a faster pace than in other EAC countries, the ratio is still lower than in the rest of the region.

Private Credit to GDP
(in percent)



Sources: IFS and staff estimate.

Uganda:Assets of Commercial Banks and Non-Bank Financial Institutions
(in billions of Shilling, 2014)



Sources: CEIC, websites.
*End of 2013

Operations in non-bank financial institutions are incipient whereas the national pension fund has gained increased relevance. While assets managed by the National Social Security Fund (NSSF) account for about 6½ percent of GDP, credit and finance companies, microfinance institutions (MFIs), and the insurance sector are still small and immature, and only partly supervised by the BoU. Despite the presence of 22 insurance companies in the

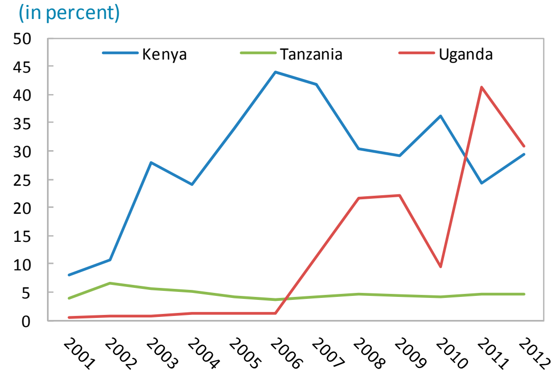
[1] Prepared by Clara Mira and Hong Wang. Edited by Ana Lucía Coronel and Ari Aisen.

[2] This analysis does not include loans and trade credits contracted by resident enterprises from creditors abroad. Some of this foreign borrowing may be filling the gap created by low long-term domestic loans.

market, penetration of insurance is only 0.85 percent of GDP—below the average rates in SSA (3½ percent in 2013). Combined assets of credit companies and both deposit and non-deposit taking MFIs amount to only 1¼ percent of GDP. Savings and Credit Cooperatives (SACCOs) and MFIs still experience sustainability weaknesses, due to low savings mobilization, overdependence on government, lack of regulation, and fraudulent activities.

The development of capital markets also faces constraints that hamper long-term financing. The Uganda Securities Exchange (USE), established in 1997, has provided a platform for transaction of domestic and foreign shares, Treasury bills, and government and corporate bonds. A market segment designed for small-and-medium-sized enterprises (SMEs) was introduced in 2012, but has not been very active. The equities market capitalization has risen by almost 40 times between 2002 and 2012. At about 30 percent of GDP, it now exceeds that of Kenya and Tanzania. Currently, there are 15 listed companies (eight local and seven Nairobi Stock Exchange cross-listings). However, with a narrow investor base and no new listings in the last three years, the turnover ratio is low and liquidity limited. The size of the government bond primary market has increased, but the corporate bond market has remained depressed, with only five issuances outstanding in 2014. Consequently, the overall capital market's contribution to savings and investment is limited.

Market Capitalization to GDP Ratio: Listed Companies
(in percent)



Sources: CEIC

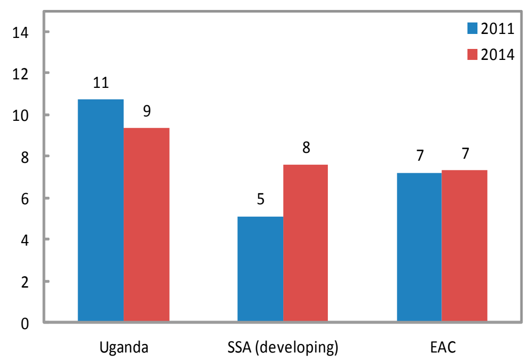
B. Financial Inclusion: Low Access to Financial Services

Financial access remains low, although it has improved over the last few years. Only 28 percent of the adult population owns an account at a formal financial institution,[3] with access of those at the bottom 40 percent of income being significantly lower (13 percent). Access to agricultural credit by the rural communities remains small.

There are also distributional differences in access to credit. Despite a small improvement in financial inclusion of women over the last three years, the gender gap remains larger than in the rest of the region. There has been a sustained expansion of access points to the banking system (with bank branches increasing from only 167 in 2004 to 658 in 2013), but these remain low in proportion to population; and their distribution is uneven, with bank branches concentrated in the central region of the country.

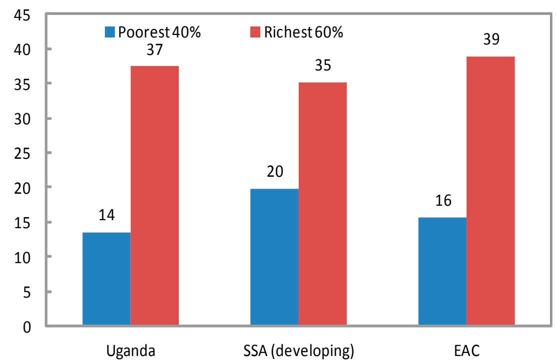
[3] As defined by World Bank's Global Findex (Global Financial Inclusion Database). This concept includes the percentage of respondents to interviews who report having an account (by themselves or together with someone else) at a bank or another type of financial institution; having a debit card in their own name; receiving wages, government transfers, or payments for agricultural products into an account at a financial institution in the past 12 months; paying utility bills or school fees from an account at a financial institution in the past 12 months; or receiving wages or government transfers into a card in the past 12 months.

Financial Inclusion Gender Gap
(Percentage of Men minus Percentage of Women with an Account at a Financial Institution)



Source: Findex database, World Bank

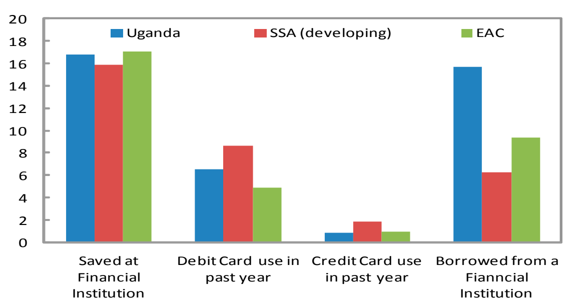
Account at a Financial Institution
(Percent of population 15+, 2014)



Source: Findex database, World Bank

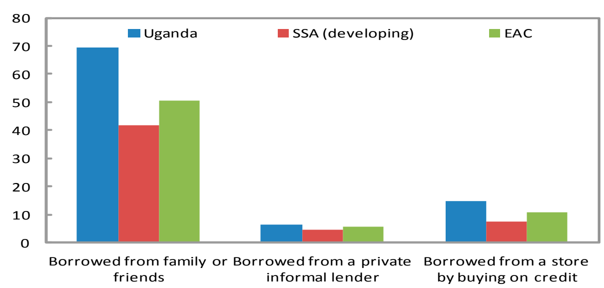
Formal finance channels are less widely used than non-formal channels and bank penetration is low. Recent statistics show that less than 20 percent of the population borrowed or saved in a financial institution, while about 70 percent had borrowed money from family and friends. Similarly, bank penetration lags behind SSA countries. Although 85 percent of companies own a checking or saving account, less than 10 percent has obtained a loan or used bank services to finance their investments. Furthermore, the proportion of loans that require collateral are above the SSA average.

Formal Finance
(Percent of population 15+, 2014)



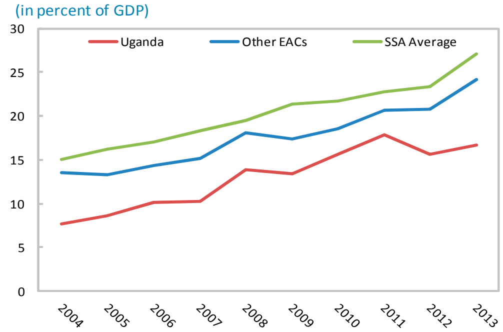
Source: Findex database, World Bank

Informal Finance
(Percent of population 15+, 2014)



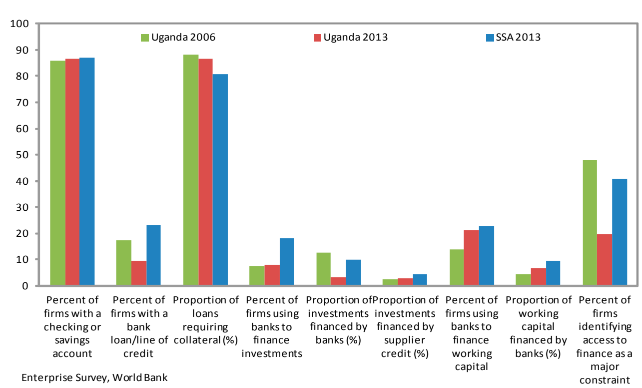
Source: Findex database, World Bank

Outstanding Loans from Commercial Banks
(in percent of GDP)



Sources: FAS

Enterprise Survey Indicators

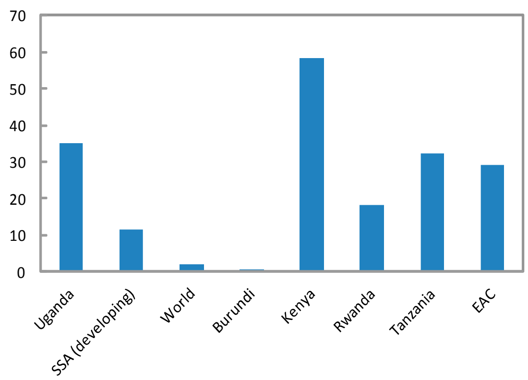


Enterprise Survey, World Bank

Against this background, Uganda has witnessed a dynamic growth in mobile banking. The use of mobile money accounts is more prevalent than the use of ATMs. About 40 percent of the population and 76 percent of the adult population (87 percent in EAC and 18 percent in SSA) has access to mobile money accounts. In the last two years the number of registered users for mobile transactions has increased by 110 percent to reach 18.8 million, with an expansion of 75 percent in the value of transactions. Credit companies and microfinance institutions have offered an array of innovative financial products in this area. Furthermore, the recourse to village savings and other voluntary groups has provided further access to savings for the rural population.

Mobile Account

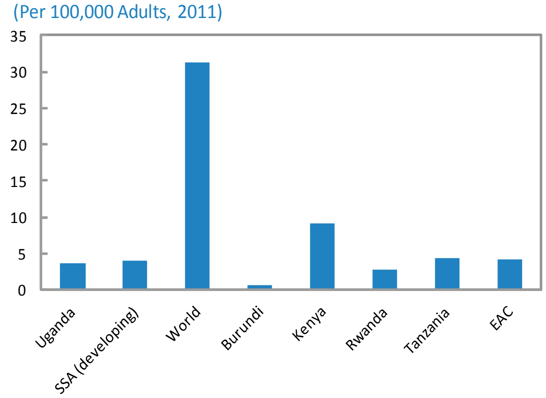
(Percent of population 15+, 2014)



Source: Findex database, World Bank

ATM's

(Per 100,000 Adults, 2011)



Source: Findex database, World Bank

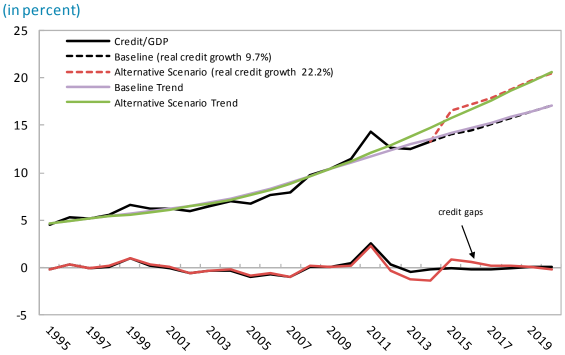
The establishment of the Credit Reference Bureau in 2008 (CRB) is facilitating access to finance. The CRB improves information sharing between financial institutions and borrowers, reducing default rates and protecting borrowers against over-indebtedness, and builds clients' reputational collateral. Its introduction resulted in a significant improvement in Uganda´s ranking under the "getting credit" category of the World Bank Doing Business Indicators.

C. Improving Financial Deepening and Financial Inclusion: A Big Challenge

International experience shows that financial development is positively correlated with high growth and reduced inequality. Financial development increases economic resilience; improves resource allocation; facilitates diversification and management of risk; and promotes information sharing. Financial development also improves the efficiency of fiscal and monetary policies by strengthening policy transmission and generating growth-financing opportunities. Moreover, financial development allows for a productive allocation of capital and investment with positive effects on total factor productivity. Evidence also confirms that income inequality is lower in countries with deeper and more accessible financial markets, and that financial development exerts a disproportionately positive impact on the relatively poor (Beck et al, 2007).

The needed increase in the credit-to-GDP ratio in Uganda has to be gradual and sustained, but will be limited if access to banking services is not expanded. An increase in credit of about 10 percent per year in real terms in the next 5 to 6 years, consistent with the authorities' medium-term projections, will provide a welcome improvement in the credit-to-GDP ratio from 14 percent to almost 17 percent in FY2020/21. While this will be enough to close the existing credit-to-GDP gap, further efforts to support financial deepening will be needed.[4] For illustrative purposes, an alternative exercise assuming a real credit growth similar to the one observed on average during the 2008-2011 credit boom would trigger an unsustainable credit bubble, risking growth stability and financial sector soundness. This exercise shows that the financial system is not prepared to achieve a higher expansion in credit if the deposit base and other bank funding sources do not equally grow.

Credit Growth and Credit to GDP Gap
(in percent)



Note: The baseline assumes credit growth projections as per the macroframework tables for 2015-20. The alternative scenario assumes that real credit grows at the average rate of 2008-11 in the projection period 2015-20.
Sources: IFS and staff estimates.

To improve the deposit base and other banks funding sources, a wide array of financial sector administrative actions and institutional improvements are needed. The switch from the cash-based system that currently prevails for most economic transactions to the use of bank accounts and credit cards will be slow. However, in the meantime, there are ways of encouraging the use of bank services. Expanded account ownership could be achieved by simplifying opening documentation requirements; offering basic low-fee accounts and other attractive products; and locating outlets in more remote areas on a more cost-effective basis. By upgrading trading and settlement systems; reducing listing and trading costs; and improving investors' literacy, the USE could enhance market attractiveness and support longer-term financing needs through more developed corporate bond and stock markets. The USE would also need to leverage regional opportunities through the EAC financial market integration process.

There are ongoing and prospective actions to improve financial inclusion. A project launched by the BoU in 2012,[5] which includes work along key initiatives with the goal of increasing the percentage of adult population financially included to at least 70 percent by 2017, should be helpful in this regard. Financial inclusion is expected to benefit from the following actions:

Introducing financial innovations. This mainly includes optimizing the use of mobile and agent banking:

[4] This gap is calculated by comparing the credit-to-GDP ratio to its long term trend: $\mathrm{GAP_t} = \mathrm{Ratio_t} - \mathrm{Trend_t}$. The trend is based on Hodrick-Prescott filtered historical annual data using a smoothing parameter λ=100.

[5] The Promoting Financial Inclusion project became a strategic objective in Bank of Uganda's Strategic Plan 2012-2017.

- Mobile banking is functioning well, supported by existing guidelines that stipulate roles and responsibilities of all participants and regulate activities carried out under this mechanism. Given the fast growth of mobile transactions, however, the institutional capacity to oversee operations needs to be overhauled, an overarching national payments system law needs to be enacted, and better coordination between the telecommunications regulator and the BoU is needed.

- Agent banking is also expected to contribute significantly to step up financial inclusion, but parliamentary approval of the supporting legal framework, contained in the Financial Institutions Act, has been delayed. BoU is however ready with guidelines to start implementing it as soon as the Act is passed. Agent banking will foster competition and improve access by allowing commercial banks to offer financial services through an agency network.

Reforming the pension system. Ongoing reforms in the pension sector are expected to contribute to financial inclusion by expanding the coverage of the population that contribute to or are part of a pension scheme—now only an estimated 5 percent of the working age population, or 29 percent of wage earners. The reform agenda consists in turning the public service pension scheme into an independently and professionally managed contributory fund. This would ensure the system’s long-term financial sustainability, while introducing transparency and discipline.

Improving access of small farmers to bank services. With the majority of the population living in rural areas and having farming as their main activity, the availability of bank credit to agriculture, at 11 percent, is low and mainly directed to the larger farmers. Programs to boost agricultural financing in rural areas can play a role in contributing to enhancing agricultural productivity.

Improving financial literacy and ensuring financial consumer protection. Actions on this front are contributing to increase transparency and efficiency of financial operations. Workshops to enhance financial literacy have been ongoing. Financial institutions are now required to provide key facts to clients before agreeing on any deposit or loan product, and to disclose information on the terms and conditions of financial products. These and other similar efforts will address existing gaps in financial education.

Enhancing the production of financial services data. Actions under this pillar are deemed to improve data availability related to access, usage, and quality, through coordination of the BoU with the Uganda Bureau of Statistics, the Uganda Cooperative Savings and Credit Union, the Insurance Regulatory Authority, and the Association of Microfinance Institutions in Uganda.

Improving and expanding land registration. With only 20 percent of total land titled, the use of land as collateral remains low. Interventions to improve land use regulation and development and the recent digitalization of the land registry can allow for more broad-based and efficient registration of transactions.

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Annex V. Uganda: Fiscal Policy, Inequality and Inclusive Growth[1]

Fiscal policy can play a role in supporting growth and reducing inequality. The synthetic control method shows marked improvement in long-run growth in Uganda after the fiscal policy reform episode that took place in the 1990s. A general equilibrium model demonstrates that the impact of fiscal policy on inequality varies depending on the type of tax adjusted and on how the revenue gains are spent, and that increases in VAT are the most effective means of raising revenues without large negative consequences for inequality.

A. Background

Uganda has experienced high growth and declining poverty rates. For the last two decades, Uganda's growth has been consistently higher than average growth in sub-Saharan Africa. The poverty headcount declined to below 20 percent of the population in FY2012/13, from close to 40 percent in FY2002/03 (Figure 1). However, the recent GDP rebasing revealed a more moderate path of growth for the last few years. Poverty remains high, particularly in certain parts of the country. In northern Uganda, high youth unemployment, gender inequality, lack of access to basic services, and low economic development explain high levels of poverty.

Despite recent improvements, inequality remains a key concern. Although the Gini coefficient has declined in recent years (Figure 2), inequality is high mostly in urban areas. The uneven distribution of public services—particularly in education and infrastructure—limited access to financing, low agricultural sector productivity, and high regulatory obstacles such as license fees and permits are some of the factors behind the inequality trends.

Figure 1. Poverty headcount

(share of population)

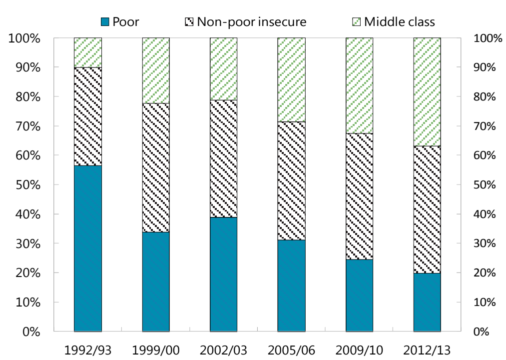
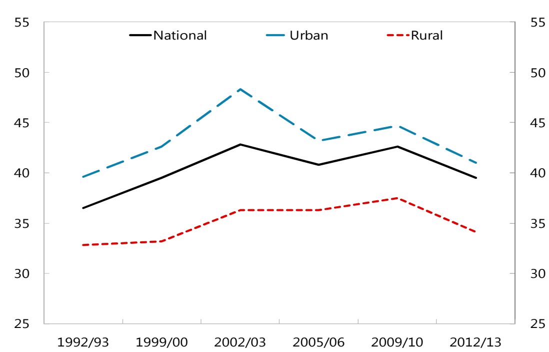


Figure 2. Gini index of per adult consumption

(percentage points)



Source: Poverty Status Report, 2014.

Fiscal policy can play an important role in ensuring price stability that supports economic growth, and it can also help reduce income inequality. Well-designed tax and spending policies

[1] Prepared by Jeff Danforth and Futoshi Narita, benefiting from helpful discussions with MoFPED, URA, and UBOS staff. Edited by Ana Lucía Coronel and Clara Mira.

can boost employment, investment, and productivity. Even budget neutral reforms aimed at enhancing the efficiency of the tax system or reallocating expenditure in favor of public investment have a positive impact on growth.[2] Similarly, both the tax regime and expenditure policies have an impact on disposable incomes and on income distribution. Empirical studies find that greater reliance on income taxes and higher social spending reduces inequality, and that high inequality is harmful for growth sustainability (IMF, 2014a; and Ostry et al., 2014).

B. Fiscal Policy and Growth

The authorities undertook important fiscal policy reforms during the 1990s.The first wave of fiscal reforms aimed at achieving macroeconomic stability by reigning in deficits; reducing inflation; and encouraging exports (including liberalizing the coffee market); moving towards a floating exchange rate regime; and largely reducing expenditure following strengthened fiscal institutions and improved public financial management. The second wave of reforms included tax reform and targeted expenditure on poverty alleviation. Box 1 describes and summarizes the main reforms carried out in the 1990s.[3]

Gains in trade, tax collection and poverty reduction were achieved. Trade increased from 10 percent of GDP in 1982 to around 60 percent of GDP in 2016. The tax-to-GDP ratio increased from 5 percent in FY1997/98 to 12.5 percent in FY 2012/13. Spending on education, health, water quality, and agriculture increased from 1.6 percent of GDP in 1998 to 5.3 percent in 2011, before slowing to 4.3 percent of GDP in 2013. The proportion of Ugandans living below the poverty line decreased significantly, allowing Uganda to meet the MDG of halving the number of people living in extreme poverty. However, the number of people living in extreme poverty remains high.

As a result of these reforms, economic growth increased and inflation declined as the government became less reliant on deficit monetization. Real GDP growth averaged 6.5 percent from 1991 to 2013, and real GDP per capita growth 3.2 percent over the same period. The overall budget deficit, excluding grants, peaked in FY1991/92 at 14.7 percent of GDP; however, by FY1995/96 the deficit was just over 6 percent of GDP and since then it has averaged about 7 percent of GDP. Inflation, as measured by the GDP deflator, was nearly 200 percent in 1987 and 1988. Over the period 1964 to 1986, it averaged 38 percent per year and since 1989, it has averaged around 16 percent. Since 1999, inflation has averaged 7.1 percent (Figure 3).

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[2] Improvements in tax efficiency as well as increases in investment spending with offsetting reduction in unproductive spending could increase long-run growth by ½ percentage points and 0.15-0.2 percentage points, respectively (IMF, 2015).

[3] The analysis utilizes the reform episode in the 1990s so that there are sufficient data post-reform, to provide a comparison. The selected period corresponds to a period during which substantial reforms took place and purposely begins four years after conflict has ceased so as not to attribute any post-conflict boost in growth to fiscal policy. For comparison purposes also , the analysis uses GDP statistics prior to the rebasing that took place in late 2014 and that went back only to 2002.

Box 1. Major Fiscal Reforms in the 90s

On trade, export duties, mainly on coffee, were phased out in the early 1990s. Import duties, (350 percent in the early 1990s), were reduced to a maximum of 20 percent by 2000. The unification of the parallel and official exchange rates put the Ugandan shilling on the path to a floating rate regime, reducing distortions and encouraging trade. Finally, the monopoly on coffee exports was terminated in 1991.

On public financial management, *s*trengthened public service institutions helped reduce deficits and kept inflation low. A newly created Ministry of Finance Planning and Economic Development used cash management to ensure compliance with planned spending targets. The Uganda Revenue Authority (URA) was created in 1991, the second of its kind in sub-Saharan Africa, consolidating tax and customs collection management and operations. It was given the clear objective of increasing the tax-to-GDP ratio by 1 percent per year.

On taxes, (i) a VAT replaced a distortionary sales tax in 1996, set at 17 percent to keep tax revenue neutral in the short term and ease transition into the new tax regime, and (ii) a new Income Tax Act was introduced in 1997, clarifying existing laws and expanding the income tax base by repealing non-taxable allowances, redefining gross income to worldwide concept, and eliminating tax holidays granted under the Investment Code. Public sector incomes became taxable and the discretionary powers given to the Minister of Finance to grant exemptions were eliminated.

On expenditure prioritization, the government began targeting high-priority spending areas including education, health, agriculture, and water quality to focus efforts on the reduction of poverty, as there was a concern that the increase in economic growth was not benefitting the most vulnerable. This process was fully incorporated into the Medium-Term Economic Framework (MTEF), which increased the efficiency of spending and allowed for closer monitoring of its effectiveness.

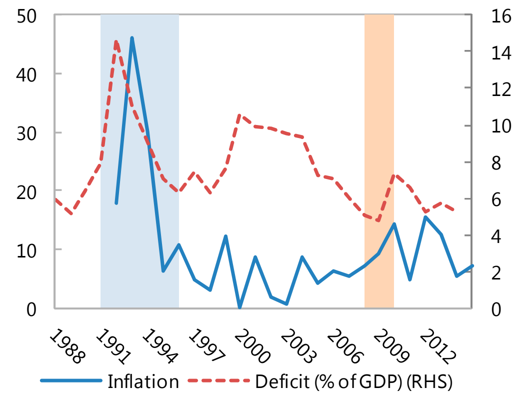
Summary of Fiscal Reforms

Reform Areas	Year	Reform Steps
1. Trade Reform		
Floating Exchange Rate	1990-	Gradual move to floating exchange rate.
Privitization of SOEs	1991-	Coffee Marketing Board monopoly ended.
Non-Tariff Barriers	1991-95	Non-tariff bariers reduced.
2. Expenditure Reform		
Spending Reductions	1992-	Large reduction in deficits through cuts in expenditures.
Budget Planning	1997/98	Medium term expenditure framework.
Expenditure Prioritization	1997-	PEAP and PAF created.
3. Fiscal Institutional Frameworks		
Revenue Administration	1991-	Uganda Revenue Authority (URA) created.
PFM	1992-	Cash management begins.
PFM	1992-	Merger of Ministry of Finance and Ministry of Economic Development.
4. Tax Reform		
Trade Taxes	1991-	Export taxes eliminated and import duties reduced.
VAT	1996-	VAT replaced distortionary Commercial Transaction Levy (CTL) and Sales Tax.
PIT	1997-	Exemptions removed and base widened.

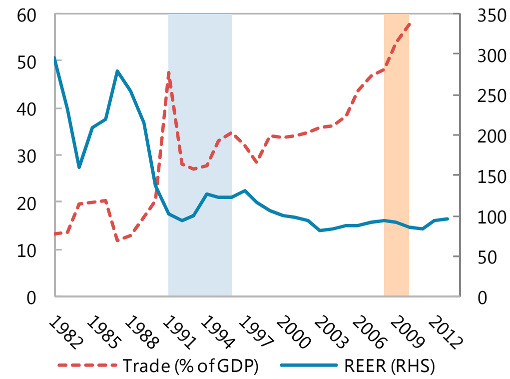
Source: IMF staff reports, Kuteesa and others (2010).

Figure 3. Uganda: Fiscal Policy and Growth, 1982–2014

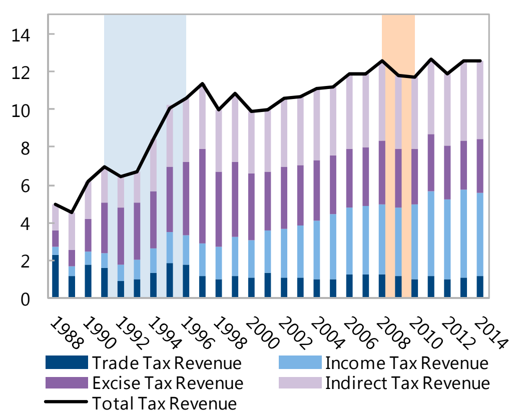
Improved budget implementation reduced inflation and created stability…



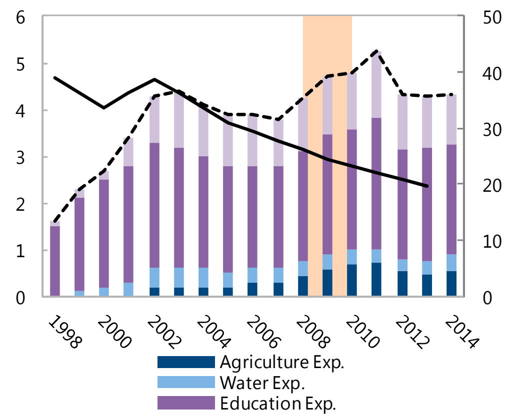
…which together with a floating exchange rate and less distortionary trade taxes improved trade.



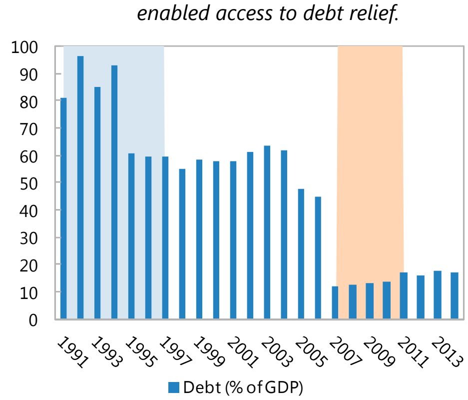
The introduction of a VAT and income tax reform increased the tax to GDP ratio.



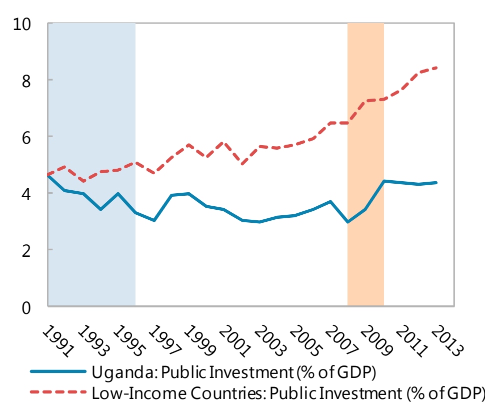
Expenditure reform allowed for spending targeted towards the alleviation of poverty…



…which together with macroeconomic stability enabled access to debt relief.



Despite growth improvements, a significant infrastructure gap remains.

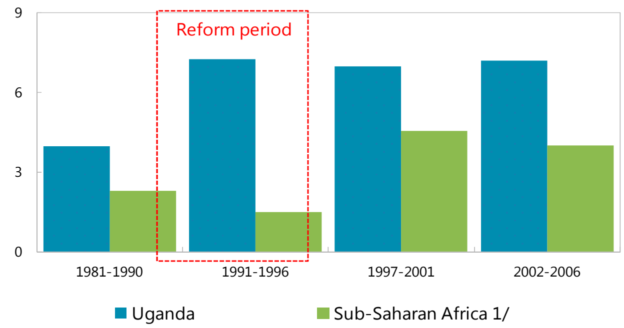


Source: IMF staff calculations, WDI, and WEO.

Note: Shaded blue areas indicate reform period; orange areas indicate global financial crisis.

Post-reform real GDP growth in Uganda was substantially higher than in its sub-Saharan African peers (Figure 4). Real GDP growth in Uganda averaged 4.2 percent in the ten years leading up to the reform period, and averaged 7 percent over both five-year periods after the reforms. Average growth over the first five-year period (1997–2001) was 2.5 percentage points higher than the average growth in sub-Saharan Africa. The gap increased further to 2.9 percentage points over the 2002–2006 period.

Figure 4. Uganda vs. Sub-Saharan Africa
(Annual GDP growth, 10-year average)



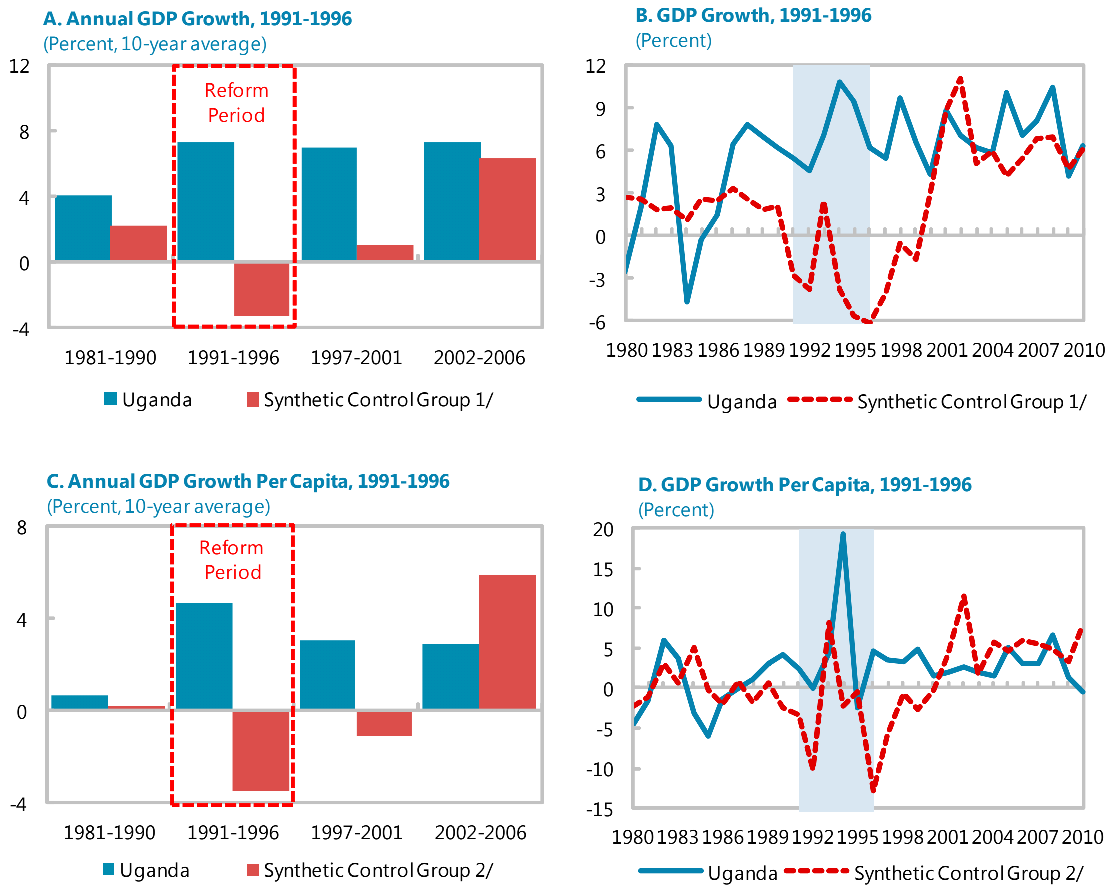
Source: IMF Staff calculations.
1/ Low-income and low middle-income Sub-Saharan Africa (excluding oil producers and Tanzania).

This result is supported by comparing post-reform growth with an estimated counterfactual growth series that would have prevailed in the absence of reforms. The analysis is based on a 2015 IMF paper for Uganda. Using the synthetic control method (SCM)—a data-driven technique to quantify the impact of an event on an outcome variable of interest—a counterfactual, or "synthetic" country, is constructed as a weighted average of a large number of countries that have similar characteristics to the country of interest, but are unaffected by the reform. Once the counterfactual is created, the post-reform growth performance in the country of interest is compared to the growth performance in the counterfactual and the estimated impact of the fiscal reform is then the difference between the two series.[4] When Uganda's post-reform growth rates are compared to its synthetic counterpart, the results show that average real GDP growth during the five-year period following the reform was about 5.2 percentage points higher than the average growth generated by the synthetic control group (Figure 5). The relatively superior performance narrowed over the second five-year period to 2.5 percentage points of GDP.

The exercise was repeated using real GDP per capita growth. Real GDP per capita growth in Uganda exceeded growth in the synthetic control group by 4.3 percentage points during the first five-year post-reform period—similar to results found using real GDP growth. However, growth in Uganda during the second five-year period (2002–06), was actually lower than growth in synthetic Uganda by 1.8 percentage points.

[4] The limitations of the SCM method suggest interpreting the results with caution. It is difficult to disentangle the growth impact of reforms from that of various other factors affecting growth.

Figure 5. Synthetic Control Method: Uganda



Source: IMF staff calculations.
Note: Shaded blue areas indicate reform periods.
1/ Zambia, Sierra Leone and Burundi.
2/ Sierra Leone, Malawi, Ghana and Mozambique.

C. Fiscal Policy and Inequality[5]

To assess the impact of fiscal policy on inequality, a simple general equilibrium model to conduct counter-factual analyses of fiscal policy changes is used. The purpose is to estimate the quantitative impact of tax policy and administration improvements on inequality. The exercise, consequently, does not intend to quantify the revenue gains/losses obtained as a result of the introduction of fiscal measures. A small-open economy model is developed where two types of goods—agriculture and non-agriculture—are produced in the urban and rural sectors, respectively.

[5] This section is based on a model developed by Adrian Peralta-Alva (SPR), Marina Mendes Tavares (SPR, Instituto Tecnológico Autónomo de México), and Irina Telyukova (SPR, University of California, San Diego) as part of a project to study income inequality in low income countries with financial support by the U.K.'s Department for International Development (DFID).

Households with different skill levels in each sector choose whether to work for a formal employer or to work informally by themselves. Key parameters of the model are calibrated to include detailed tax system information; the size of the informal sector; and relevant distributional household-level data, including Gini coefficients for rural and urban areas, and share of food consumption conditional on income levels taken from the 2011/12 Uganda National Panel Survey (Table 2). Using "compensating variation"—a measure of welfare gain/cost—for each group of households, the distributional impacts are assessed.

Table 2. Calibration Results

(Percent)

	VAT/ GDP	PIT/ GDP	CIT/ GDP	Tax Revenue /GDP	Informality in Agriculture	Informality in non-Agriculture	Gini for overall economy	Gini for urban areas	Gini for rural areas
Data	6.91	2.72	1.33	10.96	86.30	31.00	39.5	41.0	34.1
Model	6.91	2.72	1.33	10.96	86.32	30.86	39.5	41.1	34.1

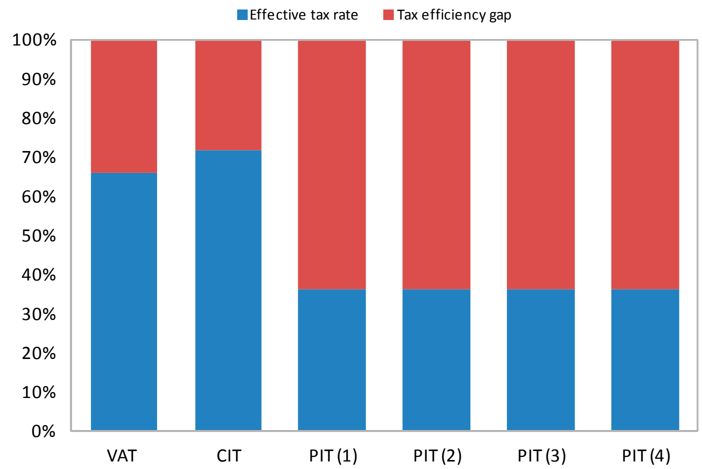
Sources: Ugandan authorities and IMF staff calculations

Changes in effective tax rates are used as a measure of fiscal policy action. The effective tax rate is obtained as a product of tax efficiency coefficients for various taxes—value added tax (VAT), personal income tax (PIT), and corporate income tax (CIT)—and the statutory tax rates. Tax efficiency coefficients reflect the impact of tax policy and the effectiveness of tax administration. The coefficients are calibrated so that model data generate tax-to-GDP ratios that match historical data for each type of tax for FY2011/12—the year covered by the micro-data. Then, the effective tax rates are modified to indirectly assess the effect of reductions in tax exemptions and/or improvements in tax administration, as well as the actual changes in statutory rates.

The calibrated tax efficiency coefficients highlight a large scope for tax revenue gains through improvements in efficiency. Tax efficiency coefficients in the formal sector are found to be very low, in particular for PIT (Figure 6). The overall tax efficiency is even lower because tax efficiency coefficients are assumed to be zero in the informal sector, and the size of the informal sector is roughly 50 percent of the total economy. This suggests that expanding the tax base to the untaxed informal sector and also improving tax administration and compliance could significantly raise Uganda's low tax collection relatively to its peers.

Increasing the effective VAT rate can raise tax revenue more effectively than increasing PIT and CIT. Raising the effective VAT rate from 66 to 76 percent could lead to a one percent increase in the total tax-to-GDP ratio. On the other hand, it would not be possible to obtain the same amount of revenue from an increase in the CIT effective rate because the tax base is much smaller. In order to raise one percent of GDP in revenue through changes in CIT, the statutory rate would need to increase by 3.6 percentage points in addition to 100 percent administrative efficiency. An increase in the effective PIT rate from 37 to 55 percent would result in an increase in the total tax-to-GDP ratio of 0.3 percent. However, any increase beyond this amount would start to reduce tax revenue because economic activity would be shifted to the informal sector, making it impossible to achieve a one percent increase in the tax-to-GDP ratio.

Figure 6. Effective Tax Rates in the Formal Sector



Sources: Uganda Bureau of Statistics and IMF staff estimates.
Note: Statuatory (marginal) tax rates are shown at the top of bar graphs. For PIT, uniform tax efficiency coefficients are assumed across incomre brackets.

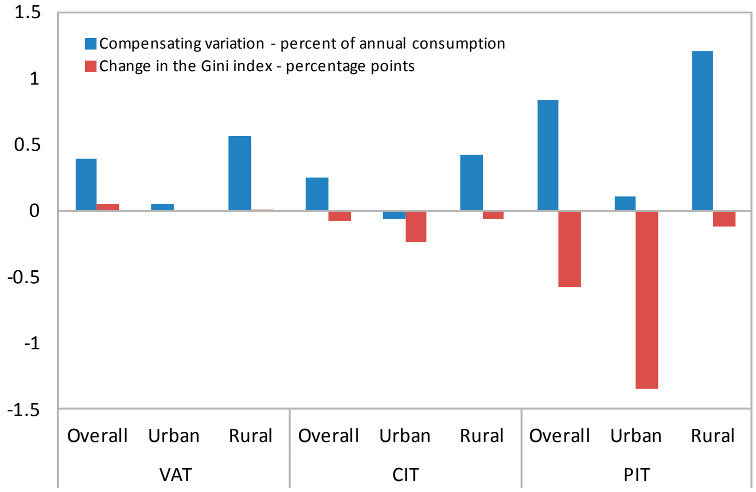
The implications for inequality and the welfare costs vary for each tax reform. The distributional implications of VAT, CIT, and PIT increases are compared in a situation where a 0.3 percent increase in the tax-to-GDP ratio is achieved. For all tax categories, the welfare cost of the tax change is disproportionally borne by poorer households (Figure 7). The overall welfare cost is lowest for changes in CIT and highest for changes in PIT. In terms of the Gini coefficient, changes in PIT have the largest positive impact—although they disproportionally reduce the welfare of rural households—while changes in VAT actually increases the coefficient slightly.

On balance, a VAT increase would be more effective than CIT and PIT increases in achieving revenue gains while limiting welfare costs. The required change in the effective tax rate is much lower for VAT (3 percent) than CIT (19 percent) and PIT (18 percent). Although the welfare cost is lower for CIT than VAT by about 0.1 percent of households' annual consumption, the size of the CIT required change would make it much harder to implement. The welfare cost from VAT increases is less than half of the welfare cost from PIT increases. The increase in the Gini coefficient resulting from VAT increases is positive but almost zero.

Overall, the results highlight the role of the informal sector in the distributional consequences of fiscal measures. As a large part of the economy is untaxed, changes in tax policy do not significantly affect income distribution. Moreover, there are offsetting impacts for each type of tax. VAT is less regressive than expected because relatively rich households consume more goods in the formal sector—where consumers pay VAT—than relatively poor households. This result is consistent with empirical studies for developing countries that show that VAT is mildly progressive, partly due to informality (Bird and Gendron, 2007; Keen, 2009). Results show that PIT is less progressive than expected because relatively poor households shift to the untaxed but unproductive informal sector, ending up earning low income.[6]

The results depend on how the increased revenue will be spent. In this exercise, the increased revenue is assumed to be spent on non-agriculture goods, for simplicity, which may be considered as an increase in public investment. This assumption is, however, not innocuous. If the government spends more on non-agriculture goods, the relative price of non-agriculture goods would increase, which benefits the producers of those goods—i.e., urban households in this model.[7] If the increase in revenues were assumed to be spent on agriculture goods the improvement in inequality would be greater.

Figure 7. Welfare Costs and Gini Index Changes from a Tax Increase



Sources: Uganda Bureau of Statistics and IMF staff estimates.
Note: Compensating variation is a measure of welfare costs upon a change in fiscal policy. It is a required percentage increase in annual consumption that can compensate the utility loss caused by the policy change, and thus, a higher value means a higher welfare cost. The chart shows a simple average of calculated values for each type of households.

[6] The results of this analysis differ from the ones obtained in a previous study that shows that the personal tax system is neutral from a redistributive point of view as the Gini coefficient was practically the same before tax and once personal taxes were excluded (IMF, 2013).

[7] Peralta-Alva (2014) discusses the same mechanism in the context of infrastructure expansions. Infrastructure expansions may affect inequality by changing the relative price of agriculture and non-agriculture goods.

D. Policy Implications

Closing the infrastructure gap in Uganda could play an important role in stimulating long-term growth. Public investment can have a significant impact on growth through its positive effects on private investment and productivity, especially given that the initial level of the public capital stock is low. Unlike labor and capital that can be substituted for each other when they are scarce, infrastructure is an input into production that is difficult to replace and costly for private sector participants to supply themselves (Selassie 2008). In countries where significant infrastructure bottlenecks exist, like Uganda, public investment can lead to higher output in the short and long term (WEO, Fall 2014). Unfortunately, before ongoing efforts to boost infrastructure investment, public investment in Uganda has essentially been flat as a share of GDP over the last 20 years, and significantly below that of its sub-Saharan peers (Fiscal Monitor, Spring 2014).

Taking into account the level of informality in the Ugandan economy is important when designing fiscal policy measures. In the context of high inequality, the large share of the informal sector and the tax disincentives of entering the formal sector play central roles in policy design. To achieve the desired distributional impact, therefore, a comprehensive use of rich micro data within a model that captures changing incentives of economic agents is important. The analysis in this annex suggests that increases in VAT revenues—through the removal of tax exemptions and/or improvements in tax administration—would have limited adverse impact on equality.

The modalities of expenditure of increased tax collections can also have significant distributional implications. The use of windfall revenue on social transfers and pro-poor spending can partially offset welfare taxation costs. International experience—including from several countries in sub-Saharan Africa—shows that well-designed social protection systems can significantly reduce poverty and inequality, create employment and stimulate local economies by improving access of children to school, providing better nutrition, building community assets, and boosting trade within communities.

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Annex VI. Uganda: Lessons from the Implementation of Inflation Targeting[1]

This annex reviews the lessons learned after nearly four years of implementation of the inflation targeting framework in Uganda. It concludes that the experience has been successful, as it has allowed for a strengthened monetary policy transmission mechanism and a more transparent monetary policy. Despite significant improvements, further strengthening of the framework is needed. The annex addresses five issues, which may also be relevant for other low income countries that may be considering modernizing their frameworks: (i) what are the preconditions for the introduction of inflation targeting?; (ii) what sort of safeguards are needed to prevent fiscal dominance?; (iii) what are the challenges for accurate inflation forecasting?; (iv) how can the central bank attain its operating target?; and (v) how strong is the monetary policy transmission mechanism?

A. Introduction

The Bank of Uganda (BOU) introduced inflation targeting (IT) in July 2011 replacing its previous monetary targeting framework (MTF). The BOU's motive for this move was the recognition that the efficacy of the MTF used since the early 1990s was being undermined because money demand and the money multiplier were becoming unstable and unpredictable as a result of the development of the financial sector and its increasing integration with the global economy. An IT framework offered better opportunities for signaling the monetary policy stance through the announcement of a policy interest rate and greater scope for short-term monetary policy fine tuning.

The main features of the new IT framework in Uganda, compared to the MTF, are illustrated in Table 1. The primary policy objective of controlling core inflation and the numerical 5 percent core inflation medium-term target remained unchanged. The BOU added a secondary objective—stabilizing real output as close as possible to estimated potential output—modifying a previous view, no longer valid, that real output was exogenous to demand management policies. A new operating target—the 7-day interbank interest rate—replaced the MTF's operating target of reserve money. There is no explicit need for an intermediate target under IT, although the inflation forecast can be viewed as such. Because good communication with the public is essential to influencing inflationary expectations and building monetary policy credibility, the BOU overhauled its communications policy, with the centerpiece being the monetary policy statement provided by the Governor after each Monetary Policy Committee (MPC) meeting.

[1] Prepared by Martin Brownbridge (Advisor to the Governor of the Bank of Uganda) and Clara Mira. Edited by Ana Lucía Coronel.

Table 1. Key features of the Monetary Targeting and IT in Uganda

	Monetary Targeting	Inflation Targeting
Primary policy objective	Inflation	Inflation
Secondary policy objective		Output
Instruments	Primary securities auctions	Secondary market operations
Operating target	Reserve money	Short-term interest rate
Intermediate target	Broad money	Inflation forecast
Frequency of adjustments to policy stance	Usually annually	Monthly if needed
Communications	Minimal	Integral

B. Preconditions for Introducing an IT Framework

The BOU paid careful consideration to whether Uganda was ready to implement IT before its introduction. The prevalent view in the early 2000s was that a long list of institutional, structural, and technical preconditions had to be met for IT to be feasible, including well-functioning financial markets and strong technical capacities in the central bank; preconditions which are not likely to be fully met in LICs. Subsequent research showed that many countries that successfully adopted IT did so without having first met all of these preconditions (Gemayel et al, 2011). After reviewing the experience of IT adoption in developing countries, Freedman and Otker-Robe (2009) identified three essential preconditions (i) the central bank must have inflation as its primary policy target; (ii) it must have instrument independence, and (iii) there must be no fiscal dominance.

The BOU took the view that it met these relevant preconditions to introduce IT. Controlling core inflation with a publicly announced target had been the BOU's priority since the 1990s. The BOU's operational independence is enshrined in the Constitution and has never been challenged in practice. Compliance with the third condition—absence of fiscal dominance—is more complex. While both public debt levels and government domestic borrowing were relatively low, explicit institutional arrangements to prevent government borrowing from the BOU were not in place.

C. Safeguards Against Fiscal Dominance

Under the MTF, fiscal and monetary policies were intertwined, with the distribution of domestic financing between the BOU and market participants determined passively. The government did not explicitly issue securities to fund its domestic financing requirement; the BOU issued them through primary auctions to mop up liquidity to meet its reserve money target. From the standpoint of an IT central bank, this was problematic for two reasons. First, it was an obstacle to the transparency of monetary policy, one of the essential ingredients of a successful IT framework. Second, there were no watertight institutional safeguards against government borrowing from the BOU, despite the limit on advances for cash management of 18 percent of recurrent revenues on borrowing established in the BoU Act.

In 2012, the authorities clearly separated the domestic financing of the budget through issuances of securities in primary auctions from monetary policy operations, now conducted in the secondary market. While this separation enhanced transparency, there are still no automatic institutional constraints, such as explicit rules, on the BOU providing financing to the government through a drawdown of funds from government accounts in the central bank. This is complicated by the existence of several government accounts at the central bank, including the Uganda Consolidated Fund (UCF)—through which most government day-to-day transactions take place—project accounts, and the oil, energy, and infrastructure funds. Resources in project accounts and the funds have specific and at times earmarked uses. The net government position—all accounts considered—is positive, but the UCF has a negative balance. While net financing of the budget from the BOU has not been a usual practice in the recent past, it nonetheless happened when other sources of financing faltered, including in FYs 2011/12 and 2012/13, when donor support sharply declined.

Two key reforms are needed to strengthen institutional safeguards against unplanned use of government deposits from the BOU. First, an explicit floor below which the balance on the UCF cannot fall should be put in place. Second, the legal restrictions on government borrowing from the central bank, stipulated in the BOU Act, should be clarified and tightened up. Both reforms are being discussed. The first one will be facilitated by the ongoing TSA implementation, although it will require enhanced fiscal discipline and improved cash management practices. The second one is included in the amendments being prepared to the BOU Act.

D. Monetary Policy Formulation: The Importance of Inflation Forecasts

A robust inflation forecast is essential for monetary policy formulation in an IT framework. The policy interest rate—the Central Bank Rate (CBR)—is set bi-monthly by the BOU's MPC[2] on the basis of a medium-term core inflation forecast conditional on unchanged monetary policy. The VAR model initially used by the BOU was suitable for short term but less so for medium-term forecasts because of the volatility in inflation—on average core inflation showed a variance of 2.6 percentage points over a 3-month period but this rose to 7.5 percentage points over a 12-month period (table 2). More recently, the VAR model was replaced with a more forward-looking model, the Forecasting and Policy Analysis System (FPAS), which incorporates forecasts of exogenous variables.[3] In addition to the use of the FPAS, the BOU uses expert judgment, private sector forecasts and market intelligence when making its decisions.

Table 2. Variance between current and past inflation rates

Interval	3 months	6 months	9 months	12 months	15 months
Variance (percentage points)	2.6	4.7	6.4	7.5	8.4

Source: Bank of Uganda

[2] Initially it was set on a monthly basis. The switch at the start of FY2014/15 was motivated by increased stability of inflation forecasts (Tumusiime-Mutebile, 2014).

[3] See Laxton et al. (2009) for a description of a generic FPAS.

A good understanding of the determinants of inflation, and the capacity to project medium-term changes to the exogenous drivers of inflation are essential for forecasting inflation and monetary policy formulation. In Uganda, much of the volatility of inflation emanates from the important role of:

- **The exchange rate.** Opolot and Kyeyune (2012) find that, in the long run, the exchange rate, the terms of trade, and foreign inflation all have an impact on inflation, along with the money supply and output. The openness of the Ugandan economy—imports of goods and services account for 31 percent of GDP—explain a high long run pass-through of the exchange rate to inflation, estimated at about 0.5 (Bwire et al (2013) and Apaa Okello and Brownbridge (2013)). The exchange rate pass-through to domestic prices in SSA countries is also on average about 0.4, with the full impact dissipating after four quarters (Razafimahefa, 2012).

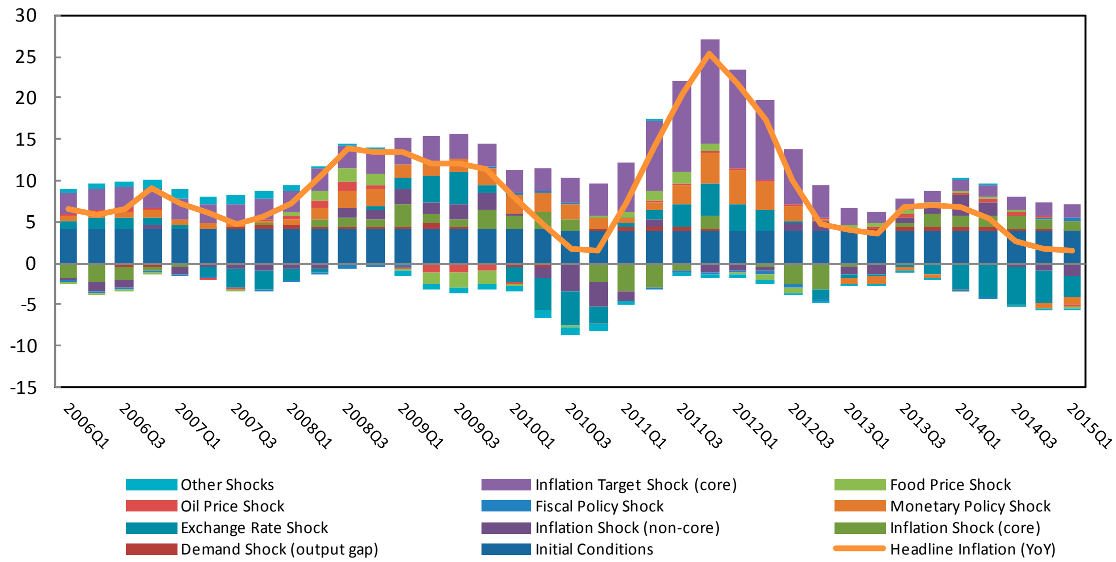
- **Agricultural supply shocks.**[4] Even though the BOU targets core inflation—excluding food crop prices—agricultural price shocks affect core inflation through their direct impact on the price of processed food crops, meat and dairy products as well as the indirect effects on the cost of other goods and services. The very steep rise in inflation in 2011 in Uganda was driven initially by the rapid rise in food prices.

- **Domestic demand factors.** Mayanja and Mawejje (2014) find that there is a causal relationship between budget deficits and inflation, a finding which is consistent with research on other developing countries (Catao and Terrones, 2003). Using cross-country data for Africa, Barnichon and Peiris (2007) find that output gaps create demand pressures that generate inflation, with a cumulative elasticity of about 0.4 percentage points and that the real money gap, measured as excess money supply, also impacts inflation with an elasticity of 0.6 percentage points.

All in all, the determinants of inflation in Uganda and other LICs are multidimensional, entailing both supply side and demand side shocks. Figure 1 shows the key determinants of inflation in Uganda from the FPAS model. In the last months of 2014, the lagged impact of the exchange rate appreciation and lower food prices were behind the reduction in core inflation. Given the importance of a good understanding of the inflation process for building robust forecasting models and formulating monetary policy, this is an issue for which more research would be very useful.

[4] As illustrated by Kabundi (2012) and Mwejje and Mwanga (2015) for Uganda; and by Loungani and Swagel (2001); Mohanty and Klau (2001); Walsh (2011) for LICs.

Figure 1. Historical Shock Decomposition of Headline Inflation (YoY)



Source: IMF staff estimates based on quarterly projections from a semi-structural model

E. Monetary Policy Implementation: Achieving the Operating Target

Policy implementation—aligning a short-term risk-free interest rate with the CBR to set a benchmark for other interest rates in the economy—takes place through regular interventions in the money market. The BOU offers repos or reverse repos to commercial banks, depending on whether it wants to withdraw or inject liquidity, with all bids at the CBR accepted (i.e. the BOU fixes the price of liquidity and allows the market to determine the quantity).[5] Until May 2012, the BOU had auctioned a fixed quantity of repos or reverse repos. The switch to the current modalities ensures that the repo/reverse repo rate matches the CBR at every issue, and obviates the need for the BOU to make precise liquidity forecasts before issuing a repo or reverse repo.

The optimal management of liquidity through money market operations requires the central bank to have an adequate quantum and range of marketable instruments. Because repos are short term instruments, they become less effective for liquidity management when it is necessary to lock up large volumes of liquidity for longer than a few weeks. In such circumstances a longer term instrument is required. The ongoing recapitalization of the BOU with Treasury bills and bonds has provided the central bank with a useful policy instrument to mop up structural liquidity, as the BOU can now sell these securities on the secondary market for this purpose.

Changes in the policy rate are transmitted to other rates in the economy. The transmission mechanism between the CBR and the 7-day interbank rate works better than the one between the interbank rate and longer-term interest rates. The first stage in the transmission mechanism —the

[5] The BOU will accept bids below the CBR for the repo and above the CBR for the reverse repo, but these are rare.

link between the CBR and the 7-day interbank rate—works well in Uganda. Since April 2012, the average monthly 7-day interbank rate has been close to the CBR, deviating in absolute terms on average by only 41 basis points over this 36-month period. The months in which there were larger deviations were mostly those in which the exchange rate was under strong pressure, and the BOU bought dollars to smooth excessive volatility without immediately sterilizing the operations. Regarding the impact of changes in the 7-day interbank rate on longer-term interest rates—the second stage in the interest rate transmission mechanism—average time deposit rates have been slightly more volatile, but they have tracked the CBR quite closely.[6] The BOU has been less successful so far in influencing bank lending rates, which are stickier than deposit rates. Sande and Apaa Okello (2013) find that the bank lending rate responds to a 100 basis point change in the CBR by slightly less than 50 basis points.

F. How Strong is the Monetary Policy Transmission Mechanism?

Empirical evidence indicates that the adoption of IT has strengthened the monetary policy transmission mechanism in Uganda. Mishra et al (2010) note that the rudimentary nature of financial systems in LICs imply that the traditional channels of monetary transmission—interest rate, bank lending, and asset channels—are likely to be impaired. Nonetheless, Davoodi et al (2013) find that monetary policy shocks affect both prices and output in Uganda. They also find that the policy interest rate has more impact on prices in Kenya and Uganda than in other EAC countries, because of their deeper financial markets and more competitive banking systems. Berg et al (2013) compare the impact of the monetary policy response to the inflationary shock that hit EAC countries in 2011, and find clear evidence of a working transmission mechanism. They argue that the monetary policy framework has a significant impact on the strength of the transmission mechanism, and that in Kenya and Uganda, a coherent monetary policy framework and clear signaling of the monetary policy stance has strengthened the standard features of the transmission mechanism.

There is also evidence of functioning bank lending and interest rate channels in Uganda. Abuka et al (2015) find evidence that the bank lending channel works relatively well in Uganda, although the transmission is moderate compared to that in advanced economies. Banks' excess holdings of capital above regulatory requirements dampen the transmission mechanism. Opolot (2013) finds evidence of an interest rate channel in Uganda: increases in the 91-day Treasury bill yield lead to decreases in the banks' loan supply. On the other hand, Mugume (2011) finds that important channels of the transmission mechanism, notably the interest rate channel, are not fully functional in Uganda, although his research predates the introduction of IT, and hence may not capture improvements brought about by the change in the monetary policy framework. Montiel (2013) argues that the small size of the stock market in Uganda undermines the asset price channel of the transmission mechanism.

[6] Since April 2012, the average absolute deviation between the average monthly time deposit rate and the CBR was 97 basis points.

G. Conclusions and Recommendations

The introduction of IT has strengthened the effectiveness of monetary policy. The BOU has been able to clearly signal its monetary policy stance and its inflation forecast for inflation through the CBR setting and its public announcements. Monetary policy formulation has been significantly strengthened by the use of inflation forecasting techniques. Recent experience, together with econometric studies, provides evidence that the interest rate, bank lending, the exchange rate, and possibly also inflationary expectations play a key role in monetary policy transmission in Uganda. The transparency of monetary policy has been enhanced by the clear separation of monetary policy operations from those to finance the budget. Economic commentaries from sophisticated market participants and analysts suggest that the BOU has gained credibility as an "inflation hawk" since the introduction of IT. The Ugandan experience over the past four years supports the contention that even if not all preconditions for successful introduction of IT are present, LICs could benefit from the use of the regime to efficiently implement monetary policy.

Work under way to address the remaining challenges will further strengthen the IT framework. On the institutional side, it is important to provide explicit safeguards against automatic overdrafts of government accounts at the BOU. This can be achieved in the short term by formalizing an agreement to establish a predetermined floor in the UCF. In the medium-term, reforms to the legal framework are needed to reduce the existing limits for intra-year advances to the government borrowing and to eliminate the possibility of automatic overdrafts. The ongoing central bank recapitalization will continue to provide the BOU with marketable instruments for longer-term open market operations. On the operational side, there is a need to better understand the quantitative importance of key inflation drivers that show high volatility, such as exchange rate and food prices, to achieve more robust medium-term inflation forecasts. This is a matter that deserves more research. Finally, as the BOU's monetary policy gains further credibility through time, and as the financial system deepens, the monetary policy transmission mechanism is expected to become more effective.

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Appendix. Letter of Intent

Kampala, Uganda,
June 12, 2015

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, DC 20431, USA

Dear Madame Lagarde:

On behalf of the Government of Uganda, we would like to provide you with an update on the progress we have achieved under our economic program supported by the IMF's Policy Support Instrument (PSI). In FY2014/15 economic growth has been relatively high and expected to pick up led by our public investment program and a recovery in private sector activity supported by stronger credit growth. In the context of our inflation targeting framework, we have successfully kept inflation under control. Despite a slowdown in exports and the recent exchange rate depreciation, we have maintained our international reserves at adequate levels.

Performance under the PSI-supported program remains positive. In particular, we observed all of December 2014 quantitative assessment criteria and most indicative targets. Because our inflation was lower than the inner limit of the consultation clause, we conducted consultations with IMF staff. Inflation is now picking up, reflecting the depreciation pass-through, and will be contained within the target bands. The reduction in domestic arrears was lower than targeted in December, but we have speeded it up since then.

We are pleased to share with you that the indicative target on tax revenue was met with a substantial margin, helped by the implementation and strict enforcement of the strong revenue enhancing measures. We remain committed to further implementing tax policy and administration measures with a view to increasing tax revenue by at least ½percent of GDP per year in the medium term.

Reducing the infrastructure gap remains at the center of our growth and development strategy. This will boost growth, generate employment and address inequality in Uganda. We will ensure that our infrastructure plan is gradually and efficiently implemented, consistent with macroeconomic stability, debt sustainability and the absorption capacity of the economy.

For FY2015/16 we will make sure to adhere to the budget, and will keep the overall deficit and its composition of financing fully aligned with PSI understandings.

These and other important details of our economic program are set out in the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU), which extend our commitments to end-March 2016. Consistent with our plan to add a few infrastructure projects to the agreed package, we request raising the non-concessional debt ceiling from $2.2 to $3.0 billion. Given that Uganda is a strong performer, the ceiling will be requested to be dropped at the time of the next review once the new debt limits policy comes in force. We also propose introducing an overall deficit ceiling in anticipation of the coming in force of the new policy.

In light of this satisfactory performance and our continued commitment to and ownership of the program, we request completion of the fourth review under our PSI-supported program. We also request modification of the June 2015 quantitative assessment criteria and indicative targets in line with recent developments.

We intend to work with the IMF and other development partners on the implementation of our program, and will consult with the Fund on the adoption of any further measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We will provide the IMF with such information as the Fund requests in connection with our progress implementing the policies and reaching the objectives of the program. We also consent to publication of the staff report, the letter of intent, the MEFP and the TMU for the fourth review under the PSI.

Sincerely yours

/s/	/s/
Honorable Matia Kasaija	Louis Kasekende
Minister of Finance, Planning, and	For Prof. Emmanuel Tumusiime-Mutebile
Economic Development	Governor
	Bank of Uganda

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

A. Introduction

1. This Memorandum of Economic and Financial Policies complements the previously agreed policies under the June and December 2013 and the June and December 2014 Memoranda of Economic and Financial Policies. It presents an update on the economic performance in FY2013/14 and the first half of FY2014/15, and provides details of the policies Government intends to implement over the period ahead to preserve price stability and fiscal sustainability and, in general, to achieve Uganda's macroeconomic objectives. The memorandum requests extension of quantitative targets, structural benchmarks, and other reform commitments to end-March 2016.

B. Recent Economic and Policy Developments

2. Growth continues to be relatively high. According to rebased estimates released in November 2014, GDP in FY2009/10 was 17 percent higher than earlier thought. Real GDP growth was 4½ percent in FY2013/14 driven by construction, tourism, and telecommunications. On the expenditure side, public investment in infrastructure and human capital (education and health) was a major contributor of growth. There has also been an upturn in private investment supported by a rapid recovery in private sector credit. Improved business sentiment is evidenced by higher capital equipment imports and above-target revenue collections. Improved profitability of the banking sector was evident in the tax returns posted in December 2014. Economic activity seems to be picking up and is projected to improve further during the course of the year ending June 2015, led by higher construction and manufacturing activities.

3. Inflation remained subdued trending below the 5 percent Bank of Uganda's (BOU) average core inflation target. In December 2014, the 12-month average was 3.1 percent. Low inflation was largely on account of subdued food crop prices due to the good harvests and low import prices. Inflation seems to have bottomed out and the trend began to reverse in February 2015 due to increasing prices of food crops as well as the pass through of exchange rate depreciation.

4. The recent oil price decline lowered the import bill and gradually passed through to domestic fuel prices. This was partially offset by the global strengthening of the United States dollar, which led to a weakened shilling and consequently higher domestic prices for many imported goods.

5. The current account deficit including grants is projected to remain large at 8.5 percent of GDP in FY2014/15, owing mostly to subdued exports amidst strong import demand. The stock of reserves at the end of February 2015 amounted to $2,972.4 million, equivalent to 4.2 months of future imports of goods and services.

6. The financial system remained sound and well placed to support economic growth. The banking system is liquid and well capitalized with all banks meeting the regulatory capital adequacy

requirements. During the course of the financial year, notable growth was registered in commercial banks' balance sheets. Their total assets grew by 9.0 percent between June 2014 and March 2015. The banks' asset quality improved, with the ratio of nonperforming loans to total gross loans falling from 5.8 per cent in June 2014 to 4.2 per cent in March 2015.

7. On the legal framework of the financial sector, Government remains committed to address all deficiencies in Uganda's Anti-Money Laundering and Combating the Financing of Terrorism regime identified through the Financial Action Task Force (FATF) review. In this regard, the bill on the amendments to the Anti-Terrorism Act has been submitted to Parliament. Furthermore, proposed amendments to the Financial Institutions Act 2004 are currently before Cabinet and once passed will allow for Islamic banking and adoption of some of the Basel III recommendations including improving liquidity coverage and introducing additional capital buffers.

8. On the fiscal side, Government embarked on an ambitious revenue enhancing program. The strong package of tax measures included in the FY2014/15 budget eliminated many VAT and income tax exemptions and increased excise taxes on fuels, sugar and money transfers. The package has so far yielded revenue beyond expectations, and the PSI target to increase tax revenue by 0.5 percent of GDP during the fiscal year is likely to be significantly surpassed. On the expenditure side, Government has maintained its focus on infrastructure investment while improving the efficiency of recurrent spending, for example through payroll reforms that yielded significant savings. Government has kept total public debt significantly below standard sustainability thresholds. Our debt sustainability analysis shows that Uganda remains at low risk of debt distress.

9. Since January 2015, the BoU has had to respond to volatile foreign exchange rate movements by intervening in the foreign exchange market and to some extent allowing tight shilling liquidity conditions. The BoU is committed to avoiding excessive volatility in the exchange rate without impeding the real exchange rate from reflecting market conditions.

10. Over the medium term, Government plans to significantly advance the infrastructure program through projects that are necessary to improve the business environment, enhance regional integration, and develop Uganda's oil sector. Project financing is anticipated to rely mainly on external non-concessional borrowing, but also public-private partnerships, revenue enhancement and the use of government's savings.

C. Performance under the PSI

11. Performance under the PSI has been on track. Growth is high led by public investment and consumption; inflation has come down significantly; and international reserves remain at comfortable levels. All end-December 2014 quantitative assessment criteria (QACs) were met, although the lower inner limit of the band of the inflation consultation clause was breached, with average core inflation reaching 3.1 percent at end-December, against an inner band of 3.7 percent. The indicative target (IT) on tax revenue was met with a large margin. The target on the net change in the stock of domestic arrears was missed by a small margin; however, we expect the annual target

to be met, with a large reduction in FY2014/15 largely as a result of sustained efforts by Government to reduce arrears in line with the debt strategy.

12. Progress has been made on complying with structural benchmarks (SB).The planned recapitalization of the Bank of Uganda with marketable securities amounting to Shs.250 billion was done ahead of schedule (September 2014). The Ministry of Finance, Planning and Economic Development (MoFPED) published the report on the stock of unpaid bills of all government entities contained in the central government votes on May 15, 2015 for the quarter ending March 31, 2015. The Uganda Revenue Authority (URA) registered, assessed and collected revenue using the trading license regime in the municipalities of Arua, Gulu, Jinja, and Mukono meeting the structural benchmark target. The regime should be in effect in Kampala by the end of the fiscal year while Entebbe and Wakiso should be added next year. The municipalities of Hoima, Lira, Mbale, Mbarara and will follow. Amendments to the Bank of Uganda Act were not sent to parliament within the agreed timeline, but will be submitted by April 2016 (structural benchmark). The second phase of TSA was partially met, as the TSA was converted into a head and subaccount structure, but progress is ongoing regarding the elimination of movements of cash by giving votes appropriate level of spending authority within cash limits consistent with the macro-framework. Furthermore, there were delays in conducting the pilot exercise to include donor accounts due to extended discussions with development partners regarding the inclusion of their accounts, though work is in progress (requested to be rescheduled).

13. In light of recent low inflation outturns, we held consultations with staff in accordance to the rules governing the inflation consultation clause. Core inflation fell below the lower inner band of the consultation clause for the reasons described in paragraph 3. Nonetheless, the forecast points to an increase in average core inflation to 6.3 percent for FY2015/16, due to the upside risks posed by the pass-through of the exchange rate depreciation as well as the weak prospects for the external current account. On account of this inflation outlook, in April 2015 the BoU tightened monetary policy by raising the Central Bank Rate (CBR) to 12 percent from 11 percent, a level it had been at since June 2014.

D. Macroeconomic Outlook and Risks

14. The short-term outlook is favorable. Real GDP growth is projected at 5.3 percent for FY2014/15 and 5.8 percent for FY2015/16, driven by scaled-up public investment and a rebound in private demand. Consumer prices are anticipated to increase gradually reflecting the exchange rate pass-through and a strengthening of economic activity both at home and abroad. At about 3.5 percent and 6.3 percent for FY2014/15 and FY2015/16, respectively, average core inflation is projected to remain within the inner bands of the inflation consultation clause.

15. The current account deficit is projected to widen on account of higher non-oil private sector imports and public infrastructure related imports; lower personal transfers; and weak exports, on account of subdued global commodity prices and constrained aggregate demand from key trading partners. Against this background, international reserves are projected to decline somewhat in FY2014/15 to 4 months of the next year's imports of goods and services. The ratio of reserve

adequacy will improve gradually from FY2015/16 to achieve 4.5 months of import of goods and services cover by FY2020/21 in line with the requirements of the East African Community Monetary Union Protocol.

16. The medium-term outlook assumes that the oil price decline will halt and gradually reverse. Prospects for the development of Uganda's oil sector remain positive. A number of companies whose exploration licenses expired have applied for renewal and new companies have applied for licenses. Notwithstanding this positive outlook, potential investments in Uganda's nascent oil and gas sector could be negatively affected if crude oil prices do not improve.

17. There are some risks to the outlook related to domestic, regional and global developments. Domestically, the country heads into an election in February 2016 when the presidential and parliamentary votes will be cast. Successful elections will boost investor confidence and reduce speculative damage to the economy. Geopolitical developments and conflicts within the region risk jeopardizing economic prospects of the countries concerned and spilling over to Uganda given the high level of regional economic integration. Uganda's trade and investment may also suffer if the recovery in advanced countries is less than expected or emerging markets slow down by more than projected.

E. Economic Policies

National Development Plan

18. The second five-year National Development Plan (NDP II) was presented to Parliament in April 2015 and will come into force in July 2015. The plan prioritizes investment in three key growth areas out of the nine areas identified in the Vision 2040. These are agriculture; tourism; and minerals, oil and gas. It has also prioritized two out of the six fundamentals: infrastructure, and human capital development. In light of the agreed strategic direction for the country's development agenda, the three prioritized growth areas and the two fundamentals for NDP II are justified based on the assessment of the achievements of NDP I and the regional and international development context. NDP II was the basis for the FY2015/16 budget.

Fiscal Policy

The Fiscal Stance

19. Higher revenue collection and savings arising from the payroll and cash management reforms will allow us to keep the FY2014/15 overall deficit within the budget limit and meet some unexpected spending needs. During the second half of the financial year, we issued a supplementary budget which was financed through the reallocation of expenditure savings and will not entail any additions to the projected domestic borrowing.

20. Spending on HPPs was lower than expected due to procedural delays in the disbursement of funds. Conditions for disbursement relating to the repayment mechanisms will be finalized this financial year.

21. For FY2015/16, we are projecting an increase in the overall fiscal deficit to 7 percent of GDP. The deficit expansion will mainly stem from the boost in public investment in infrastructure, partially offset by additional tax revenue gains. Development expenditure is budgeted to grow by more than 40 percent in FY2015/16, mainly driven by externally financed projects, while current spending excluding interest payments is expected to be flat as a share of GDP. PFM reforms in a number of areas will continue to enhance the efficiency of public expenditures. In addition we will ensure that the projected deficit expansion is contingent on the materialization of the planned infrastructure projects.

22. The deficit will largely be financed by external sources and, to a lesser extent, by issuance of domestic debt. Compared to previous years, a larger share of the deficit will be financed by external loans, allowing us to avoid an increase in relatively expensive domestic borrowing and reduce the fiscal burden of interest payments over the medium term. We will continue to pursue concessional loans as the preferred means of meeting our external financing requirements. Non-concessional external borrowing will be considered only for the financing of highly productive fixed capital investments. In addition, we will make sure to keep the current level of debt distress low while ensuring there is no crowding out of the private sector caused by excessive domestic government borrowing.

23. We will ensure that any needed modifications to the FY2015/16 budget, for technical or legal considerations, will keep the overall deficit and its composition of financing fully aligned with PSI understandings.

Boosting Tax Revenue

24. We plan to continue our efforts to further strengthen tax revenue mobilization. Successful implementation of the FY2015/16 tax package will yield an increase in the tax-to-GDP ratio of about ½ percent. This includes measures that focus on enhancing revenue mobilization and action to maintain the momentum witnessed during FY2014/15. The major tax policies include raising the excise duty on non-premium beers at 30 percent and spirits/wines at 80 percent; increasing excise duty on petroleum products by Shs.50; and introducing excise duty on furniture and confectioneries at 10 percent, and motor vehicle lubricants at 5 percent. In addition, Government has presented to Parliament proposed amendments under the Income Tax Act and the VAT Law to generate additional revenues. These include simplification of the presumptive tax regime and specification of the amount of tax payable by small businesses; denial of income tax deductions on expenses accrued from non-registered persons; limitation of carryover of losses in corporate reorganizations, requirement that all passenger service vehicles and goods motor vehicles pay income tax before renewal of annual license; compelling all regulators to make the Tax Identification Number a mandatory requirement for issuance of licenses or permits; and introduction of a 6 percent withholding tax on income of suppliers of agricultural produce and on the CIF value of all imports

except where the importers are tax compliant. Government has also made amendments to clarify VAT application in the oil, gas and mining industry to facilitate investments. Finally adjustments on fees and charges administered by Government Agencies were made, especially passport fees, visa fees and vehicle licensing to generate additional non-tax revenue.

25. We will pursue the following improvements in tax administration:

a) Strengthening and expanding the collaboration between government ministries, departments, and agencies to encourage registering and sharing of tax related information to bridge the compliance gap.

b) Creating an interface between customs and domestic taxes datasets to ensure comprehensive analysis on the activities of multinational firms and other large taxpayers so as to mitigate revenue eroding practices.

c) Sanctioning taxpayers who are registered but have not complied with issued assessments, which will consequently ensure enforcement of the penalties within the law and improve compliance.

d) Dedicating resources to the enforcement of motor vehicle registration, third party stamp duty, and renewal of third party for motor vehicles.

e) Enhancing the business analysis function by reviewing the debt management processes and procedures, ensuring real time analysis of data and real time segmentation to facilitate control and monitor lane performance.

f) Increasing the number of audits and also monitor vigorously the usage of duty remission schemes.

g) Increasing the goods that are cleared under the EAC Single Customs Territory Platform to include tyres, steel (coils, bars), bitumen, building glass, bulk paper, among others.

h) Expanding the implementation of the Automated Valuation Control to mitigate misclassification and undervaluation of goods. In addition, create a single central processing center for all customs clearances.

26. For the medium term, we plan to enhance revenue by strengthening enforcement and reviewing the management strategy and staffing levels of the URA to meet the increasing demands of the growing economy. Government will also build capacity of URA's staff to combat the challenges associated with international taxation. Sufficient resources will be provided to build a sustainable monitoring framework to ensure URA continues to meet its revenue collection targets. Tax laws will continuously be reviewed to identify and close loopholes that undermine revenue collection, and to further simplify the tax code to ease implementation and reduce the cost of compliance.

Containing Current Spending Growth

27. In order to accommodate the pressing needs in infrastructure investment contained in the budget, Government will strictly manage current spending while ensuring that poverty-reducing spending is preserved. Expenditure requirements related to the 2016 general election have been fully incorporated in the budget. Any unforeseen spending requirements will be accommodated within the Contingencies Fund established under the PFM Act (2015) or savings in other areas, without jeopardizing spending on social sectors. Consequently, the budgeted level of domestic debt issuances will be preserved.

Implementing Infrastructure Projects

28. Successful implementation of infrastructure investment projects is a key priority. We note that further delays in implementation will negatively impact our growth prospects. We also recognize that executing planned projects too fast could risk overheating the economy. Therefore we are committed to properly sequence the projects once their feasibility studies and commercial viability have been confirmed. We are also strengthening our capacity in project planning and implementation. A new Department within the Ministry of Finance has been established to analyze, appraise, monitor and evaluate public investment projects and facilitate the implementation of PPP initiatives. With technical assistance from the World Bank, we are in the process of developing Public Investment Management Guidelines to strengthen the capacity of Government agencies in the preparation of feasibility studies, project preparation and financing assessments (structural benchmark requested to be rescheduled for December 2015).

29. The non-concessional infrastructure projects that we will implement in FY2015/16 are 1) continuation of the construction of the Karuma and Isimba HPPs, with spending amounting to $733 million. The projects started in FY2014/15 using the government's share of financing, and are expected to proceed smoothly following the recent parliamentary approval of the loan agreements and the expected prompt finalization of the repayment mechanisms; 2) road construction using machinery acquired through a loan; 3) the upgrade of the Entebbe airport with a total value of $200 million, with $80 million expected to be spent in FY2015/16; 4) the Kabale-Mirama transmission line ($84 million); the construction of a small-sized HPP in Muzizi; and 5) the National Transmission Backbone ($15 million) to improve information and communication technology.

30. Other projects to commence over the medium term include the first stage of the Standard Gauge Railway; roads and an airport serving the Albertine region, which are necessary for oil development; and various other road projects and transmission lines. A feasibility study for the 680MW Ayago HPP is ongoing, but to ensure a smooth expansion of infrastructure investment within the economy's absorptive capacity, this project is not expected to begin until FY2020/21.

31. In addition, there are medium-term plans to advance PPP arrangements including for the construction of the Kampala-Jinja expressway and several other roads serving the Greater Kampala area (including Kibuye-Busega-Nabingo, the Kampala Southern bypass and the Kampala-Bombo expressway). The oil refinery is also being discussed and will be a PPP.

F. Monetary and Financial Sector Policies

32. BoU's monetary policy will continue to focus primarily on the inflation objective. The BoU will continue to carefully adapt the monetary policy stance to changing economic domestic and external developments with the aim of maintaining core inflation within its target. The BoU remains committed to limiting foreign exchange interventions to times of heightened volatility and fully sterilizing them to avoid conflict with monetary policy signals.

33. To preserve financial sector stability, the BoU will further strengthen its prudential oversight to guard against potential market, liquidity and operational risks, as well as vulnerabilities emerging from credit sector concentration and currency mismatches. Specifically, we plan to continue monitoring banks' foreign exchange exposure in relation to total capital and their liquidity coverage ratio, and ensure adequate provisioning for non-performing loans.

34. Compliance with the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) international standards plays an important role in enhancing the financial system's integrity. Government is committed to addressing the recent Financial Action Task Force's concerns on the shortcomings in Uganda's AML/CFT. An action plan detailing steps to be taken will be developed by June 2015.The amendments bill to the Anti-Terrorism Act is currently before Parliament.

G. Policy Coordination and Communication with the Markets

35. The MoFPED and the BoU will upgrade their regular meetings to enhance information sharing and better coordinate economic and financial policies with the purpose of ensuring consistency and maintaining credibility of the policy mix.

36. The MoFPED and BoU will continue to strengthen communication with the market to keep economic agents and the general public aware of economic developments and provide efficient policy signaling. This will be essential to manage expectations in the current electoral environment.

37. The level of domestic financing received from the Bank of Uganda will not exceed amounts prescribed in the PSI which are Shs 1,140 billion and Shs.385 billion for FY2014/15 and FY2015/16, respectively. The MoFPED and BoU will institutionalize this arrangement within the next six months and will coordinate fiscal and monetary policies to anchor public expectations regarding economic management.

38. Given that the NSSF is a significant player in the market, the Ministry of Finance will coordinate with the NSSF the timing and the pace of its financial investments abroad to avoid undue

significant market volatility, while respecting their independent and market-based decision making.

H. Social Protection

39. Government is committed to further strengthening social protection to improve the quality of life of the most vulnerable segments of the population. A comprehensive social protection system will complement the significant progress made on poverty reduction and act as a shock-absorber, benefiting the wider local economy, and enhancing inclusive growth.

40. Government will review the national roll out plan for social protection in order to ensure that the requirements for the first years of the plan are accommodated within the available resources. The NDP II emphasizes interventions to reduce household poverty and increase access to child protection and basic education services. Future budgets will continue to make provisions for programs targeted at youth, women, elderly, disabled and other vulnerable groups, including the Youth Livelihood Programme (YLP), the Youth Venture Capital Fund and the Social Assistance Grant for the Elderly (SAGE). The development of regulatory and planning frameworks for social protection shall be accelerated, including the National Policy on Older Persons; the National Policy on Disability; and the regulations on elections of older persons.

I. Structural Reforms

41. Progress on PFM reforms has been significant. The new PFM Act (2015) incorporates good practices; prepares the economy for oil revenue management; and institutionalizes the preparation of a fiscal risks statement and a charter on fiscal responsibility. Government has prepared the PFM regulations, which will come into force in July 2015 (structural benchmark). A Charter of Fiscal Responsibility has also been developed, which presents Government's overall strategy on the formulation and implementation of fiscal policy, consistent with sustainable fiscal balance and debt paths over the medium term. The Charter shall be sent for Parliamentary approval (structural benchmark), in line with the timeline requirements of the PFM Act, and shall cover the period FY2016/17 to FY2020/21.

42. Efforts will be made towards the implementation of the next phase of the Treasury Single Account, including the setting up of the pilot project to integrate donor-supported projects in the TSA framework by March 2016 (structural benchmark).

43. Government is rolling out the national identification project to support efforts to strengthen revenue collection, promote unique identification of financial sector clients and combat money laundering and the financing of terrorism. We have already issued a total of 753,610 ID cards in Kampala and Wakiso and are on track to have issued a minimum of 3 million by July 2015 (structural benchmark). A total of about 5.7 million cards had been printed as of April 2015 and 15.9 million citizens have registered for cards.

44. To facilitate the control and reduction of domestic arrears, the MoFPED will continue to publish quarterly reports signed by the Permanent Secretary on the unpaid bills of all Government

entities contained under Central Government votes and an annual report on the stock of domestic arrears (structural benchmarks).

45. To further improve the inflation targeting regime, we seek to finalize the amendments to the BoU Act, which will be tabled before parliament by April 2016 (structural benchmark). Government will also continue to recapitalize the central bank with marketable securities to bring its capital to the statutory level until amendments to the Bank of Uganda Act come into force (structural benchmark). Continuous support from the IMF African and Research Departments on capacity building for modeling and forecasting will help improve monetary policy formulation and implementation.

46. Despite recent progress spurred by the growth in the mobile money business, a large share of the population and small and medium-sized businesses do not have access to financial services. To improve this situation, the BoU has included in the amendments to the Financial Institutions Act provisions for agent banking.

47. Strengthening the compilation and dissemination of statistics remains one of our critical objectives to help enhance economic management. On the real sector side, efforts to improve the quality and coverage of surveys will be made—including compiling GDP from the expenditure side and on a quarterly basis. In the fiscal area, there is a need to overcome the considerable coordination difficulties that prevent the straightforward collection and dissemination of arrears data.

48. Progress towards EAC regional integration will continue and economic policies and frameworks shall be oriented towards our integration agreements with other Partner States. Work is ongoing to establish regional institutions required for the successful functioning of the East African Community Monetary Union (EAMU) and to create a regional fiscal surveillance process. The EAMU Protocol requires each Partner State to develop a Medium Term Convergence Programme (MTCP) to facilitate attainment of the agreed convergence criteria. We have prepared the first annual MTCP which outlines the medium-term macroeconomic and fiscal objectives, strategies and policies to ensure that the Ugandan economy attains a high degree of monetary and economic convergence and compatibility with other EAC Partner States, and follows a stable and sound trajectory towards meeting the convergence criteria. Greater intra-regional trade among EAC Partner States will reduce the costs and increase the benefits of forming the single currency. Government is therefore introducing various measures to further reduce the costs of trade, such as the implementation of one stop border posts, joint infrastructure projects and integrated payment systems, and fast tracking of the Common Market Protocol.

J. Program Monitoring

49. Progress in the implementation of the policies under this program will be monitored through QAC, ITs, and SBs detailed in the attached Tables 1 and 2 and through semi-annual reviews. The net domestic financing and the net international reserves QACs are proposed to be modified for end–June 2015, and new QAC are proposed to be established for end-December 2015, to be monitored at the fifth and sixth PSI reviews, respectively. To be able to accommodate our planned investment projects, we request to increase the nonconcessional borrowing limit to $3.0 billion for end-June. ITs are proposed for September 2015 and March 2016. A new IT on the overall fiscal deficit of the central government is proposed to be established, which will comprehensively capture debt-creating activities and will be fully consistent with the implementation of the infrastructure plans. The fifth review is expected to be completed by end-December 2015 and the sixth by end-June 2016. The attached Technical Memorandum of Understanding—which is an integral part of this memorandum—contains the needed definitions.

Table I.1. Uganda: Quantitative Assessment Criteria and Indicative Targets for September 2014 - March 2016[1]

	September 30, 2014 [2]				December 31, 2014 [2]				March 31, 2015 [2] (Preliminary)				June 30, 2015 [2]		Sept 30, 2015 [3]		December 31, 2015 [3]		March 31, 2016 [2]
	Program	Adjusted Target	Outturn	Result	Program	Adjusted Target	Outturn	Result	Program	Adjusted Target	Outturn	Result	Program	Revised Program	Program	Revised Program	Program	Revised Program	Program
(Billions of Ugandan shillings)																			
Assessment criteria																			
Ceiling on the increase in net domestic financing of the central government	1,539	1,323	1,355	Not met	2,461	2,081	1,632	Met	2,896	2,518	2,002	Met	2,832	2,526	353	647	937	921	1,280
(Millions of US dollars)																			
Ceiling on the stock of external payments arrears incurred by the public sector	0		0	Met	0		0	Met	0		0	Met	0	0	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 [4,5]	2,200		201	Met	2,200		201	Met	2,200		2,134	Met	2,200	3,000	2,200	3,000	2,200	3,000	3,000
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector [4, 6]	0		0	Met	0		0	Met	0		0	Met	0	0	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda (US$mn)[7]	-250	-248	-262	Not met	-275	-175	16	Met	-175	-77	-323	Not met	-236	-482	63	49	125	111	174
Share of oil revenue placed in the Petroleum Fund [8]	100		100	Met	100		100	Met	100		100	Met	100	100	100	100	100	100	100
(Billions of Ugandan shillings)																			
Indicative targets																			
Ceiling on the increase in base money liabilities of the Bank of Uganda	236		109	Met	n.a.		n.a.		n.a.		n.a.		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Ceiling on the overall deficit of the Central Government														3,371		1,682		3,215	4,479
Floor on tax revenue	2,078		2,035	Not Met	4,362		4,452	Met	6,576		6,749	Met	9,132	9,397	2,345	2,441	5,028	5,199	7,823
Expenditures on poverty alleviating sectors	701		782	Met	1,277		1,419	Met	2,141		2,231	Met	2,994	2,994	884	768	1,443	1,570	2,367
Ceiling on the issuance of guarantees by the Government/Bank of Uganda	0		0	Met	0		0	Met	0		0	Met	0	0	0	0	0	0	0
Net change in the stock of domestic arrears[9]	-20		-26	Met	-70		-58	Not met	-80		-96	Met	-80	-212	-20	-20	-40	-40	-60
Ceiling on withdrawals from energy and petroleum funds[10]	1,102		652	Met	1,230		899	Met	1,230		899	Met	1,230	1,096	0	70	0	95	120
(Annual percentage change)																			
Inflation consultation clause																			
Outer band (upper limit)	9.0				8.7				8.3				8.0	8.0	8.0	8.0	8.0	8.0	8.0
Inner band (upper limit)	8.0				7.7				7.3				7.0	7.0	7.0	7.0	7.0	7.0	7.0
Core inflation target [11]	6.0		4.2	Met	5.7		3.1	Not met	5.3		2.9	Not met	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Inner band (lower limit)	4.0				3.7				3.3				3.0	3.0	3.0	3.0	3.0	3.0	3.0
Outer band (lower limit)	3.0				2.7				2.3				2.0	2.0	2.0	2.0	2.0	2.0	2.0

[1] Defined in the Technical Memorandum of Understanding (TMU). Values for December 2014, June 2015 and December 2015 are quantitative assessment criteria except as marked. Values for March and September are indicative targets.

[2] Proposed targets are measured as the change from June 2014, except as marked.

[3] Proposed targets are measured as the change from June 2015, except as marked.

[4] Continuous assessment criterion.

[5] Cumulative change from June 28, 2013. To be used exclusively for infrastructure investment projects. Two loans from the Islamic Development Bank were contracted in December 2013 and June 2014 to finance development projects, one of which was classified to be concessional at the time of the Third Review, but revealed to be non-concessional.

[6] Excluding normal import-related credits.

[7] As stated in the TMU, the NIR outturn is assessed using program exchange rates.

[8] To ensure full and transparent transfer of oil revenues to the fiscal accounts.

[9] For quarters other than the one ending June 30, the net change in the stock of unpaid bills will be used as the indicative target, as stated in the TMU.

[10] September and December 2015 program targets were inadvertently shown as 1,230 at the Third Review without being reset to be zero at the beginning of FY2015/16.

[11] Annual percentage change, twelve-month period average core inflation. Calculated as stipulated in the TMU.

Table I.2. Structural Benchmarks

Policy Measure	Macroeconomic Rationale	Date	Status
Ministry of Finance to submit to Parliament amendments to the Bank of Uganda Act including a provision for capital adequacy of BoU as an adequate percent of monetary liabilities, as well as other provisions to support implementation of inflation targeting in line with international best practices.	To enable monetary policy independence and credibility of the central bank.	April 2015 Proposed to be rescheduled to April 2016	Not met
Government to continue with annual recapitalizations of the Bank of Uganda with marketable securities to bring capital to the statutory level until amendments to the Bank of Uganda act come into force, on the basis of the BoU's commitment to implement its business plan to contain operational and administrative costs.	To enhance central bank efficiency. To enhance central bank discipline and monetary policy independence.	October 2014 October 2015	Met
Ministry of Finance to publish quarterly reports signed by the PS/ST on the stock of unpaid bills of all government entities contained in the central government votes.	To facilitate control and reduction of unpaid bills.	November 15, 2014 for quarter ending September 30, 2014. February 15, 2015 for quarter ending December 31, 2014. May 15, 2015 for quarter ending March 31, 2015. November 15, 2015 for quarter ending September 30, 2015. February 15, 2016 for quarter ending December 31, 2015. May 15, 2016 for quarter ending March 31, 2016.	Met Met Met

Table I.2. Structural Benchmarks (continued)

Ministry of Finance to publish a report signed by the PS/ST on the stock of domestic arrears of all government entities contained in the central government votes.	To facilitate control and reduction of expenditure arrears.	September 30, 2014 for the quarter ending June 30, 2014. September 30, 2015 for the quarter ending June 30, 2015	Not met. Published on October 24, 2014
Government to have issued a minimum of 3 million ID cards under the new national identification system.	To support efforts to strengthen revenue collection, promote the unique identification of financial sector clients, and combat money laundering and the financing of terrorism.	July 2015	
URA to register, assess, and collect revenue using the trading license regime in at least three municipalities.	To enhance revenue collections.	December 2014	Met
Ministry of Finance to complete the second phase of the TSA implementation and strengthen its design by converting to a TSA head and TSA sub-account structure. This would eliminate movements of cash by giving votes appropriate level of spending authority within cash limits consistent with the macro-framework.	Complete the process of improving cash management and controls.	May 2015	Not met The TSA was converted to a TSA head and TSA sub-account structure, but movements of cash remain.
Ministry of Finance to finalize regulations for implementation of the PFM Act.	Ensure efficient PFM implementation and oil revenue management by providing guidelines, clarifying and making specific those aspects that are general in the law.	May 2015	Met

Table I.2. Structural Benchmarks (concluded)			
Regulations for implementation of the PFM Act to become effective.	Ensure efficient PFM implementation and oil revenue management by providing guidelines, clarifying and making specific those aspects that are general in the law.	July 2015	
Ministry of Finance to finalize the charter of fiscal responsibility.	To improve fiscal and macroeconomic management.	May 2015	Met
Present to Parliament the charter of fiscal responsibility.	To improve fiscal and macroeconomic management.	April 2016	
Development of the Public Investment Management Guidelines and Procedures.	To strengthen the capacity of MDAs in the preparation of feasibility studies, project preparation, analysis and appraisal, and financing assessments.	June 2015 Proposed to be rescheduled to December 2015	
Ministry of Finance to conduct a pilot exercise aimed at including donor-supported projects in the TSA.	Provide a key milestone for full TSA implementation.	July 2015 Proposed to be rescheduled to March 2016	

Attachment I. Technical Memorandum of Understanding

A. Introduction

1. This memorandum defines the quarterly quantitative assessment criteria (QAC) and indicative targets (ITs) described in the Memorandum of Economic and Financial Policies (MEFP) for the economic program supported by the IMF Policy Support Instrument (PSI) over the period June 30, 2015—March 30, 2016, and sets forth the reporting requirements under the instrument. The stock of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the cross exchange rates referred to in the table below for the various currencies and then converted into Uganda shillings using the program U.S. dollar-Uganda shilling exchange rate for end-March 2015, unless otherwise indicated in the text.

Program Exchange Rates (end-March 2015)	
US dollar (US$)	1.0
British pound/US$	0.7
Japanese yen/US$	120.1
SDR/US$	0.7
Kenyan shilling/US$	91.4
Tanzanian shillings/US$	1788.1
Euro/US$	0.9
Canadian dollar/US$	1.3
Australian dollar/US$	1.3
Ugandan shillings/US$	2970.6

B. Consultation Mechanism on Inflation

2. The quarterly consultation bands for the twelve-month average rate of consumer price inflation (as measured by the core consumer price index (CCPI) published by the Uganda Bureau of Statistics (UBOS)) are specified in Text Table 1. The consultation bands specify the range of admissible CCPI inflation. Projected CCPI inflation for end-June 2015 and end-December 2015 will be subject to the consultation mechanism, while those for end-September 2015 and end-March 2016 are indicative targets.

Text Table 1. Inflation Targets

	Jun. 2015	Sep. 2015	Dec. 2015	Mar. 2016
Outer band (upper limit)	8.0	8.0	8.0	8.0
Inner band (upper limit)	7.0	7.0	7.0	7.0
Core inflation target	5.0	5.0	5.0	5.0
Inner band (lower limit)	3.0	3.0	3.0	3.0
Outer band (lower limit)	2.0	2.0	2.0	2.0

3. Should the observed average CCPI inflation for the test date linked to a PSI program review (i.e., end-June 2015 for the fifth review and end-December 2015 for the sixth review) fall outside the outer band as specified in the above table, the authorities will complete a consultation with the Executive Board of the Fund on their proposed policy response before requesting completion of the review under the program. The authorities will not be able to request completing a review under the PSI-supported program if the average CCPI inflation has moved outside of the outer band as of the test date linked to such review, until the consultation with the Executive Board has taken place. In line with the accountability principles, the BoU will report to the public the reasons for any breach of the outer bands, and its policy response. In addition, the BoU will conduct discussions with the Fund staff when the observed average CCPI inflation falls outside the inner band as specified for the end of June 2015 and December 2015 in Text Table 1.

C. Ceiling on the Cumulative Increase in Net Domestic Financing of the Central Government[1] (QAC)

4. The cumulative increase in net domestic financing of the central government (NDF) is defined from below the line on a cash basis as the sum of:

a. *the change in net claims on the central government by the banking system:* Net claims on the central government 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 deposit corporations, excluding deposits in administered accounts and project accounts with the banking system, including the central bank. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. NDF by deposit corporations will be calculated based on data from balance sheets of the monetary authority and deposit corporations as per the deposit corporations' survey (DCS).

b. *the change in net claims on the central government of domestic nonbank institutions and households*: Net claims on the general government of domestic nonbank institutions and households are defined as treasury bills, bonds or other government securities held by nonbank institutions and households (including nonresidents and nonresident financial institutions), plus any other liabilities of the central government to domestic nonbank institutions or households.

All changes will be calculated as the difference between end-of-period stocks, net of any valuation changes resulting from currency movements.

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

D. Floor on the Net International Reserves of the Bank of Uganda (QAC)

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

6. For program-monitoring purposes, reserve assets and short-term liabilities at the end of each test period will be calculated in U.S. dollars by converting the stock from their original currency denomination at program exchange rates (as specified in paragraph 1). The NIR limits are the cumulative changes of the NIR stock from July 1 of the respective fiscal year to the specified dates.

E. Floor on Expenditures on Poverty Alleviating Sectors (IT)

7. The indicative target on the floor on poverty alleviating expenditures includes domestic expenditures inclusive of wages and salaries in the health, education, water and environment, and agriculture sectors, as defined by the Government of Uganda's (GOU) functional budget classification, excluding those which are externally financed. Compliance with the indicative floor for poverty alleviating expenditures will be verified on the basis of releases.

F. Ceiling on Issuance of Guarantees by the Government or Bank of Uganda (IT)

8. The indicative target on issuance of guarantees by the GoU or the BoU aims to prevent accumulation of contingent liabilities by the GoU (including entities such as ministries, agencies and authorities). Included against the ceiling are any direct, contingent liabilities of the GoU (including entities that are part of the GoU such as ministries, agencies and authorities) issued after June 28, 2014, and including any guarantees issued prior to this date but which are extended after June 28, 2014. This excludes guarantee programs which have explicit budget appropriations.

G. Share of Oil Revenue Placed in Petroleum Fund (QAC)

9. The purpose of this quantitative assessment criterion is to avoid a situation whereby petroleum revenues bypass the Ugandan budget framework. The 2015 PFM Act has established a petroleum fund; while it becomes operational, government has established a petroleum revenue account in the BoU. This QAC will be deemed satisfied if 100 percent of petroleum revenues are transferred to this account upon collection by URA. These resources may then be spent or saved as governed by the 2015 PFM Act.

H. Tax Revenue (IT)

10. A floor applies on tax revenue of central government measured cumulatively from the beginning of the fiscal year. For program-monitoring purposes, tax revenue is defined as the sum of direct domestic taxes (PAYE, corporate tax, presumptive tax, other direct taxes, withholding tax, rental income tax, tax on bank interest, casino tax and unallocated receipts); excise duty and value-added taxes net of refunds; infrastructure levy; and taxes on international trade minus temporary road licenses and fees to hides and skins, as defined by the GoU's revenue classification.

I. Net Accumulation of Domestic Arrears of the Government (IT)

11. A ceiling applies to net accumulation of domestic arrears of the central government as an indicative target.[2] The ceiling for each test date is measured cumulatively from July 1 of the respective fiscal year.

12. An unpaid bill is defined as any verified outstanding payment owed by any entity that forms part of the central government votes for the following: utilities, rent, employee costs, other recurrent, court awards, compensation, contributions to international organizations, development, taxes, and other deductions. Domestic arrears are the total stock of unpaid bills as of June 30 of the fiscal year as reported in the consolidated financial statements of the GoU.

13. For quarters other than the one ending June 30, the net change in the stock of unpaid bills will be used as the indicative target. For the quarter ending in June 30, the change in the total stock of unpaid bills as reported in the consolidated financial statements of the GoU will be used as the indicative target.

J. Ceiling on Withdrawals from the GoU Deposits from the Petroleum and Energy Funds (IT)

14. The indicative target on the ceiling on withdrawals from the GoU deposits from the Petroleum Fund and the Energy Fund aims at channeling these resources to key infrastructure projects while ensuring coordination on accompanying impact on liquidity. A ceiling applies on withdrawals from the GoU deposits from the Petroleum Fund and the Energy Fund measured cumulatively from the beginning of the fiscal year. Withdrawals will be restricted to meet the following uses: (i) spending on Karuma and Isimba hydro-power projects and the associated industrial substations, specifically related to the loan agreement between the GoU and China Eximbank (the GoU's share adds up to US$413 million covering 15 percent of total costs of projects, loan insurance, and management fees); (ii) spending on land acquisition for Karuma and Isimba HPPs (Ush20 billion), and (iii) a maximum of the domestic currency equivalent of US$64 million to finance the government's share of these projects, as stated in paragraph 19 below.

[2] A negative target thus represents a floor on net repayment.

K. Ceiling on Overall Deficit of the Central Government (IT)

15. The indicative target on the ceiling on the overall deficit of the Central Government is defined as the cumulative sum, from July 1 of the relevant fiscal year, of:

a. NDF as defined in section C;

b. net external financing (NEF), defined as the sum of the difference between disbursements and amortization of any loans (including budget support loans and project loans, both concessional and nonconcessional), internationally-issued bonds, and any other forms of liabilities by the Central Government to nonresidents, excluding nonresidents' holdings of domestically-issued government securities (which are covered under NDF), plus external exceptional financing; and

c. net proceeds from sales of non-financial assets including privatization receipts;

where any amounts in foreign currency are converted to Uganda shillings at the current exchange rate as of the date of the transaction.

Changes in NEF will be measured using external financing (net) provided in the monthly government financial statistics. These data, in turn, will be based on the reconciled donor disbursement figures obtained by the central bank and by MoFPED through the Debt Management and Financial Analysis System (DMFAS) and Aid Management System (AMS).

L. Adjusters

Adjustor related to budget support

16. The NIR, the NDF, and the overall deficit targets are based on program assumptions regarding budget support excluding assistance provided under the Heavily Indebted Poor Countries (HIPC) Initiative and the MDRI.

17. The Uganda shilling equivalent of projected budget support (grants and loans) excluding HIPC Initiative and MDRI assistance in the form of grants on a cumulative basis from July 1 of the relevant fiscal year is presented under Schedule A. The ceilings on the cumulative increase in NDF 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, excluding HIPC Initiative and MDRI assistance, exceeds (falls short of) the projected amounts. The ceilings on the cumulative increase in overall deficit will be adjusted downward (upward) by the amount by which budget support grants, excluding HIPC Initiative and MDRI assistance, exceeds (falls short of) the projected amounts.

Schedule A: Budget Support[1]
(Ush billions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from July 1 of the respective fiscal year budget support loans	113	16	36	45
Cumulative from July 1 of the respective fiscal year budget support grants	0	0	0	0

[1] Budget support loans and grants excluding HIPC initiative and MDRI assistance.

Adjustors related to the financing of the hydropower plants

Background on Hydropower Plant Projects and Energy and Petroleum Fund Stocks

18. The GoU is cofinancing the Karuma and Isimba hydropower plant projects (HPPs) and the associated industrial substations, in accordance to loan agreements with China's Eximbank. By the end of the second quarter of FY2013/14, the GoU had already spent US$338 million, coming from the Energy Fund and temporarily the Uganda Consolidated Fund —as bridge financing while the budget was approved and thus the Petroleum Fund could be used—with the stocks described in the table below. The foreign currency-denominated deposits of the Petroleum Fund do not constitute part of the BoU's international reserves and as such are recorded under other foreign assets of the BoU. Any further foreign currency denominated inflows to the Fund will continue to be recorded outside of the reserves and under other foreign assets of the BoU.

Stock of the Energy and Petroleum Funds at March 31, 2015
(Ush billions and USD millions)

	Ush	USD	
Energy Fund	92	0	(BoU reserves)
Petroleum Fund	1,368	0	(BoU other assets)

Adjustor on Expenditures on HPP

19. The ceilings on the cumulative increase in NDF, overall deficit, and the cumulative withdrawals from the GoU deposits from the Petroleum Fund and the Energy Fund will be adjusted downward (upwards) by the amount by which the domestic currency equivalent of the aforementioned spending—(i) and (ii) in paragraph 14—financed by withdrawals from the Petroleum Fund and the Energy Fund (using the market exchange rate) falls short of (exceeds) the projected amounts as set out in Schedule B. Any upward adjustment to meet higher-than-expected share will be capped at US$64 million. Spending on these projects financed by external borrowing are not included in this adjuster.

Schedule B: Expenditures on hydropower projects
(Ush billions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from July 1 of the respective fiscal year				
Land acquisition for Karuma and Isimba HPPs	0	0	0	0
Government share associated with the China Eximbank loan	1,096	43	43	43

Adjustor on Inflows into the Petroleum Fund

20. The ceilings on the cumulative increase in NDF and overall deficit will be adjusted upward (downward) by the amount by which inflows into the petroleum fund (excluding valuation changes) falls short of (exceeds) the projected amounts as set out in Schedule C.

Schedule C: Inflows into Petroleum Fund
(Ush billions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from November 1, 2013	0	0	0	0

Adjustor on Foreign Currency Spending for HPPs

21. The floor on the change in NIR will be adjusted upward (downward) by the amount by which the GoU's spending in foreign currency to cofinance the hydropower projects in line with point (i) above in paragraph 14 (converted at the market exchange rate) falls short of (exceeds) the projected amounts set out in Schedule D. Any downward adjustment will be capped at US$64 million. The GoU will first withdraw the foreign currency denominated portion of its deposits once there are new foreign currency inflows to the Energy and Petroleum Funds.

Schedule D: GoU's foreign-currency spending to cofinance the hydropower projects
(US$ millions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from October 1, 2014 up to June 2015, and cumulative from July 1, 2015 afterward	61	14	14	14

Adjustor related to the Bank of Uganda recapitalization

22. The ceilings on NDF and overall deficit will be adjusted upward (downward) by the amount by which the recapitalization of the BoU exceeds (falls short of) the projected amounts as set out in Schedule E.

Schedule E: Recapitalization of the Bank of Uganda
(Ush billions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from July 1 of the respective fiscal year	250	200	200	200

Adjustor related to externally financed projects

23. The ceiling on overall deficit will be adjusted downward by the amount by which (both concessional and nonconcessional) external financing tied to projects falls short of the projected amounts as set out in Schedule F.

Schedule F: External financing tied to projects
(Ush billions)

	Jun-15	Sep-15	Dec-15	Mar-16
Cumulative from July 1 of the respective fiscal year	1,093	1,128	2,480	3,455

M. Ceiling on the Contracting or Guaranteeing of New Non-concessional External Debt by the Public Sector, and Ceiling on the Stock of External Payments Arrears Incurred by the Public Sector[3]

24. 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.

25. The program includes a ceiling on new non-concessional borrowing with maturities greater than one year contracted or guaranteed by the public sector, measured cumulatively from June 28,

[3] 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.

2013.[4] Non-concessional borrowing is defined as debt with a grant element of less than 35 percent. The discount rate used for this purpose is 5 percent. The ceiling on non-concessional external borrowing or guarantees is to be observed on a continuous basis. Therefore, the limits, increased with effect from end-June 2015, should be respected on a daily basis, until either lifted or modified by a new Executive Board decision. 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 non-concessional external borrowing. Excluded from these limits are also non-concessional borrowing within the limits specified in Table 1 of the MEFP. The ceiling also excludes the non-concessional borrowing of one state-owned bank, Housing Finance Bank, which poses limited fiscal risk and is in a position to borrow without a government guarantee.

26. 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 sometime 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

[4] Contracting and guaranteeing is defined as approval by a resolution of Parliament as required in Section 36(5) and 39(1) of the Public Finance and Management Act, 2015.

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.

27. 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-December 2014. 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.

N. Monitoring and Reporting Requirements

28. The GoU will submit information to IMF staff with the frequency and submission time lag as indicated in Table 1. The quality and timeliness of the data submission will be tracked and reported by IMF staff. The information should be mailed electronically to afruga@imf.org.

Attachment II. Table 1. Summary of Reporting Requirements			
Reporting institution	**Report/Table**	**Submission Frequency**	**Submission Lag**
I. Bank of Uganda	Issuance of government securities, repurchase operations and reverse repurchase operations.	Weekly	5 working days
	Operations in the foreign exchange market.	Weekly	5 working days
	Interest rates (7 day interbank, commercial bank prime lending rate, government securities).	Weekly	5 working days
	Private sector credit growth by shilling and forex, and excess reserves of commercial banks.	Weekly	5 working days
	Disaggregated consumer price index.	Monthly	2 weeks
	Balance sheet of the BoU, consolidated accounts of the commercial banks, and depository corporations' survey.	Monthly	4 weeks
	Daily balances of net foreign assets, net domestic assets, and base money of the BoU.	Monthly	4 weeks
	Details on the government position at the central bank including deposits broken down by i) net public debt, ii) government project accounts, iii) Petroleum Fund (specifying the currency), iv) Energy Fund, v) government ministries accounts, and the remainder in vi) other deposits. In addition, liabilities broken down by i) appropriation account (UCF), ii) other drawdown accounts iii) government securities accounts and the remainder in iv) other liabilities. Detailed information about the recording of the recapitalization of the BoU.	Monthly	4 weeks
	Monthly foreign exchange cash flow table of BoU.	Quarterly	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.	Quarterly	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.	Quarterly	6 weeks
	Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	Quarterly	6 weeks

Attachment II. Table 1. Summary of Reporting Requirements (continued)			
Reporting institution	**Report/Table**	**Submission Frequency**	**Submission Lag**
	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) net claims on central government by the banking system; (ii) new non-concessional external borrowing; and (iii) net international reserves.	Quarterly	6 weeks
	Currency composition of the BoU's international reserves in unit of each currency at each end of quarter.	Quarterly	6 weeks
II. Ministry of Finance	Summary of central government accounts. Revenues shall be recorded on a cash basis, with a breakdown including infrastructure levy. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments[1], 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).	Monthly	4 weeks
	Summary of the stock of unpaid bills by government entities contained in the central government votes as reported by the Accountant General and signed by the PS/ST.	Quarterly	6 weeks
	Summary of the stock of arrears by government entities contained in the central government votes as reported by the Accountant General and signed by the PS/ST.	Annual	3 months
	Summary of contingent liabilities of the central government and the BoU. 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 monthly central government account of disbursed budget support and project grants and loans (less change in the stock of project accounts held at the BoU and commercial banks), HIPC support, and external debt service due and paid.	Quarterly	4 weeks

[5] The budget records domestic interest payments on cash-basis while for program purposes this entry will be reported on an accrual basis.

Attachment II. Table 1. Summary of Reporting Requirements (concluded)			
Reporting institution	**Report/Table**	**Submission Frequency**	**Submission Lag**
	Detailed central government account of disbursed donor project support grants and loans.	Monthly	6 weeks
	Statement on new external loans contracted or guaranteed by the central government and the BoU during the period according to loan agreements. Parliament resolutions on any new loans.	Quarterly	6 weeks
	Updated national accounts statistics (real and nominal) according to UBOS and medium-term projections.	Quarterly	12 weeks
	Releases of domestic expenditures on wages and salaries in the Health, Education, Water and Environment and Agriculture sectors, as defined by the Government of Uganda's functional budget classification, with a breakdown based on financing (domestically financed or externally financed).	Quarterly	6 weeks

INTERNATIONAL MONETARY FUND

UGANDA

June 12, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FOURTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—INFORMATIONAL ANNEX

Prepared By

The African Department
(in consultation with other departments)

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FUND RELATIONS

Membership Status: Joined: September 27, 1963 — Article VIII

General Resources Account:	**SDR Million**	**%Quota**
Quota	180.50	100.00
Fund holdings of currency (Exchange Rate)	180.50	100.00
Reserve Tranche Position	0.00	0.00

SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	173.06	100.00
Holdings	47.92	27.69

Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ECF Arrangements	0.60	0.33

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 17, 1997	120.51	120.51

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal	0.40	0.20			
Charges/Interest	0.05	0.06	0.06	0.06	0.06
Total	0.45	0.26	0.06	0.06	0.06

Implementation of HIPC Initiative:

Commitment of HIPC assistance	Original Framework	Enhanced Framework	Total
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	

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

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	PRGT	Total
January 2006	N/A	87.73	87.73

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

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[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.

[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.

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 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.

Exchange Rate Arrangement:

The official exchange rate is determined on the interbank foreign exchange market. As of end of April, 2015, the official exchange rate was USh 2998.95 per US dollar. The exchange rate is free of restrictions on the making of payments and transfers of current international transactions. Uganda's de iure exchange rate is classified as free floating and its de facto arrangement is floating.

Article IV Consultation:

The Executive Board concluded the last Article IV consultation on June 28, 2013. Following completion of the current Article IV, the next Article IV consultation with Uganda will be held in accordance to the decision on consultation cycles adopted by Decision No. 14747, as amended.

Technical Assistance:

Uganda has continued to receive extensive technical assistance from the Fund in recent years in the areas of public finance management, tax policy and tax administration, monetary policy formulation and implementation, statistics and national accounts, among others.[1]

In February 2015, FAD provided a follow-up TA mission in tax and customs administration. The objective of the mission was to further sharpen the focus of compliance actions targeted to the various taxpayer segments; coordinate core functions across the URA, and strengthen audit and enforcement actions; and improve the accuracy of taxpayer account information in the e-tax system. In support of the new PFM Act, FAD also provided in March 2015 TA on the drafting of the regulations to implement the Act and the preparation of a Charter for Fiscal Responsibility. Furthermore, in order to assist in strengthening natural resource management in light of the recent oil discoveries, a diagnostic assessment mission was conducted in February/March 2015 to evaluate the existing fiscal regime, assess the present regulatory framework, and advise on appropriate reforms, as well as other general tax policy and legal issues for the mining and petroleum sectors.

[1] For a description of technical assistance provided prior to December 2014, see the staff report for Uganda: Third Review under the Policy Support Instrument (IMF Country Report No. 14/344).

In March 2015, a multi-topic MCM TA mission visited Kampala to assist in enhancing monetary and foreign exchange operations, advance the central bank recapitalization initiative, and review the amendments to the BoU Act.

STA, with the support of the African Department, conducted a monetary and financial statistics mission in January 2015, aimed at expanding the institutional coverage of monetary statistics for other depository corporations and develop practices for the compilation of data for other financial corporations.

An East AFRITAC TA mission was in Kampala in November 2014 to assist the BoU in developing a supervisory and regulatory framework for agency banking in Uganda. Furthermore, East AFRITAC has been assisting the Insurance Regulatory Authority of Uganda (IRA) since 2013, in its multi-year effort to move from compliance based to risk based supervision and regulation of insurers.

Resident Representative:

The Fund has maintained a resident representative in Uganda since July 1982. Currently, the Senior Resident Representative, Ms. Ana Lucía Coronel, is also Mission Chief for Uganda.

JOINT WORLD BANK-IMF WORK PROGRAM

Title	Products	Provisional Timing of Missions (if relevant)	Expected Delivery Dates
World Bank	The current IDA portfolio consists of 15 active operations with net commitment of $1.9 billion, and 5 regional projects with net commitment of $134 million. With a low disbursement rate, only about $1.5 billion has been undisbursed. About 60 percent of the portfolio finances transport and energy infrastructure investments. Other key sectors include agriculture, water, urban development, education, health, and private sector competitiveness. Projects approved by the Bank Board between FY2013/14 and 2014/15, but are still not effective include the Albertine Region Sustainable Development Project, the Regional Pastoral Livelihoods Resilience Project, and Skills Development. The Bank is managing other trust funded projects such as the $100 million fund for teacher and school effectiveness (under the Global Partnership for Education facility grant), and other smaller grants. Discussions on the possibility of a Development Policy Loan (DPL) operation are underway.		
	The Public Investment Management project (with support from DFID trust fund) aims at streamlining analysis and appraisal of projects, as well as starting the process of building capacity to this end.	May / June 2015	Project expected to be delivered by August 2015

	Economic Update (two series) Special focus to be determined		August 2015 Feb 2016
Fund Work Program	Fourth Review of the PSI and Article IV Consultation	May 2015	June 2015
	Fifth review of the PSI	November 2015	December 2015
	Sixth review of the PSI	May 2016	June 2016
	TA priorities: • Public Financial Management • Customs Administration • Tax Administration • Natural Resource Taxation • Central Bank Governance • National accounts	TBD TBD TBD TBD TBD TBD	TBD TBD TBD TBD TBD TBD
Joint Work Program	Joint DSA update	May 2015	June 2015

STATISTICAL ISSUES

(As of May 30, 2015)

I. Assessment of Data Adequacy for Surveillance
General: Overall data provision is adequate for surveillance purposes, although some shortcomings remain.
Real Sector Statistics: Since 2004 Uganda has been receiving technical assistance (TA) from the EastAfrican Technical Assistance Center (East AFRITAC) on the compilation of **annual and quarterly national accounts and price statistics**. With assistance from East AFRITAC and an external consultant, the Uganda Bureau of Statistics (UBOS) developed supply and use tables (SUT) that include preliminary product balances for 155 activities by 161 products. An East AFRITAC mission in May 2014 assisted in finalizing the SUT and rebasing the annual and quarterly GDP estimates at current and constant prices. The rebased GDP estimates (FY2009/10) were released in November 2014. Efforts to improve the annual expenditure measure of GDP and new quarterly expenditure measures in current and constant prices continue. STA has recently begun a project to assist the authorities to improve financial transactions accounts and balance sheets by institutional sector. **Labor market indicators** such as employment and wages/earnings are infrequently compiled and disseminated. UBOS aims to compile and disseminate these data categories on an annual basis, but due to resource and data unavailability, these data are compiled with a two year lag. The **consumer price index** (CPI) series released in January 2010 were replaced in June 2014 by the new CPI series that use the expenditure weights from the 2009/2010 Uganda National Household Survey. UBOS compiles and disseminates a Producer Price Index (PPI) for manufacturing (separately for imports and domestic output) and for hotels. East AFRITAC has been providing TA to rebase and expand the coverage and quality of the PPI and to commence development of export and import price indices.
Government Finance Statistics (GFS): The Ministry of Finance, Planning and Economic Development (MoFPED) compiles and reports annual (GFSY) budgetary central and local government data and monthly (IFS) budgetary central government data on a cash basis following the Government Finance Statistics Manual 2001 (GFSM 2001). East AFRITAC provides technical assistance to the national authorities in expanding the coverage and improving the quality of these statistics. The national GFS Technical Working Group, comprising representatives from MOFPED, UBOS and the BOU are working on the implementation of the GFSM development plan, which aims to meet East African Monetary Union (EAMU) Protocol's fiscal statistics requirements. Implementation of the plan will result in several important improvements in the Uganda's GFS, such as expansion of coverage to the general government sector by 2015. The target date for adopting a modified cash basis of reporting is 2017. In addition, according to the plan, Uganda will disseminate estimates of the stock of financial assets and liabilities by 2017.

Monetary and Financial Statistics: TA in FY2015 aims at improving the institutional coverage and classification of other depository corporations (ODCs) and initiation of the collection and compilation of data for other financial corporations, mainly insurance companies and pension funds. This would build on previous missions financed by DFID on the standardized report forms (SRFs). Uganda began publishing SRF-based monetary data from 2002 in IFS beginning in early 2009. In addition, the TA also aimed at developing a system that would allow the Bank of Uganda (BOU) to collect information on financial positions with non-residents in the other East African Community (EAC) partner states, for the purpose of compiling union-wide MFS for the EAC. The BOU compiles and submits to STA all core financial soundness indicators (FSIs) and some FSIs for deposit takers, households, and real estate markets **External Sector Statistics (ESS):** The BOU, with the assistance of East AFRITAC has improved the quality and timeliness of ESS and implemented *Balance of Payments and International Investment Position Manual (BPM6)* standards. In May 2015, an STA technical assistance mission will visit Uganda to finalize the compilation methods for the unit value based export and import price indexes, as well as develop more reliable survey based export and import indexes.

II. Data Standards and Quality	
Uganda is participating in the IMF–DFID Enhanced Data Dissemination Initiative, Quarterly National Accounts (QNA) Statistics Module. An initial mission was undertaken during November 2010 to review the data sources and compilation methodology used to compile QNA estimates and to make recommendations for improvements. Follow-up missions were undertaken during May and November 2011, May and November 2012, and May and November 2013. CPI, PPI and annual estimates of rebased GDP have been released. Major improvements have been made to the associated data sources, especially benchmark surveys and the compilation methodologies. Comprehensive supply and use tables (SUTs) have been compiled; and quarterly GDP by production approach (GDP-P) at constant and current prices disseminated. The quality and timeliness of the ESS has been improved and the estimates are consistent with the BPM6 standards.	Uganda has been GDDS participant since May 2000. In February 2005, a STA mission prepared a Report on the Observance of Standards and Codes (ROSC), with results published in July 2006. The ROSC mission assessed data compilation and dissemination practices against international standards in national accounts, prices, government finance, and balance of payments statistics. The monetary and financial statistics were not assessed.

III. Reporting to STA
Uganda reports government finance statistics (GFS) data according to the GFSM 2001 framework for the GFS Yearbook, but does not report any high frequency data for inclusion in the International Financial Statistics (IFS). The BoU reports regularly monetary data for the central bank and other depository corporations (ODCs) in the format of Standardized Report Forms (SRFs). and it also reports all core FSIs and some FSIs for deposit takers, households, and real estate markets

Uganda—Table of Common Indicators Required for Surveillance

(May 31, 2015)

	Date of Latest Observation	Date Received	Frequency of Data[5/]	Frequency of Reporting[5/]	Frequency of Publication[5/]	Memo Items:	
						Data Quality – Methodological Soundness[6/]	Data Quality - Accuracy and Reliability[7/]
Exchange Rates	April 29, 2015	April 30, 2015	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1/]	March, 2015	April 30, 2015	M	M	M		
Reserve/Base Money	March, 2015	April 30, 2015	M	M	M		
Broad Money	March, 2015	April 30, 2015	M	M	M		
Central Bank Balance Sheet	March, 2015	April 30, 2015	M	M	M		
Consolidated Balance Sheet of the Banking System	March, 2015	April 30, 2015	M	M	M		
Interest Rates[2/]	April 24,2015	April 27, 2015	D	M	M		
Consumer Price Index	March, 2015	April 30, 2015	M	M	M	O,LO,O,O	O,O,LO,O,O
Revenue, Expenditure, Balance and Composition of Financing[3/] - Central Government	March,2015	April,2015	M	M	M	O,LNO,O,LO	O,O,O,O,LO
Stocks of Central Government and Central Government-Guaranteed Debt[4/]	March, 2015	April, 2015	M	M	M		
External Current Account Balance	Q2 FY2014/15	April, 2015	Q	Q	Q	LO,LO,LO,LO	LO,O,O,O,LO
Exports and Imports of Goods and Services	Q2 FY2014/15	April, 2015	M	M	M		
GDP/GNP	Q2 FY2014/15	April, 2015	Q	Q	Q	LO, LO,O,LO	LO,O,LO,O,O
Gross External Debt	FY2012/13	December, 2014	A	A	A		
International Investment Position	FY2012/13	December, 2014	Q	Q	Q		

1/ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, rates of treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ Foreign, domestic bank, and domestic nonbank financing
5/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular and not available (NA)
6/ Reflects the assessment provided in the data ROSC (published on July 12, 2006, and based on the findings of the mission that took place during the February 9-22, 2006) for dataset corresponding to the variable in each row. The data ROSC mission did not cover monetary and financial statistics. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis of recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO) and not available (NA).
7/ Same as footnote 6, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and revision studies

INTERNATIONAL MONETARY FUND

UGANDA

June 12, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FOURTH REVIEW OF THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS[1]

Approved By
Roger Nord and Masato Miyazaki (IMF); John Panzer (IDA)

The Debt Sustainability Analysis (DSA) indicates that Uganda's risk of debt distress is low and will remain so notwithstanding the planned infrastructure investment program. Nonetheless, the debt service-to-revenue ratio is high owing to the relatively low revenues and the short maturity of domestic debt, posing some sustainability risks. Uncertainty about oil production and related infrastructure investments assumed in the baseline scenario also presents some downside risks, albeit limited so far.

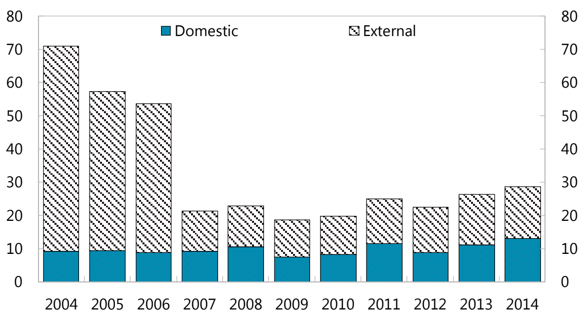
[1] The last Debt Sustainability Analysis update was conducted at the time of the third PSI Review in December 2014 (IMF Country Report No. 14/344). A full joint DSA is expected to be prepared once every three years for PRGT-eligible IDA-only countries, according to the Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries (www.imf.org). Under the Country Policy and Institutional Assessment (CPIA), Uganda is rated as a strong performer. Therefore, the DSA uses the policy-dependent thresholds for strong performers. All data refers to the fiscal year which runs from July to June (e.g., FY2015 covers July 2014 to June 2015). External debt is defined as foreign-currency denominated debt.

BACKGROUND AND RECENT DEVELOPMENTS

1. **The accumulation of new external public debt has been gradual since debt relief was granted.** The authorities have cautiously limited the increase in public and publicly guaranteed (PPG) external debt at 4 percent of GDP since FY2007 (Chart 1). New borrowing was used to finance public investment on infrastructure projects, including in energy and transportation. Uganda's PPG debt mostly comprises concessional multilateral debt, primarily from the World Bank and the African Development Bank, which accounts for 80 percent of the total, slightly lower than their pre-debt relief level (Chart 2). The share of non-Paris Club creditors has increased to 9 percent of the total, reflecting higher borrowing from China.

Chart 1. Uganda: Public Debt

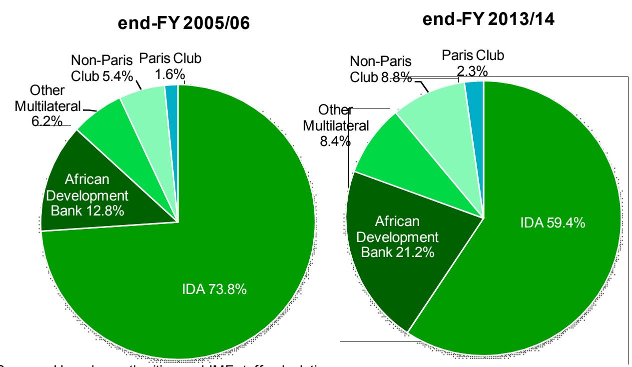
(In percent of GDP, fiscal year)



Sources: Ugandan authorities and IMF staff calculations.

Note: External debt is defined as foreign-currency denominated debt.

Chart 2. Uganda: Composition of PPG External Debt



Sources: Ugandan authorities and IMF staff calculations.

2. **In the same period, the domestic public debt market has steadily developed.** The share of public domestic debt in total debt remains at less than 50 percent, with a moderate increase by 4 percent of GDP since FY2007. Increased domestic debt reflects efforts to diversify funding sources, together with the issuance of marketable securities for central bank recapitalization since May 2013, now being used for the conduct of monetary policy. The maturity of government securities has been expanded to 15 years, while securities with maturities lower than one-year constitute 48 percent of the total. Average yields ranged from 12 to 17 percent in early 2015, depending on maturity. Foreign investors have increasingly participated in the domestic debt market, holding about 13 percent of local-currency denominated government securities (1½ percent of GDP at end-December 2014).

3. **Private external debt has also increased, reflecting steady foreign direct investment flows.** Private external debt has increased by 8 percent of GDP since FY2007, amounting to 15 percent of GDP at end-December 2014. Half of the debt is classified as direct investment in the form of debt instruments and the rest is also mostly long-term debt taken by the foreign-owned companies from partners other than their owners' group companies.

4. **The authorities plan to scale up infrastructure investment, mostly financed by non-concessional borrowing (NCB).** To address the country's infrastructure gap, the authorities formulated an ambitious package of medium-term infrastructure investment, including the construction of

hydropower plants, transmission networks, roads, and pipelines in preparation to envisaged oil production. Financing of this package includes a scaling-up of public debt including NCB, neighbor countries' government participations, and Public-Private Partnerships (PPPs). A large part of the planned NCB is expected to be provided by the Export-Import Bank of China, Japan Bank for International Cooperation (JBIC), and the Islamic Development Bank, as well as traditional creditors.

5. **In preparing for the scaling-up of public investment, the authorities have taken steps to enhance their institutional capacity.** A centralized institutional body has been established, within the Ministry of Finance, Economic Planning and Development, which takes care of all the aspects of government debt—from planning to issuance to repayment regarding both external and domestic debt. They have also strengthened the legal framework, including through the new 2015 PFM Act. To ensure that investment is efficiently managed, Public Investment Management Guidelines and Procedures will be developed by the end of FY2014/15 (structural benchmark).

6. **Statistically, the recent GDP rebasing results in lower debt-to-GDP ratios than earlier thought.** The national accounts have been rebased from calendar year 2002 to FY2009/10 to improve the methodology and expand coverage, leading to higher nominal GDP estimates by 17 percent in the base year. All the debt ratios relative to GDP are therefore lower than in the previous DSA, even without any changes in the numerators.

Underlying Macroeconomic Assumptions

7. **Macroeconomic assumptions in this DSA are consistent with the authorities' framework supported by the PSI.** The baseline scenario assumes implementation of the authorities' economic and structural policies. Expected gains in revenue mobilization, further deepening of domestic debt markets, and greater availability of NCB with reasonable terms (i.e., a grant element of 15 percent over the long run) are expected to create fiscal space for infrastructure investment. Revenues from the envisaged oil production are assumed to come in FY2020/21, with significant uncertainty regarding the timing and magnitude (Box 1). Compared to the previous DSA update, this version includes the expected oil revenues as the framework now incorporates the oil-related medium-term infrastructure projects. Lower growth projections reflect the GDP rebasing that revealed lower growth in the past few years (Text Table 1).

- *Growth* is projected at 6½ percent on average over the medium term, mainly supported by public investment. The successful completion of infrastructure investment would help sustain private sector development and boost the economy, bringing Uganda to middle-income status as envisaged in the authorities' National Development Plan. Therefore, the non-oil long-term growth assumption of 5¼ percent is anchored by the average per-capita growth among middle-income countries from 1990-2012 and UN's population growth projections.

- *The current account deficit* is projected at 12 percent of GDP on average over the medium term, reflecting Uganda's structurally high deficits and large import demand associated with the construction of large infrastructure projects. Project financing partly include foreign direct investment, while PPPs are treated as contingent liabilities to the government. Once the projects are completed, import demand would decline while export receipts would increase on account of potential energy surpluses and better road and railway infrastructure, in addition to crude oil exports and reduced fuel imports. As a result, the current account deficit is projected, on average, at 4 percent of GDP in the long term.

- *The fiscal deficit* is projected to widen to an average of 6½ percent of GDP in the medium term, peaking at 7 percent in FY2016/17. This increase reflects the scaled-up investment, while current spending is assumed to broadly stabilize in terms of GDP. The amount of investment is higher than the previous DSA, leading to a higher overall deficit. After completion of the investment scale-up, the fiscal deficit long-term average is expected to come down to 1½ percent of GDP.

- *The envisaged NCB* under the PSI would increase over the medium term. The original $2.2 billion will finance part of the construction of the Karuma and Isimba dams, a road project, and industrial substations with transmission lines. The NCB is expected to be broadly $3.0 billion at end-December 2015. The additional $0.8 billion will finance the Entebbe Airport rehabilitation, purchase of road construction equipments, and other electricity and rural electrification projects. Over the medium term, NCB is projected to increase to about $8 billion (cumulative from June 28, 2013), reflecting projects currently in the pipeline.

Text Table 1. Selected Macroeconomic Indicators–Compared to the Previous DSA

	FY2015	FY2016-20 Average	FY2021-25 Average	FY2026-30 Average	FY2031-35 Average
Real GDP growth (percent)					
Baseline	5.3	6.3	8.8	5.5	4.8
excl. oil production	5.3	6.3	7.4	5.9	5.3
Previous DSA	6.1	6.7	7.2	7.2	7.2
Nominal GDP (US$ billion)					
Baseline	26.7	31.7	55.4	95.6	143.8
excl. oil production	26.7	31.7	52.0	88.3	136.3
Previous DSA	26.3	32.4	53.6	90.5	152.0
Current account balance (percent of GDP)					
Baseline	-8.9	-12.9	-5.4	-4.0	-4.1
excl. oil production	-8.9	-8.6	-7.2	-7.1	-6.0
Previous DSA	-10.3	-8.5	-7.2	-7.0	-6.7
Overall fiscal balance (percent of GDP)					
Baseline	-4.5	-6.3	-2.2	-0.8	-1.1
excl. oil production	-4.5	-6.0	-3.7	-3.1	-3.0
Previous DSA	-6.8	-4.7	-3.0	-2.8	-2.8
Oil-related Revenue (percent of GDP)					
Baseline	0.0	0.0	2.7	4.2	3.3
excl. oil production	0.0	0.0	0.0	0.0	0.0
Previous DSA	0.0	0.0	0.0	0.0	0.0

Source: IMF staff projections

Note: Previous DSA's GDP is before the recent GDP rebasing from CY2002 to FY2009/10. The GDP ratios for the line excluding oil production are based on nominal GDP excluding oil production.

Box 1. Assumptions on Envisaged Oil Production

The baseline scenario reflects the impact of envisaged oil production on growth, trade, and revenue projections. These assumptions are based on information currently available and subject to a high degree of uncertainty, regarding the timing and volumes. In this regard, a customized alternative scenario is also examined, where all flows from oil production are removed. Oil prices are taken from the Spring 2015 WEO projections over the medium term (with $74 per barrel in 2020) and assumed to be constant in real terms thereafter.

Oil production is projected to raise real GDP growth by 1½ percentage points on average during FY2020/21-2024/25. The construction of oil-related infrastructure would also raise growth before FY2020/21. Oil production is expected to account for 10 percent of Uganda's GDP during the peak extraction period, while its large direct contribution to growth is concentrated until production reaches its full capacity in about FY2025/26. Oil reserves are anticipated to last for about 30 years.

Oil trade is projected to improve the current account balance by 2½ percent of GDP on average during the 15 years after oil production starts. Oil exports would amount to 6 percent of GDP on average. Fuel imports would decrease marginally, in line with the production capacity of the refinery.

Oil revenues are projected to add 4 percent of GDP on average after oil production reaches its full capacity. Oil revenues would constitute about 25 percent of total revenue at the peak. The projection is subject to uncertainty about fiscal regimes put in place.

EXTERNAL DEBT SUSTAINABILITY

8. **PPG external debt is assessed to be sustainable over the projection period.** The PV of external debt-to-GDP ratio peaks at about 25 percent in FY2021, while nominal PPG external debt stays below 35 percent of GDP in the projection period. All debt burden indicators are projected to remain below Uganda's country-specific debt burden thresholds under the baseline scenario and the standardized stress tests (Figure 1, Tables 1 and 3). Compared to the previous DSA update, the debt burden indicators have increased because of the projected higher borrowing for scaling-up infrastructure investment.

9. **Alternative scenarios highlight the importance of improving revenue performance and maintaining high quality policies and institutions.** The most extreme stress tests indicate that the debt burden indicators related to fiscal revenue are the closest to the thresholds. This highlights the importance of improving domestic revenue collection for debt sustainability. As discussed in the previous DSA update, there remains a risk of downgrading in the CPIA rating from "strong performer" to "medium performer" if the three-year average CPIA index during 2012-2014 were to remain below 3.75. In this case, the thresholds for debt sustainability indicators would become lower and the risk of debt distress higher (Text Table 2). It is therefore important to retain the high quality of policies and institutions to maintain debt sustainability.

10. Uncertainty about oil production adds debt sustainability risks, albeit limited so far. A customized alternative scenario, where no oil revenues or oil exports would materialize, shows a limited increase in the debt burden indicators, reflecting the authorities' prudent debt accumulation plan. Given the high uncertainty regarding the timing and volumes of proceeds from oil production, keeping the prudent planning without relying on oil proceeds is warranted. In addition, it is important to strengthen productivity and competitiveness for non-oil exports, including through successful completion of scaled-up infrastructure projects, not only because of the uncertainty about oil production, but also considering that oil exports could potentially lead to real appreciation of the shilling and weaken competitiveness for non-oil exports (a symptom of "Dutch Disease").

Text Table 2. PPG External Debt Thresholds

		Strong performer	Medium performer
PV of debt in percent of	Exports	200	150
	GDP	50	40
	Revenue	300	250
Debt service in percent of	Exports	25	20
	Revenue	22	20

PUBLIC DEBT SUSTAINABILITY

11. Total public debt (external and domestic debt) is also assessed to be sustainable over the projection period. The PV of public debt-to-GDP ratio is projected to peak at about 45 percent in FY2020, well below the benchmark level of 74 percent associated with heightened public debt vulnerabilities for strong performers. However, the relatively short average maturity of domestic debt (less than three years) combined with a low revenue base leads to a debt service-to-revenue ratio of about 45 percent at its peak, among the highest in low-income countries, and increases the rollover and interest rate risks. This is a matter of concern. The risks need to be mitigated by a combination of stronger revenue mobilization and deeper financial markets to extend average maturities over the medium term.

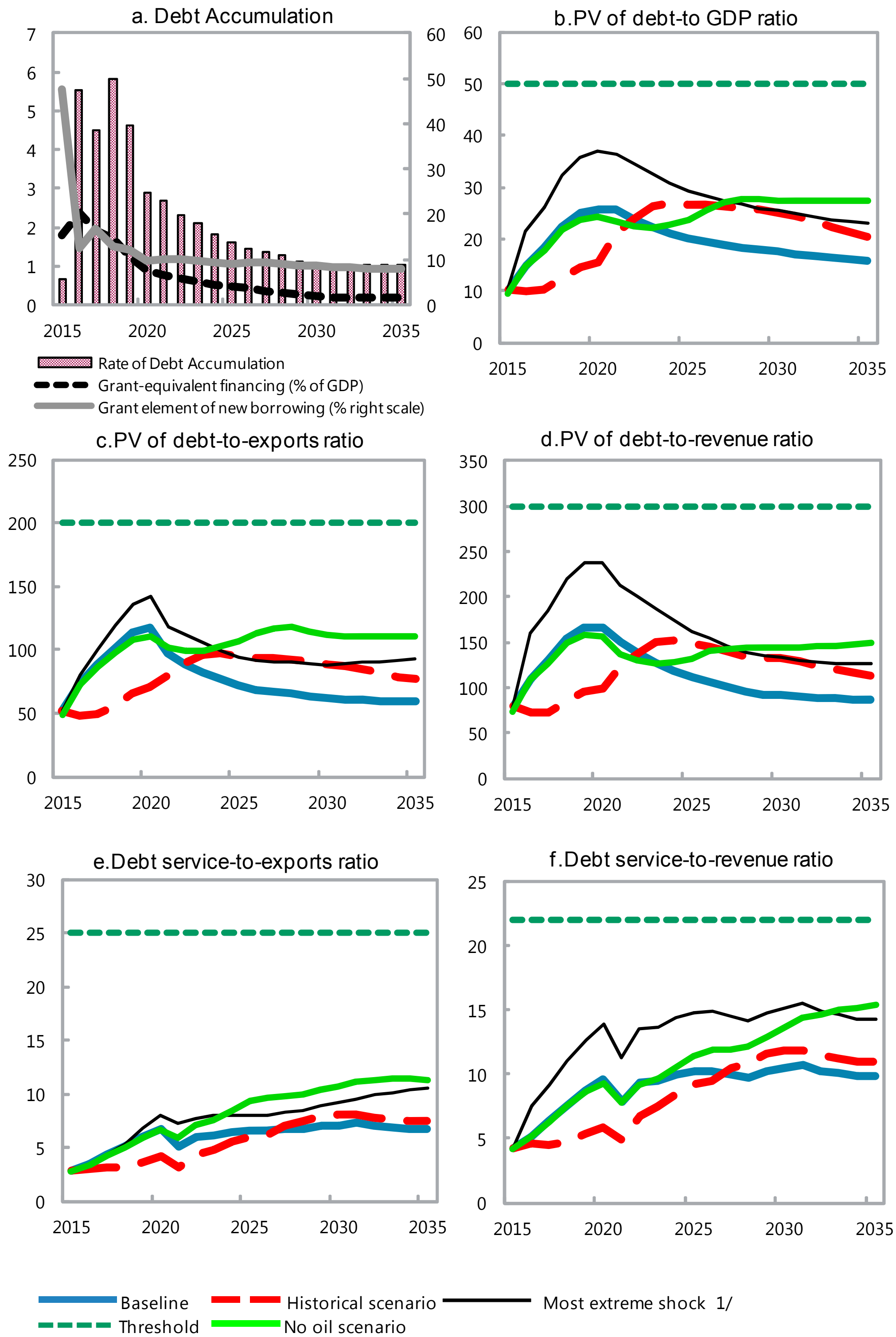
12. Stress tests indicate the importance of fiscal consolidation over the long term. An illustrative scenario with a fixed primary deficit over the projection period indicates a significantly high PV of public debt-to-GDP ratio, about 55 percent of GDP by FY2035 (Figure 2, Tables 2 and 4). This highlights the importance of reducing fiscal deficits after the temporary increase during the scaling up of public investment. The customized alternative scenario without oil flows indicate higher but limited risks stemming from uncertainty about oil revenues as is the case for the external debt analysis.

CONCLUSION

13. Uganda's risk of external debt distress remains low. The government's ambitious plan to scale up public investment remains consistent with debt sustainability, because the authorities have cautiously retained borrowing space after they received debt relief, and have started the planned improvement in tax revenue collection. However, the authorities need to ensure economic viability and appropriate cost recovery of any new projects, with a careful sequencing of execution that would be compatible with the economy's absorptive capacity and the government's implementation capacity constraints. They should also avoid delays and inefficiencies that could add costs Fiscal deficits should be lowered when the projects are concluded to keep public debt on a sustainable path. The planned increase in tax revenues and maintenance of a stable economic environment should help reduce the existing rollover and interest risk of domestic debt. Maintaining the country's prudent debt strategy is warranted because of a high degree of uncertainty about flows from envisaged oil production. We welcome the steps taken to enhance debt management capacity, including monitoring and reporting, given the large scaling-up in public investment.

14. The authorities concurred with staff's views. The authorities remain committed to ensuring debt sustainability through the long-term prudent debt management outlined in their Medium Term Debt Management Framework, which aims to minimize costs and risks from financing large public investment projects. The authorities acknowledged the importance of taking into account the absorptive capacity of the economy to maintain macroeconomic stability, as well as ensuring projects' viability and efficient implementation. The authorities will continue to engage with IDA/IMF staff on debt management issues.

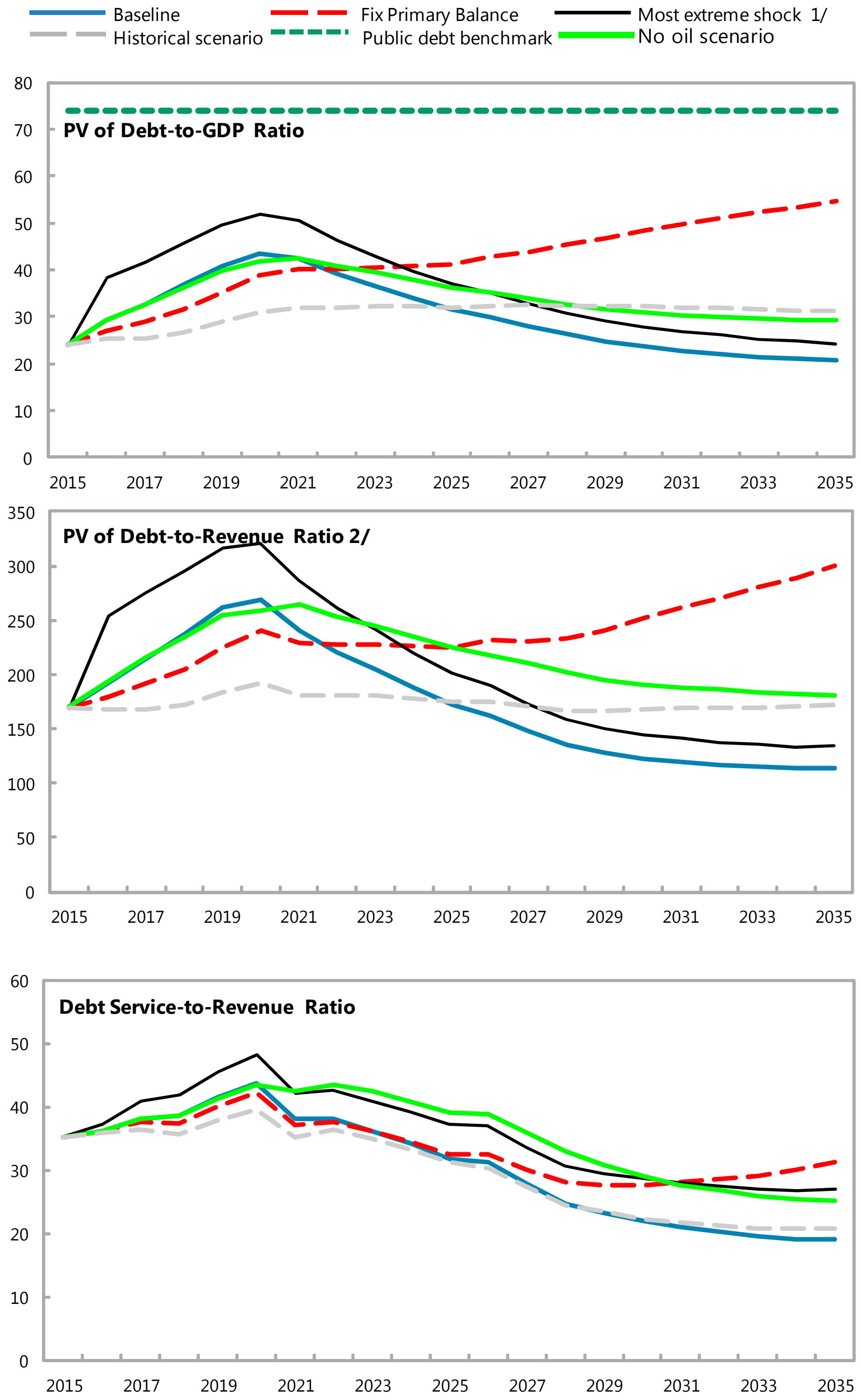
Figure 1. Uganda: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–2035



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

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Terms shock; and in figure f. to a One-time depreciation shock.

Figure 2. Uganda: Indicators of Public Debt Under Alternative Scenarios, 2015–2035



Sources: Ugandan authorities; and IMFstaff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.
2/ Revenues are defined inclusive of grants.

Table 1. Uganda: External Debt Sustainability Framework, Baseline Scenario, 2012–2035

(In percent of GDP, unless otherwise indicated)

	Actual			Historical [6/] Average	Standard [6/] Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**26.6**	**29.3**	**30.7**			**35.3**	**41.4**	**45.6**	**47.3**	**47.3**	**46.8**		**24.9**	**18.3**	
of which: public and publicly guaranteed (PPG)	13.2	15.2	16.1			18.2	22.9	26.5	30.7	33.1	33.4		24.5	18.8	
Change in external debt	-1.3	2.8	1.3			4.6	6.2	4.2	1.7	0.0	-0.5		-1.4	0.5	
Identified net debt-creating flows	2.2	3.2	1.7			4.0	5.7	4.6	2.5	1.2	0.7		-0.6	0.6	
Non-interest current account deficit	**8.1**	**6.3**	**6.3**	**5.0**	**3.0**	**6.8**	**8.9**	**10.1**	**10.5**	**11.0**	**11.1**		**4.9**	**4.2**	4.0
Deficit in balance of goods and services	12.8	10.3	9.5			10.0	11.5	12.8	12.7	12.9	12.9		3.7	4.3	
Exports	20.2	20.2	19.2			19.7	20.5	20.6	22.1	21.9	21.9		28.0	26.7	
Imports	33.0	30.5	28.7			29.8	32.1	33.4	34.8	34.8	34.8		31.6	31.0	
Net current transfers (negative = inflow)	-5.3	-4.9	-4.0	-6.2	1.4	-3.8	-3.8	-3.6	-3.5	-3.4	-3.2		-2.5	-2.0	-2.3
of which: official	-1.7	-0.3	-0.3			-0.4	-0.3	-0.3	-0.3	-0.3	-0.2		-0.3	0.0	
Other current account flows (negative = net inflow)	0.6	0.9	0.8			0.5	1.1	0.9	1.4	1.5	1.4		3.7	2.0	
Net FDI (negative = inflow)	**-3.9**	**-2.9**	**-3.8**	**-3.5**	**0.9**	**-3.4**	**-3.3**	**-5.6**	**-7.9**	**-9.7**	**-10.4**		**-4.3**	**-3.2**	-4.5
Endogenous debt dynamics 2/	**-2.1**	**-0.2**	**-0.9**			**0.5**	**0.2**	**0.0**	**-0.1**	**-0.1**	**0.0**		**-1.2**	**-0.5**	
Contribution from nominal interest rate	1.5	1.3	1.6			2.2	2.2	2.3	2.6	2.8	2.9		0.7	0.3	
Contribution from real GDP growth	-1.1	-0.8	-1.2			-1.6	-2.0	-2.2	-2.7	-2.9	-3.0		-1.8	-0.8	
Contribution from price and exchange rate changes	-2.5	-0.7	-1.3			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-3.5**	**-0.4**	**-0.4**			**0.6**	**0.5**	**-0.4**	**-0.8**	**-1.2**	**-1.1**		**-0.8**	**-0.1**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	23.6			27.3	33.4	37.4	39.0	39.1	39.1		20.3	15.3	
In percent of exports	...	...	122.8			138.1	162.9	181.8	176.6	178.4	178.9		72.8	57.1	
PV of PPG external debt	**...**	**...**	**9.0**			**10.3**	**14.9**	**18.3**	**22.4**	**24.9**	**25.7**		**20.0**	**15.8**	
In percent of exports	**...**	**...**	**46.7**			**51.9**	**72.7**	**88.9**	**101.4**	**113.7**	**117.4**		**71.6**	**59.1**	
In percent of government revenues	**...**	**...**	**75.1**			**78.7**	**110.0**	**130.0**	**153.1**	**165.7**	**165.1**		**110.9**	**86.9**	
Debt service-to-exports ratio (in percent)	**9.7**	**9.3**	**12.3**			**14.7**	**17.5**	**18.3**	**15.9**	**19.0**	**18.7**		**2.9**	**4.2**	
PPG debt service-to-exports ratio (in percent)	**2.4**	**2.3**	**2.8**			**2.8**	**3.4**	**4.3**	**5.0**	**6.0**	**6.8**		**6.6**	**6.7**	
PPG debt service-to-revenue ratio (in percent)	**4.3**	**4.1**	**4.5**			**4.2**	**5.1**	**6.3**	**7.6**	**8.7**	**9.5**		**10.2**	**9.8**	
Total gross financing need (Billions of U.S. dollars)	1.8	1.6	1.6			2.0	2.8	2.7	2.3	2.2	2.1		1.6	5.3	
Non-interest current account deficit that stabilizes debt ratio	9.4	3.5	5.0			2.2	2.7	5.9	8.8	11.0	11.5		6.3	3.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	4.4	3.3	4.5	6.9	2.5	5.3	5.8	5.9	6.4	6.7	6.8	6.1	8.0	4.6	6.4
GDP deflator in US dollar terms (change in percent)	9.8	2.8	4.6	5.6	8.1	-5.9	-4.5	2.4	0.4	2.0	1.7	-0.6	5.4	3.3	4.0
Effective interest rate (percent) 5/	6.2	5.1	5.9	6.7	2.4	7.1	6.3	6.0	6.1	6.5	6.8	6.4	2.8	1.7	1.8
Growth of exports of G&S (US dollar terms, in percent)	22.4	6.6	3.5	18.2	10.7	2.0	4.9	8.6	14.8	8.0	8.3	7.8	15.1	6.7	12.3
Growth of imports of G&S (US dollar terms, in percent)	12.3	-1.8	2.8	17.2	12.6	2.8	8.7	12.9	11.2	9.0	8.5	8.8	13.3	8.0	9.8
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	47.4	12.6	16.8	12.8	12.2	9.7	18.6	9.2	7.8	9.0
Government revenues (excluding grants, in percent of GDP)	11.2	11.4	11.9			13.0	13.6	14.1	14.6	15.1	15.6		18.1	18.2	18.4
Aid flows (in Billions of US dollars) 7/	0.8	1.0	0.5			0.6	0.7	0.7	0.7	0.5	0.4		0.4	0.4	
of which: Grants	0.4	0.4	0.3			0.3	0.4	0.3	0.3	0.2	0.2		0.2	0.0	
of which: Concessional loans	0.3	0.6	0.2			0.3	0.3	0.4	0.4	0.3	0.2		0.3	0.4	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.8	2.4	1.9	1.7	1.2	0.9		0.5	0.2	0.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			70.0	29.4	30.7	22.8	21.5	23.0		16.7	7.8	13.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	23.2	24.7	27.0			26.7	27.0	29.2	31.2	34.0	36.9		71.2	167.4	
Nominal dollar GDP growth	14.7	6.1	9.3			-0.9	1.0	8.4	6.9	8.8	8.6	5.5	13.8	8.1	10.6
PV of PPG external debt (in Billions of US dollars)			2.4			2.5	4.0	5.2	6.9	8.4	9.4		14.3	26.4	
(PVt-PVt-1)/GDPt-1 (in percent)						0.7	5.50	4.5	5.80	4.6	2.9	4.0	1.6	1.0	1.5
Gross workers' remittances (Billions of US dollars)	0.8	1.1	1.0			0.9	0.9	1.0	1.0	1.1	1.1		2.2	4.6	
PV of PPG external debt (in percent of GDP + remittances)	...	...	8.6			9.9	14.4	17.7	21.7	24.2	24.9		19.4	15.4	
PV of PPG external debt (in percent of exports + remittances)	...	...	39.2			44.3	62.2	76.6	88.4	99.6	103.3		64.6	53.6	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	2.3			2.4	2.9	3.7	4.4	5.3	6.0		5.9	6.0	

Sources: Ugandan authorities; and IMF 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, 2012–2035

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	22.0	26.2	28.9			31.9	37.1	40.8	45.1	49.1	51.1		36.1	23.8	
of which: foreign-currency denominated	13.2	15.2	16.1			18.2	22.9	26.5	30.7	33.1	33.4		24.5	18.8	
Change in public sector debt	-4.5	4.2	2.7			3.0	5.2	3.7	4.3	4.0	1.9		-2.8	-0.3	
Identified debt-creating flows	-3.7	2.6	2.1			4.7	4.4	4.6	4.7	4.1	2.1		-3.0	-0.5	
Primary deficit	1.5	2.2	2.3	1.2	1.4	2.9	5.1	4.7	4.6	3.6	1.9	3.8	-0.6	0.1	-0.5
Revenue and grants	13.1	12.9	13.0			14.1	15.1	15.1	15.5	15.7	16.1		18.3	18.2	
of which: grants	1.9	1.5	1.0			1.1	1.6	1.1	0.9	0.6	0.6		0.2	0.0	
Primary (noninterest) expenditure	14.6	15.1	15.3			17.0	20.2	19.8	20.1	19.3	18.0		17.6	18.3	
Automatic debt dynamics	-5.2	0.5	-0.3			1.5	-0.9	-0.5	-1.1	-1.4	-1.6		-2.4	-0.6	
Contribution from interest rate/growth differential	-2.2	0.1	-0.2			-0.7	-0.8	-0.9	-1.1	-1.4	-1.7		-1.6	-0.4	
of which: contribution from average real interest rate	-1.1	0.8	0.9			0.8	1.0	1.2	1.3	1.4	1.4		1.2	0.7	
of which: contribution from real GDP growth	-1.1	-0.7	-1.1			-1.5	-1.7	-2.1	-2.4	-2.8	-3.1		-2.9	-1.1	
Contribution from real exchange rate depreciation	-3.0	0.3	0.0			2.2	-0.2	0.3	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.3	0.2	0.5	1.2	1.8	1.9		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	0.1	1.1	1.7	1.9		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 (e.g., bank recapitalization)	0.0	0.0	0.0			0.3	0.2	0.4	0.1	0.1	0.0		0.0	0.0	
Residual, including asset changes	-0.9	1.6	0.6			-1.7	0.8	-0.9	-0.4	-0.1	-0.2		0.2	0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	21.8			23.9	29.1	32.6	36.8	41.0	43.4		31.6	20.8	
of which: foreign-currency denominated	...	...	9.0			10.3	14.9	18.3	22.4	24.9	25.7		20.0	15.8	
of which: external	...	...	9.0			10.3	14.9	18.3	22.4	24.9	25.7		20.0	15.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	5.1	9.5	11.0			12.5	15.4	15.4	15.5	15.1	14.4		9.3	5.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	168.2			169.5	192.7	215.5	237.8	261.4	268.8		172.7	114.4	
PV of public sector debt-to-revenue ratio (in percent)	...	...	182.8			183.7	214.8	231.6	251.8	272.1	278.8		174.9	114.4	
of which: external 3/	...	...	75.1			78.7	110.0	130.0	153.1	165.7	165.1		110.9	86.9	
Debt service-to-revenue and grants ratio (in percent) 4/	24.7	31.6	35.3			35.2	36.2	38.1	38.5	41.4	43.8		31.8	19.0	
Debt service-to-revenue ratio (in percent) 4/	29.0	35.7	38.3			38.2	40.3	41.0	40.8	43.1	45.4		32.2	19.0	
Primary deficit that stabilizes the debt-to-GDP ratio	6.1	-2.1	-0.4			-0.1	-0.1	1.0	0.3	-0.3	-0.1		2.2	0.5	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	4.4	3.3	4.5	6.9	2.5	5.3	5.8	5.9	6.4	6.7	6.8	6.1	8.0	4.6	6.4
Average nominal interest rate on forex debt (in percent)	1.3	1.2	1.3	1.2	0.4	1.0	1.8	2.4	2.9	3.2	3.3	2.4	3.7	4.1	3.8
Average real interest rate on domestic debt (in percent)	-9.4	10.6	9.5	4.0	6.3	7.5	7.8	8.2	8.1	7.8	6.6	7.7	7.0	5.7	6.9
Real exchange rate depreciation (in percent, + indicates depreciation	-20.9	2.7	-0.2	-1.7	11.2	14.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	20.9	4.1	2.4	8.4	6.0	4.4	5.1	4.7	4.3	4.1	4.2	4.5	4.2	3.9	4.2
Growth of real primary spending (deflated by GDP deflator, in percer	-15.2	6.6	6.2	-0.2	5.9	17.0	25.5	3.8	8.0	2.5	-0.4	9.4	9.0	4.0	6.5
Grant element of new external borrowing (in percent)	...	...	...	...	...	47.4	12.6	16.8	12.8	12.2	9.7	18.6	9.2	7.8	...

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

1/ The public sector includes the central government only and gross debt is used for all presentations.

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, 2015–2035

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	10	15	18	22	25	26	**20**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	10	10	10	12	14	15	**27**	20
A2. New public sector loans on less favorable terms in 2015-2035 2/	10	16	21	26	30	31	**26**	25
A3. Alternative Scenario : No Oil Scenario	9	15	18	22	24	24	**24**	27
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	10	15	18	23	25	26	**21**	16
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	10	14	17	21	24	25	**20**	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	10	15	18	23	25	26	**21**	16
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	10	15	19	23	26	27	**21**	16
B5. Combination of B1-B4 using one-half standard deviation shocks	10	11	12	16	19	19	**17**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	10	22	26	32	36	37	**29**	23
PV of debt-to-exports ratio								
Baseline	52	73	89	101	114	117	**72**	59
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	52	48	50	56	66	70	**95**	76
A2. New public sector loans on less favorable terms in 2015-2035 2/	52	80	100	119	136	142	**94**	93
A3. Alternative Scenario : No Oil Scenario	48	72	87	98	108	111	**107**	110
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	52	72	87	100	112	115	**72**	59
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	52	68	82	96	107	111	**70**	58
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	52	72	87	100	112	115	**72**	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	52	71	94	106	118	121	**74**	59
B5. Combination of B1-B4 using one-half standard deviation shocks	52	52	55	69	80	84	**56**	51
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	52	72	87	100	112	115	**72**	59
PV of debt-to-revenue ratio								
Baseline	79	110	130	153	166	165	**111**	87
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	79	73	72	84	96	99	**147**	112
A2. New public sector loans on less favorable terms in 2015-2035 2/	79	121	146	180	198	199	**146**	136
A3. Alternative Scenario : No Oil Scenario	73	109	127	148	158	155	**131**	150
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	79	111	130	155	168	167	**114**	89
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	79	106	122	146	159	158	**109**	86
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	79	107	130	155	168	167	**114**	89
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	79	107	137	161	172	171	**115**	87
B5. Combination of B1-B4 using one-half standard deviation shocks	79	80	85	110	124	125	**93**	80
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	79	159	185	220	238	237	**162**	126

Table 3. Uganda: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (concluded)

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
Debt service-to-exports ratio								
Baseline	3	3	4	5	6	7	**7**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	3	3	3	3	4	4	**6**	7
A2. New public sector loans on less favorable terms in 2015-2035 2/	3	3	4	5	7	8	**8**	11
A3. Alternative Scenario : No Oil Scenario	3	3	4	5	6	7	**9**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	3	4	5	6	7	**7**	7
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	3	4	5	6	7	**6**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	3	4	5	6	7	**7**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	3	4	5	6	7	**7**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	3	3	3	4	4	5	**5**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	3	4	5	6	7	**7**	7
Debt service-to-revenue ratio								
Baseline	4	5	6	8	9	10	**10**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	4	5	4	5	5	6	**9**	11
A2. New public sector loans on less favorable terms in 2015-2035 2/	4	5	6	8	10	11	**12**	15
A3. Alternative Scenario : No Oil Scenario	4	5	6	8	9	9	**11**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	4	5	7	8	9	10	**10**	10
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	4	5	6	7	9	9	**10**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	4	5	6	8	9	10	**10**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	4	5	6	8	9	10	**11**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	4	5	5	6	7	8	**8**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	4	7	9	11	13	14	**15**	14
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	7	7	7	7	7	7	**7**	7

Sources: Ugandan authorities; and IMF 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 assumingan 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 2015–2035

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	24	29	33	37	41	43	32	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	24	25	25	27	29	31	32	31
A2. Primary balance is unchanged from 2015	24	27	29	32	35	39	41	55
A3. Permanently lower GDP growth 1/	24	29	33	38	43	46	37	39
A4. Alternative Scenario : No Oil Scenario	24	29	33	36	40	42	36	29
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	24	30	34	39	43	46	35	28
B2. Primary balance is at historical average minus one standard deviations in 2016-201	24	27	29	33	37	40	29	19
B3. Combination of B1-B2 using one half standard deviation shocks	24	26	27	32	36	39	29	20
B4. One-time 30 percent real depreciation in 2016	24	33	36	40	45	47	35	26
B5. 10 percent of GDP increase in other debt-creating flows in 2016	24	38	42	46	50	52	37	24
PV of Debt-to-Revenue Ratio 2/								
Baseline	170	193	216	238	261	269	173	114
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	170	168	168	172	184	192	175	172
A2. Primary balance is unchanged from 2015	170	179	191	205	225	241	225	300
A3. Permanently lower GDP growth 1/	170	194	219	244	271	282	202	212
A4. Alternative Scenario : No Oil Scenario	171	194	216	234	254	259	225	181
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	170	196	225	250	277	286	194	152
B2. Primary balance is at historical average minus one standard deviations in 2016-201	170	178	189	213	237	246	160	106
B3. Combination of B1-B2 using one half standard deviation shocks	170	174	181	205	231	241	159	109
B4. One-time 30 percent real depreciation in 2016	170	220	241	261	285	293	191	144
B5. 10 percent of GDP increase in other debt-creating flows in 2016	170	254	276	295	316	320	202	134
Debt Service-to-Revenue Ratio 2/								
Baseline	35	36	38	39	41	44	32	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	35	36	36	36	38	40	31	21
A2. Primary balance is unchanged from 2015	35	36	38	37	40	42	32	31
A3. Permanently lower GDP growth 1/	35	36	39	39	42	45	34	26
A4. Alternative Scenario : No Oil Scenario	35	36	38	39	41	44	39	25
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	35	37	39	40	43	45	34	22
B2. Primary balance is at historical average minus one standard deviations in 2016-201	35	36	37	37	40	43	30	18
B3. Combination of B1-B2 using one half standard deviation shocks	35	36	37	37	40	43	30	18
B4. One-time 30 percent real depreciation in 2016	35	37	41	42	45	48	37	27
B5. 10 percent of GDP increase in other debt-creating flows in 2016	35	36	41	42	44	46	35	22

Sources: Ugandan authorities; and IMF 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.

Statement by
Chileshe Mpundu Kapwepwe, Executive Director for Uganda
and
Gloria Gasasira-Manzi, Advisor to the Executive Director for Uganda
June 29, 2015

The Ugandan authorities continue to value the constructive policy dialogue with the Fund. They welcome the insightful and thorough analysis of the country's macroeconomic policies carried out during the 2015 Article IV consultation and the fourth review of the Policy Support Instrument (PSI) and broadly agree with staff's assessment.

The Ugandan economy has remained resilient. Sound macroeconomic policies have enabled strong growth and supported adequate buffers to protect the economy against potential shocks. The risks to the outlook arise mainly from geopolitical developments especially in the region, slower recovery in advanced economies and a larger than projected slowdown in emerging markets.

Program Performance

Performance under the PSI has been on track and all end-December 2014 quantitative assessment criteria (QAC) were met. However, there was a breach of the lower inner limit of the band of the inflation consultation clause and average core inflation reached 3.1 percent at end-December, against an inner band of 3.7 percent. The indicative target (IT) on tax revenue was met with a large margin. Although the target on the net change in stock of domestic arrears was missed by a small margin, the annual target is expected to be met, with a large reduction resulting from sustained efforts by the Government to reduce arrears in line with the debt strategy. There is significant progress on structural reforms and most end of March ITs were met. The second phase of the Treasury Single Account (TSA) was partially met in spite of delays due to extended discussions with development partners regarding the inclusion of their accounts.

In light of this performance and the continued commitment to the program, the authorities request the support of Executive Directors for completion of the fourth review under the PSI and the proposed alignment of the program conditionality with the updated macroeconomic framework.

Recent Economic Developments and Outlook

Uganda continues to register strong economic growth, driven by an increase in private sector activity in agriculture, industry and services as well as public infrastructure investment especially in energy and roads. The real GDP growth is projected at 5.3 percent for FY2014/15 and 5.8 percent for FY2015/16. Social services have also expanded significantly in education and health, in pursuit of government's policy of universal access.

Inflation has remained subdued mainly due to low food and import prices. However, this trend has more recently reversed with inflation gradually rising to 4.9 percent in May 2015. Although the recent oil price decline lowered the import bill, this was partially offset by the exchange rate depreciation, in part due to global strengthening of the US dollar. The exchange rate pass-through and strengthening economic activity are expected to exert further upward pressure on consumer prices over the medium term. The annual core inflation is now projected to rise to 8 – 10 percent by the end of 2015/16, an increase of 1 percentage point compared to the April 2015 forecast. Consequently, the Bank of Uganda (BOU) increased the Central Bank Rate (CBR) by 1 percentage point to 13 percent on June 16, 2015, to ensure that medium term inflation converges towards its policy target of 5 percent. BOU will remain vigilant and take necessary monetary policy actions should the inflation outlook deteriorate.

The current account deficit is projected to widen from 8.5 percent of GDP in FY2014/15 to 10.3 percent of GDP in FY2015/16, due to lower remittances, subdued global commodity prices, lower aggregate demand in key export markets and rising import demand. However, a significant portion of imports is related to public infrastructure and private investment and will boost the long term productive capacity of the country. The current account has been comfortably financed thus far and international reserves continue to be adequate at about 4 months of imports. In addition, the development of Uganda's oil sector remains positive. To date, there are three active exploration licenses and one production license. Bidding for six new blocks to attract new companies in the exploration phase is ongoing and expected to be concluded in December 2015. Once successful, this is expected to lead to continued strong foreign direct investment and other financial inflows.

Fiscal Policy

Uganda's fiscal policy focuses on providing sustainable economic and social benefits to the society in the short, medium and long term. In this regard, the budget for FY2015/16 under the theme "***Maintaining Infrastructure Investment and Promoting Excellence in Public Service Delivery***" seeks to close existing infrastructure gaps, as well as promote socio-economic transformation while taking into account the prevailing macroeconomic conditions and future prospects.

For FY2015/16, the overall fiscal deficit is expected to increase to 7 percent of GDP compared to 4.5 percent for FY2014/15 mainly as a result of the boost in public investment in infrastructure. The infrastructure investment will enhance regional integration, develop Uganda's oil sector, unlock private sector activity, and generate the much needed tax revenues to finance development. Over the medium term, the deficit will average about 6 percent before it drops to about 4.5 percent in FY2019/20, in line with the East African Community Monetary Union Protocol. The authorities continue to pursue concessional loans as the preferred means of meeting the external financing requirements. Non-concessional external borrowing will be considered only for the financing of highly productive fixed capital investments.

Continuing with the momentum witnessed during FY2014/15, successful implementation of the FY2015/16 budget is expected to yield an increase in the tax-to-GDP ratio of about 0.5 percent. To generate additional revenues, the authorities have proposed amendments to the Income Tax Act and VAT law, including simplification of the presumptive tax regime and specification of the amount of tax payable by small businesses. The government has also made amendments to clarify VAT applications in the oil, gas and mining industry to facilitate investments.

The authorities also intend to focus on increasing non-tax revenues while improving tax administration, compliance and enforcement. They plan to improve the capacity of the Uganda Revenue Authority particularly to combat the challenges associated with international taxation. In line with this, government has ratified various agreements covering double taxation avoidance, prevention of fiscal evasion and collaboration in tax administration with other entities in the region. Furthermore, given the large informal sector, efforts are underway to enhance awareness to bring about a change in the taxpaying culture.

Implementation of public financial management reforms will continue to enhance the efficiency of public expenditures. Following the approval of the PFM Act (2015) in November 2014 and its subsequent commencement in March 2015, the authorities have prepared the PFM regulations which will come into force in July 2015, incorporating recommendations from Fund Technical Assistance. A Charter of Fiscal Responsibility (CFR) which presents the government's overall strategy on the formulation and implementation of fiscal policy consistent with sustainable fiscal balance and debt paths over the medium term is being finalized. It shall cover the period FY2016/17 to FY2020/21 and will be presented to Parliament for approval according to the timeline under the PFM Act.

Monetary and Financial Sector Policies

The authorities' monetary policy focuses primarily on the inflation objective. They are committed to keeping monetary policy centered on achieving the medium term inflation target and will continue to carefully adapt monetary policy to changing domestic and external developments. Further, the BOU will continue to strengthen the current inflation targeting framework regime by improving its monetary policy formulation and capacity building.

The financial sector is well capitalized, reasonably liquid and profitable, however, there are vulnerabilities from credit sector concentration and currency mismatches. The BOU is committed to further strengthening its prudential oversight and ensuring adequate provisioning for non-performing loans. As they continue to make progress with the implementation of the FSAP update recommendations, the BOU is carrying out programs to enhance financial deepening and access to bank services by improving financial literacy and consumer protection.

Structural Reforms and Competitiveness

To improve the business climate, the Ugandan government has undertaken legal and regulatory reforms including in land administration, business registration and licensing. A national identification project is being rolled out to support efforts to strengthen revenue collection, promote unique identification of financial sector clients and combat money laundering and terrorism financing. The authorities are committed to addressing the recent Financial Action Task Force's (FATF) concerns on the shortcomings in Uganda's AML/CFT. To this end, significant steps have been taken including the passing of the Anti-Terrorism Amendment Bill, 2015 by Parliament on June 18, 2015 which seeks to amend the

Anti-terrorism Act, 2002 to include proposals on terror financing. The authorities are also undertaking reforms in the financial sector, including pensions, to create efficient mechanisms to mobilize long term capital.

Progress towards the East African Community (EAC) integration is being made and the first annual Medium Term Convergence Program (MTCP) has been prepared. This outlines the medium-term macroeconomic and fiscal objectives, strategies and policies to ensure that the economy attains a high degree of monetary and economic convergence and compatibility with other EAC partner states and follows a stable and sound trajectory towards meeting the convergence criteria.

Conclusion

The authorities remain dedicated to maintaining economic stability and supporting sustainable and inclusive growth by generating employment and reducing poverty and will continue to strengthen controls and institutional governance. They have noted staff’s concerns on the risks stemming from the upcoming presidential and parliamentary elections in February 2016 and reiterate their commitment to maintaining election-related expenditures to levels contained in the budget.