UGANDA ECONOMIC UPDATE
8TH EDITION, JANUARY 2017

# Step by step

## Let's solve the finance puzzle to accelerate growth and shared prosperity


THE WORLD BANK
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# ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| **BoU** | Bank of Uganda |
| **BOP** | Balance of Payments |
| **CBR** | Central Bank Rate |
| **CI** | Credit Institutions |
| **CPIA** | Country Policy and institutions Assessment |
| **DPF** | Deposit Protection Fund |
| **DRC** | Democratic Republic of Congo |
| **DSA** | Debt Sustainability Analysis |
| **EAC** | East African Community |
| **EU** | European Union |
| **FAS** | Financial Access Survey |
| **FDI** | Foreign Direct Investment |
| **FIA** | Financial Institutions Act |
| **FSSC** | Financial Sector Surveillance Committee |
| **GDP** | Gross Domestic Product |
| **GOU** | Government of Uganda |
| **HIPC** | Highly Indebted Poor Countries |
| **ICT** | Information and Communications Technology |
| **IFC** | International Finance Corporation |
| **IFPRI** | International Food Policy Research Institute |
| **IMF** | International Monetary Fund |
| **LIBOR** | London Interbank Offered Rate |
| **MDI** | Micro-finance Depository Institution |
| **MDRI** | Multilateral Debt Relief Initiative |
| **MFI** | Micro-Finance Institution |
| **MoFPED** | Ministry of Finance, Planning and Economic Development |
| **MoPS** | Ministry of Public Service |
| **MSMEs** | Micro, Small and Medium Enterprises |
| **MTIC** | Ministry of Trade, Industry and Nominal Cooperatives |

| | |
|---|---|
| **NDP** | National Development Plan |
| **NEER** | Nominal Effective Exchange Rate |
| **NGO** | Non-Government Organization |
| **NPL** | Non-performing Loan |
| **NSSF** | National Social Security Fund |
| **NTBs** | Non-Tariff Barriers |
| **NTMs** | Non-Tariff Measures |
| **ODA** | Official Development Assistance |
| **OECD** | Organization for Economic Cooperation and Development |
| **PIMS** | Public Investment Management System |
| **PSPF** | Public Service Pension Fund |
| **PSI** | Policy Support Instrument |
| **PSPS** | Public Service Pension Scheme |
| **REER** | Real Effective Exchange Rate |
| **RFF** | Rural Financial Services Strategy |
| **ROE** | Return on Equity |
| **ROSCAs** | Rotating Credit and Savings Associations |
| **SACCO** | Savings and Credit Cooperative Organization |
| **SMEs** | Small and Medium-sized Enterprises |
| **SSA** | Sub-Saharan Africa |
| **UEU** | Uganda Economic update |
| **UGX** | Uganda Shillings |
| **UMRA** | Uganda Microfinance Regulatory Authority |
| **URA** | Uganda Revenue Authority |
| **URBRA** | Uganda Retirement Benefits Regulatory Authority |
| **UCSCU** | Uganda Co-operative Savings and Credit Union |
| **VSLAs** | Village Savings and Loan Associations |
| **VAT** | Value Added Tax |
| **WB** | World Bank |
| **WDI** | World Development Indicators |

# FOREWORD

Uganda's long run of rapid growth has struggled to maintain its pace in recent years. The economy has faced a number of shocks, including bad weather; disruption to her export markets in South Sudan as a result of civil unrest; election related macro instability during the post 2011 election period and high uncertainty around the 2016 election; upheavals in the domestic financial system; as well as those related to the global up and downs in growth and commodity prices. Under these circumstances, the economic policies that authorities have pursued have been successful in preserving past gains, particularly keeping inflation in low single digit levels and reducing poverty. Uganda has also made significant strides in preparations for production of its long-awaited crude oil.

Unfortunately, the ambitious public investment program meant to stimulate the economy and remove the country's long standing deficiencies in physical infrastructure, has not catalyzed acceleration of private investments. As a result, Uganda's economy has been growing at an average of 4.5 percent per year since 2012, generating only modest per capita growth as it rallied against a fast growing population, and falling below projections by at least a percentage point each year. The near term growth projection of about six percent is also lower than levels sufficient for Uganda to attain middle income status by 2020, and is subject to volatility, some of which has already materialized. It is important that fiscal policy not become an additional source of shocks. This means effective delivery of the debt-financed infrastructure program and boosting domestic revenues from among the lowest in Sub-Saharan Africa.

To boost the private sector side, Uganda needs to pay more attention to strengthening its financial systems to support faster investments and households management of risks. There has been an intensified interest in the financial systems across the East African Community due to a number of banking system distress episodes, debates around interest rate capping and innovations such as mobile money enabled by information and communication technology. Uganda cannot be alone in addressing these and other issues critical to ensuring its financial system raises the bar in supporting the country's growth and prosperity agenda.

Against this backdrop, I am pleased to introduce the Eighth Edition of the Uganda Economic Update series. In addition to the macroeconomic assessment in the first part of the report, this edition explores the options that exist for the country to get a much larger part of its population financially included and a much bigger proportion of its economic activities funded within the domestic financial system.

As with previous editions, I hope that this Eighth Uganda Economic Update will stimulate, and contribute to, the debate among stakeholders on this important agenda.

**Diarietou Gaye**

**Country Director,**
Eritrea, Kenya, Rwanda, and Uganda
Africa Region

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# KEY MESSAGES

The negative GDP growth rate recorded in the first quarter of FY 2016/17 is indicative of the recent difficulties that Uganda has faced in achieving the rates of growth required to enable the country to fulfil its aspirations. In the period from the 1990s to 2010, Uganda achieved average annual rates of economic growth of around seven percent, far higher than many peers. The sustained growth was the result of macroeconomic stability, post-conflict rebound, and market and institutional reforms which transformed Uganda from a failed state to one of the fastest growing economies in the world.

However, the average annual growth in the five-year period to FY 2015/16 has decelerated to 4.5 percent. In sharp contrast to the earlier period, this is significantly lower than the average rate recorded by low income countries in the same period. The decline since 2011 is partly related to the increasingly volatile external environment and partly to domestic policy slippages. Policy frameworks held up well during the 2016 election cycle, but serious strains related to the impact of the drought on agriculture and of the civil strife in South Sudan are now materializing. It is important to ensure that the fiscal impact of these shocks does not transmit into macro policy slippages, with past experiences showing how damaging such slippages can be to growth. In order to return to the levels of economic growth recorded in the immediate post-reform era, it is vitally necessary to address binding constraints and to transform the economy to facilitate the achievement of higher levels of productivity through diversification into a more resilient range of economic activities.

As with previous editions of this update, the eighth Uganda Economic Update provides an analysis of the current state of the economy, while also focusing on a particular subject of significance. In this update, the focus is on the state of the financial system, with an analysis of the means by which this system can be leveraged to accelerate growth and development through higher levels of financial inclusion. A well-functioning financial sector enables financial institutions to provide affordable credit and other financial services to a greater proportion of the population. This encourages the


*Banking hall in a commercial bank ready to serve customers*

*Morgan Mbabazi, 2016*

emergence of new businesses and facilitates the growth of existing businesses. At the household level, it enables to smooth the patterns of consumption, to invest in human capital development, and to accumulate physical and other assets. Together or individually, all of these outcomes play a significant role in the achievement of higher levels of economic growth and shared prosperity.

In general, low income countries face intrinsic challenges in moving beyond shallow financial systems and in overcoming informational asymmetries. In addition, growth slowdowns tend to deteriorate the quality of credit and to expose financial sector governance issues. As interest in addressing these issues is growing within the East African community, Uganda should take the opportunity to examine the current state of its financial sector with a view to implement reforms that will establish a strong basis for future growth.

Uganda's level of financial inclusion has increased significantly in recent years. At present, approximately eight million Ugandan adults have access to an account at a financial institution, with these accounts allowing them to conduct a range of transactions. However, at present, a much smaller proportion of individuals and firms are able to access credit from the formal financial system, with credit provided by the system accounting for less than an eighth of Uganda's GDP. Those unable to access credit are forced to rely on informal sources of finance or their own, their families', or their friends', often very limited resources. As a result, a significant proportion of the population is unable to increase its level of productivity, and too many Ugandans continue to rely on subsistence activities, particularly in the agricultural sector.

The main constraint on access to and the efficient use of financial services to support growth and increased productivity is the high cost. In addition, the sector suffers as a result of low levels of public confidence in formal financial institutions, largely due to historical experiences related to a series of crises and upheavals in the financial system. As a result, a large proportion of the population prefers to keep its savings in the form of cash stored at home or of livestock, gold or other similar assets. The Government has recently developed a National Financial Inclusion Strategy, which, if implemented well could be a significant step towards ensuring that a far greater proportion of Ugandan people, households and firms to have access to and use a broad range of affordable, high-quality financial services, which in turn will promote growth and prosperity.

## Part 1: The state of the economy

**During the first half of FY 2016/17, Uganda experienced subdued economic activity in response to a number of shocks, the most significant of these being the impact of adverse weather conditions on agriculture and civil unrest in South Sudan**. With the average annualized inflation rate standing at the relatively low level of 4.7 percent during the first half of the year, the Bank of Uganda continued to ease monetary policy to stimulate growth. However, liquidity conditions remained tight, with commercial banks imposing increasingly stringent conditions on loans. During the first quarter of the year, overall economic activity declined by 0.2 percent, contrasting the positive growth rate of 0.6 percent recorded in the previous quarter and a reversal of the recovery that had begun to become apparent after the completion of the election cycle in February 2016. Due to the prolonged drought conditions, agriculture declined by 1.1 percent during this quarter. Services, which in the past have been the main driver of growth, also stagnated. With manufacturing and trading activities declining strongly due to disruptions to the main market in South Sudan, the growth of industry was mainly driven by the expansion of construction activities, which was largely driven by government projects.

**The Government continued to focus on the delivery of its huge investment program, with this program being the most significant cause of the increase in the headline budget deficit**. However, implementation of the investment program was affected by quality issues that resulted in a deceleration to the rate of execution of key projects. By the end of December, the value of revenues collected during the first half of the year was significantly lower than the targeted level. It is expected that the shortfall in revenues could increase to a value of around 0.4 percent of GDP by the end of the year. With the under-execution of the development budget, overall expenditures may not reach the budgeted level of 22.5 percent of GDP. Despite this, Uganda's fiscal deficit is expected to reach the level of around 6 percent of GDP, with this deficit being predominantly met through external financing.

**The combined impact of domestic and external factors has led to a further weakening of Uganda's external position during FY 2016/17, reversing the improvement that had been recorded in recent past**. A deceleration in the growth of imports of goods and services as Uganda benefitted from the low international oil prices supported a reduction in the country's current account deficit from a value of 7.6 percent of GDP to 5.7 percent between FY 2013/14 and FY 2015/16. With the decline in exports resulting from the situation in South Sudan and with the increase in the import bill, the external current account deficit has deteriorated. This deficit is now expected to reach a value of 7.1 percent of GDP during FY 2016/17. The poor performance of the export sector is partly a result of Uganda's failure to diversify exports into higher productivity goods that are less sensitive to commodity price movements. Inflows through the capital account have also been slow. Foreign Direct Investment (FDI) to Uganda has declined steadily since FY 2013/14, when the total value of these investments was in excess of a billion dollars, almost twice the figure of US$ 512 million recorded in FY 2015/16.

**Uganda's currency remained relatively stable for almost 10 months in the period up to October 2016. However, with the increasingly weak external position, it has since begun to deteriorate**. The stability of the shilling was largely the result of the implementation of a tight monetary policy during the election period. With the easing of monetary policy starting to have impact on liquidity in the markets, the currency softened, depreciating in value by about 6 percent in the final three months of 2016.

**The performance of the economy during the second half of FY 2016/17 is expected to improve as the impact of the drought recedes, banking system distress is contained, and execution of public projects improves**. Overall, the Ugandan economy is projected to grow at the rate of between 4.0 to 5.0 percent during FY 2016/17, increasing only marginally to 5.2 percent in FY 2017/18, and to 6.0 percent in FY 2018/19. This growth is expected to be primarily driven by public investments, with private investment still constrained by a lack of business confidence, uncertainty about markets as social unrest persists in South Sudan, and the high cost of credit. In 2016, the financial sector was challenged by the significant increase in non-performing loans (NPLs), which in turn reduced the tendency of banks to increase the availability of credit or to reduce interest rates, despite the easier monetary policies. As in Kenya, the Central Bank was forced to intervene to address undercapitalization, in the case of Crane Bank. However, the banking system as a whole remains well capitalized and provisioned for NPLs.

**The main risks to the economic outlook relate to the possible failure of the Government to complete on-time its massive infrastructure development program, with such a failure having the potential to prevent reductions to the fiscal deficit, to make it harder for Uganda to comfortably pay off its increasing debt and to reduce the hoped-for efficiency and productivity gains to the economy**. Moreover, the volatility of regional markets, particularly as a result of the unrest in South Sudan and if the upcoming elections in Kenya are accompanied by disruption, and the uncertainties in the global economy, all have negative implications for exports, remittances and FDI. In this context, the high cost of and limited access to credit and financial services has become a key binding constraint on Uganda's economy, preventing the efficient allocation and reallocation of resources and thereby reducing the potential to increase productivity across all sectors of the economy.

## Part 2: Deeper finance can unlock growth accelerators

**Successful emerging countries that have achieved rapid, equitable economic growth have been characterized by their ability to develop deep financial systems that effectively mobilize savings and intermediate resources to productive activities.** Access to financial services enable individuals, households, and businesses to efficiently balance income and expenses over time, to manage shocks, and to invest in the development of their human and physical capital. Most critically, efficient intermediation encourages savers, eases access to credit for borrowers and lowers the costs of credit, which in turn reduces the overall transaction costs for enterprises, making them more competitive. Therefore, a well-functioning financial system encourages the emergence of new businesses, supports the growth of existing businesses, and ensures business sustainability. Similarly, a well-functioning financial system will encourage households to save and to engage in income generating activities in the form of investments, hence smoothing consumption and accelerating poverty reduction.

**Uganda's financial system has emerged in the context of a broader set of market-oriented policy reforms that involved liberalization of the financial sector in the 1990s.** These reforms were aimed at improving efficiency and to enable the emergence of institutions to provide a broader range of financial services, to a broader proportion of the population. Institutions providing financial services include banks, credit institutions (CIs), microfinance depository institutions (MDIs), savings and credit cooperative organizations (SACCOs), insurance companies, and pension schemes. In terms of inclusion, the development of non-bank deposit-taking financial institutions, such as credit institutions and microfinance deposit-taking institutions has been significant, because these institutions generally have a wider geographical scope and are more orientated to serving low-income clients. However, the most impact on access to financial services has been through mobile money.

**At present, slightly more than half (52 percent) of Uganda's adult population has access to an account at a formal financial institution that enables them to engage in at least a limited range of transactions.** This is a significant increase from the figure of 28 percent recorded in 2009, with most of the improvement coming from an increase in the use of mobile money services. Thus, a large proportion of households, SMEs, and agricultural producers still have only limited access to credit, savings, payment, and insurance products from the formal financial system.

**Almost half of those people who hold accounts with formal financial institutions do so with a bank, with 28 percent of the adult population holding such an account**. While this is a significant increase from the figure of 21 percent recorded in 2011, it shows that a large proportion of the population is still left out of the banking system, leaving Uganda behind many regional and global peers. With more than 7 million active users in 2016, the financial service most commonly used by Ugandans was mobile money, with the increase resulting from the widespread embrace of new technologies by consumers, who have been attracted by the potential of this service to effect financial transactions easily.

**Despite the increase in the level of access to financial services, only a very small proportion of Ugandan businesses and households have access to a bank loan and/or a line of credit**. The overall domestic credit to GDP ratio in Uganda has stood at the average level of 15 percent of GDP over the past decade, far lower than the figures recorded by regional neighbors such as South Africa and Kenya, and lower still when compared to comparators in other regions, including countries in Europe, Central Asia, East Asia and the Pacific. A number of surveys have identified the limited access to credit as the most significant constraint to doing business in Uganda. In addition to the supply of affordable credit, demand-side also plays an equally role, as lack of "bankable" projects, especially in key sectors like agriculture, prevents lenders from further increasing private sector credit.

**The high cost of finance has been a major constraint to finance in Uganda.** According to the Economic Forum Global Competitiveness Report (2016-2017), in terms of the affordability of financial services index, Uganda ranks in 120th place out of 138 countries, with a steady decline in its position over recent years. In addition, more still remains to be done to foster public confidence in formal financial institutions, largely due to limited financial literacy and also the historical developments characterized by a series of crises and upheavals in the financial system. As a result, a large proportion of the population prefers to keep its savings in the form of cash stored at home or of livestock, gold or other similar assets. While an overall growth in savings has been observed over the years, the 2013 Finscope survey shows that 65 percent of the population is still unserved in terms of savings and credit (in contrast to only 15 percent of the population being excluded from any financial services).

**Improving access to finance in Uganda cannot be achieved through any one single measure. Rather, it requires a multi-faceted approach to address the many challenges that constrain access to financial services, especially the high cost and low public confidence in the financial institutions**. The most significant constraint on financial inclusion is cost, with Uganda ranking in 120th place out of 138 countries in the area of the affordability of financial services, according to the Economic Forum Global Competitiveness Report (2016-2017). In addition, inclusion is constrained by lack of financial literacy (resulting in "self-exclusion"), the low level of public confidence in formal financial institutions; and by the undeveloped state of long-term savings products such as pensions and insurance. The stronger regulation of the pension system which has been initiated by the Uganda Retirement Benefits Regulatory Authority needs to be supported by a stronger laws and regulations. Once completed, the reformed pension sector should support competition in the financial sector.

**In order to improve the mobilization of savings, consumers must have greater confidence in the safety and integrity of financial institutions and easier access to the services these institutions provide**. Periods of instability in the banking system, including the recent instability created by the difficulties faced by Crane Bank, undermine confidence in financial institutions. Consumer confidence can be increased if an increasingly large proportion of users of financial services experience good and reliable services over sustained periods of time. An enabling environment could be achieved through the development of stronger regulatory structure, particularly in the case of the non-bank financial sector, which is currently largely unregulated; strengthening consumer awareness of existing safety measures against losses; and improving consumer protection practices among all financial institutions.

**Reducing the cost of credit requires a comprehensive, long-term effort to increase levels of competition and to improve the credit infrastructure.** However, significant short-term gains can be made through measures to address information asymmetries; to strengthen the financial infrastructure; to build capacities in the sector; and to maintain macro-economic stability. While some governments have attempted to impose interest rate caps as a remedy, such measures do not address the underlying causes of the high levels of interest rates, and hence have often proved to be counter-productive to increasing the level of financial inclusion to ensure that a greater proportion of its population can benefit from and contribute to sustainable, long-term economic growth.

**The issues constraining increased levels of financial inclusion in Uganda are multifaceted. Thus, increasing these levels requires a multifaceted approach**. The overarching objective must be to comprehensively strengthen the financial system, particularly as inclusion involves institutions other than the standard deposit taking institutions, financial service users comprising of individuals, households and firms, and durations of finance ranging from short to long term finance. Building public confidence in the financial system to raise more financial savings; adopting more cost effective modes of providing credit; and ensuring good governance through more comprehensive and up-to-date regulatory and supervision frameworks, are the most important areas to ensure the financial sector supports the much needed growth acceleration. As a priority, authorities should focus on the following:

i. Allow entrance of new strong banks that can challenge current market leaders, while consolidating banks in the lower tier by further increasing minimum capital requirements, to stimulate competition within the banking system

ii. Stimulate the development and strengthen the capacity and oversight of non-bank financial intermediaries, to mobilize more savings and increase completion in the system.

iii. Expand coverage of individuals and businesses by credit bureaus and increase the spectrum of data contributors, strengthen the legal and regulatory framework governing secured transactions and creditor rights, and establish a centralized movable collateral registry, in order to strengthen the credit infrastructure.

iv. Strengthen the legal, regulatory, institutional and supervisory framework of Uganda's financial sector to be able to support a deeper financial system.

v. Promote sound debt management policies and macroeconomic policies to avoid Government borrowing crowding out credit to private sector.

vi. Stimulate the demand side by registering land, conducting financial literacy programs, improving consumer protection practices and fostering trust of the population in the financial system to achieve better deposit mobilization and extension of the maturity of the deposit base.

**Fortunately, the Government has embarked on an ambitious strategy to dramatically increase the level of financial inclusion by ensuring that a far greater proportion of Ugandans have access to a broad range of high-quality, affordable financial services**. It is hoped that this increased financial inclusion will facilitate higher levels of productivity and enable both households and businesses to mitigate against the impact of shocks. The National Financial Inclusion Strategy (NFIS) has been developed through a multi-stakeholder consultative process, with the support of both the private and public sectors. The initiative has been driven by the Ministry of Finance, Planning and Economic Development (MoFPED) and the BoU.

**Around the world, many countries have realized that access to financial services can generate increased economic activity and reduce income inequalities by enabling lower income households and the self-employed to become more productive and resilient**. More than 50 countries around the world have committed to increasing the level of financial inclusion or to implementing national financial inclusion strategies as part of their broader national development plans. If Uganda is to achieve its aspirations of increased growth and shared prosperity, it should maintain and expand its commitment to increasing the level of financial inclusion to ensure that a greater proportion of its population can benefit from and contribute to sustainable, long-term economic growth.

# PART 1

## THE STATE OF THE ECONOMY

- During the first quarter of FY 2016/17, the economy contracted by 0.2 percent as it adjusted to the impacts of drought, the ongoing unrest in South Sudan and to a slowdown in credit from the banking system.
- With inflation pressures abating, the Bank of Uganda continued to implement easier monetary policies. However, the impact on the real economy was weak due to structural issues in the financial sector and to the increase in the level of risk aversion of banks.
- The fiscal deficit is projected to reach 6 percent of GDP in FY 2016/17 as the collection of revenues fail to meet targets, while at the same time the rate of execution of key hydroelectric projects improved and recurrent cost pressures increased. In the medium term, the high headline deficit should adjust to a more controlled level once the externally financed infrastructure is complete.
- The slow rate of export growth combined with the large import bill resulted in deterioration of the external current account deficit, which is now expected to exceed 7 percent of GDP in FY 2016/17.
- The economy will grow at a rate of around 4 to 5 percent this year, a rate similar to the average achieved over the past five years. The economy will accelerate only gradually, to 6 percent by 2019.
- Uganda's economic growth is expected to be mainly driven by public investments, with private investments struggling to overcome the effect of shocks and uncertainty regarding the pace of the Government's huge infrastructure program.
- The volatility of regional markets, due in particular to the protracted violence in South Sudan and global economic uncertainty, could result in a decline in exports, remittances and FDI. In order to achieve higher levels of resilience, the Government needs to ensure that its investment program is soundly financed and generates real productivity improvements.
- Resilience to shocks is also impeded by the inefficiency of the domestic financial system, with this inefficiency acting as a key binding constraint on risk management and increased productivity across all sectors of the economy.

A burst of activity in Nakasero Market in Kampala

Morgan Mbabazi, 2016

## 1.0 Recent economic developments

*Economic activity at the beginning of FY2016/17 was much more subdued than had been anticipated, with the sluggish performance that has characterized the economy since the second quarter in the previous year persisting. The easing of monetary policy following the completion of the 2016 electoral cycle had only a limited effect, due to bad weather conditions; the outbreak of violence in South Sudan; upheavals in the domestic financial sector resulting from an increase in the NPL ratio; and correspondingly more stringent loan conditions. Together with increased global uncertainties and decreased demand, these factors resulted in a decline in exports, remittances and FDI, thus constraining private investment. Overall, economic activity declined, with this trend being most pronounced in the agricultural and manufacturing sectors.*

**Over the past five years, the performance of the Ugandan economy has been more subdued than previous trends, with lower-than-expected growth outcomes.** The average rate of growth for this period has stood at 4.5 percent, almost half of the average figure of 8.7 percent recorded in the five-year period up until FY 2010/11 (see Figure 1). Despite the fact that the most recent period has been characterized by a high level of public investment intended to remove constraints on growth, private investment has not accelerated to the degree that might have been expected, particularly given the oil prospecting activities in Uganda. A range of external shocks, including those related to the global economic and financial crisis, high commodity prices, the post-2011 election macro-instability, and the recurrent drought conditions across the country, have contributed to the economic slowdown. In addition, as discussed in earlier editions of the Uganda Economic Update series, constraints related to inadequate infrastructure, inflexible land markets, and inefficient financial intermediation have had an increasingly negative impact on economic performance. Moreover, rather than raising capital investments that have a strong growth acceleration element, private investment has been mainly in real estate development, where real returns have been very poor; with the resultant oversupply now driving down occupancy rates as well as the property prices. During the period 2013-2015, the average rate of economic growth in Uganda was slightly higher than the Sub-Saharan average, but did not match that of the three fast growing neighbors, Tanzania, Kenya and Rwanda that had created an island of high growth amidst subdued economic performance across the world (see Figure 1)

**The slowdown in the rate of economic growth notwithstanding, the positive economic growth has continued to contribute to reduction of poverty, albeit at a slower pace.** It is estimated that the share of households living below the international extreme poverty line of US $ 1.9 a day declined to 33.9 percent by end of FY 2014/15. While this sustains the downward trend in poverty that Uganda has achieved over the past two and a half decades, the rate of decline during this period is much slower than 2.7 percentage points per year that was recorded in the period 2006 to 2013[1].

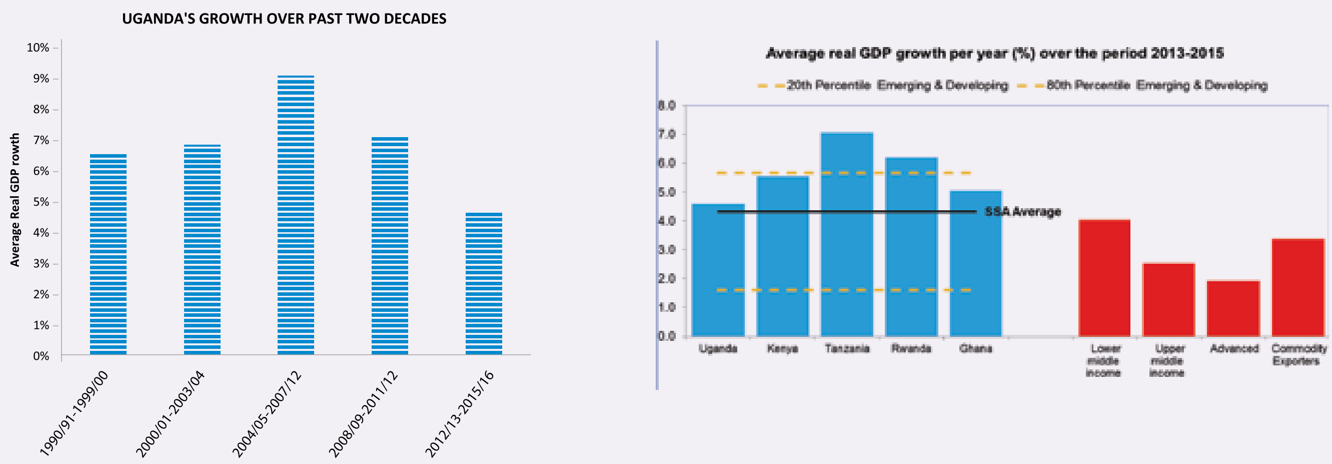
**According to estimates from the Uganda Bureau of Statistics, during FY 2015/16, the Ugandan economy grew at 4.8 percent, almost a full percentage point lower than had been projected.** The value of investments grew at the rate of 8.0 percent, a far higher rate than the average of 1.0 percent recorded over the previous two years. While this rate was lower than the 10 percent that had been projected, it reversed the negative rate recorded during FY 2014/15. The increased rate of investment compensated for the slump in both public and private consumption and the declining contribution of net exports. The decline in net exports was the result of a combination of factors, including lower regional and global demand for Uganda's products and the high level of demand for imports to support construction. For the sixth consecutive year, Uganda's overall rate of growth was lower than the rates recorded by Tanzania, Kenya and Rwanda.

**The services sector has continued to make the most significant contribution to overall GDP growth.** This sector expanded by 6.5 percent, with the ICT and financial and

1. World Bank. 2016. The Uganda Poverty assessment Report. Farms, Cities and Good Fortune: Assessing Poverty Reduction in Uganda from 2006 to 2013. Washington DC. World Bank 2016

insurance services sub-sectors being the most significant contributors. In the industrial sector, only the construction sub-sector recorded an impressive growth, with this sub-sector expanding by 6.8 percent, compared to 1.9 percent recorded in the previous year. The manufacturing sub-sector continued to perform poorly, largely due to the loss of key markets in South Sudan; protracted global weakness; and the low volume of credit available to this sub-sector, despite an easing of monetary policy. The agricultural sector accelerated to 3.2 percent per annum, on account of a strong recovery in cash crops and some improvement in weather.

Figure 1: Declining GDP growth places Uganda below many of its peers in the region




*Source: World Bank, International Monetary Fund, and Uganda Bureau of Statistics*
*Note: There is a break in the series in 2008/09 when GDP was rebased and reweighed in cognizance of changing structure of the economy.*

**The low rate of inflation and the easier monetary policy implemented over the year might have had a more stimulating impact on the economy if new shocks in the post-election period did not constrain private investments and the momentum towards increased public investment had been sustained.** In FY 2015/16, the average rate of inflation stood at 3.0 percent, with the adequate food supply and the reduced impact of external shocks throughout most of the year contributing to this low rate. However, the impact of the tight monetary policies implemented prior to this and of the uncertainties related to the election continued to constrain private investment. On the fiscal side, while funds were released as budgeted, a number of implementation challenges hampered the actual execution of a number of critical projects. While the uncertainties related to the election were anticipated, the combined impact of these uncertainties and other shocks was much more significant than had been anticipated.

## 1.1 New shocks exacerbating post-election uncertainty to weaken economic activity

**The subdued performance recorded since the second half of the previous year persisted into FY 2016/17.** With the completion of the 2016 electoral cycle, it was expected that domestic policies would create a more conducive economic environment, with policymakers balancing the need to reduce the cost of borrowing; the need to avoid exacerbating upward inflationary pressures; and the need to build the confidence of investors in the post-election period. Thus, monetary policy was eased as inflationary pressures declined and domestic public sector borrowing was reduced to increase the availability of credit to the private sector. However, just as these efforts to stimulate the economy began to have a positive impact, a number of new shocks undermined their impact: inconsistent and short rains during typical planting seasons, increased volatility in the external environment; and sporadic outbreaks of civil unrest in South Sudan, including attacks on traders and disruptions to the trading routes between Uganda and South Sudan. In addition, as of August 2016, the World Bank froze new lending to Uganda to focus attention on the implementation of existing projects, which development could have affected investor confidence.

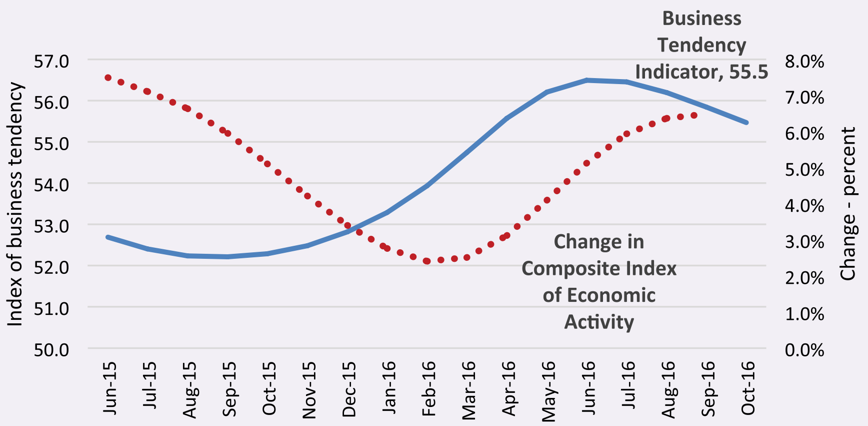
**The most recent domestic shock relates to upheavals in the financial system that have resulted in a deceleration to the provision of credit to the private sector.** This deceleration is largely the result of the sector-wide increase in non-performing loans and the Central Bank takeover of the management and subsequent resolution of the Crane Bank, one of Uganda's four largest private banks by 2016. At the same time, adverse weather incidents related to the el nino and la nina phenomena severely affected agricultural output, with the sector expected to continue to perform poorly for the remainder of the year. In terms of external factors, the effect of the poor performance of the global economy has been exacerbated by the outcomes of the Brexit referendum and the United States presidential elections, both of which have resulted in increased uncertainty.

**These shocks have had a combined negative impact on private investment.** First, in spite of the easing of monetary policies, there have been ongoing indications of financial distress in the economy, with a number of businesses urgently requesting government assistance and others declaring bankruptcy. With a reduction in the volume of trade and a decrease in money flows between Uganda and South Sudan as a result of the ongoing civil unrest in the latter, the impact of the Government's delayed payments to the suppliers of goods and services became more apparent. In July, the Government announced a plan to implement a package of measures, including the payment of all domestic arrears as a means to alleviate the pressure on distressed local businesses.[2] However, the Government's persistent difficulties with the delivery of public investments and the persistent global political and economic uncertainties continued to undermine private sector confidence.

**Uganda's public investment program has continued to be affected by significant implementation challenges.** Progress towards the completion of major projects, particularly the Karuma and Isimba hydroelectric projects, was somewhat slower than had been anticipated. In FY 2015/16, the average rate of execution for these projects stood at only 53 percent. This low rate of progress was largely the result of issues related to the involvement of a new major financer, Exim Bank, with delays resulting from resettlement procedures and insurance and disbursement arrangements. In addition, a number of quality issues affected these projects, with the most significant of these issues being the development of cracks in the dam walls. The need to establish commissions of investigation to address these issues may have resulted in a deceleration to the pace of execution. By the end of the first quarter, total development expenditure was estimated to have reached a value of only Shs 1,558 billion, almost Shs 200 billion lower than the level projected at the beginning of the year. This shortfall is expected to more than triple by December 2016, at the end of the first half of the financial year. Thus, in total, the annual rate of growth of public investment may be less than 8 percent in FY 2015/16. The World Bank's decision to suspend new loans to Uganda has focused public attention on the issue of the slow delivery of investment projects.[3]

**While economic activity increased following the completion of elections and into the fourth quarter of FY 2015/16, there has been a subsequent deceleration**. Bank of Uganda compiles indicators such as the business

Figure 2: Sectoral Annual GDP Growth Rates




*Source: Bank of Uganda*

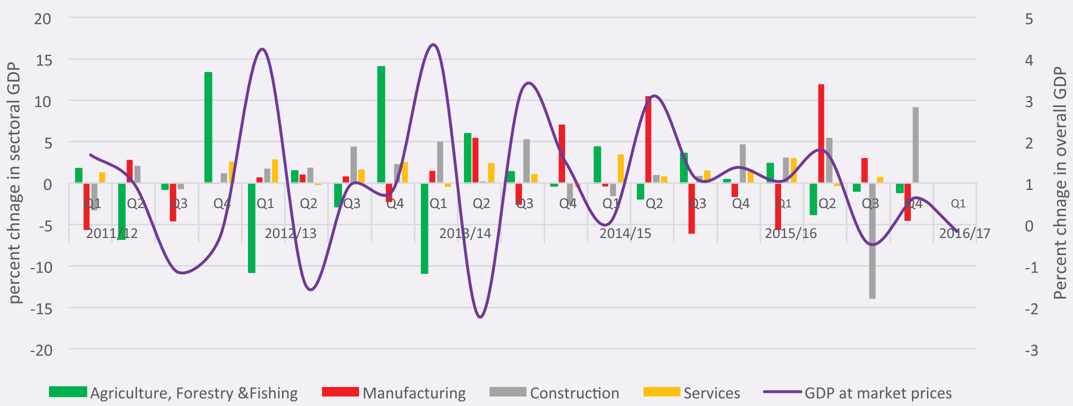
2 The Auditor General's report for June 2015 estimated arrears totaling Shs 1.3 trillion (about 5% of the FY 2016/2017 budget). The report expressed concern that despite the Government's commitment control system, the total amount of arrears has been increasing; and called upon the Government to clear them

3. Effective August 22, 2016, the World Bank Group took a decision to suspend new lending to Uganda, while reviewing the country's portfolio performance and social impacts in consultation with the Government of Uganda.

tendency indicator and composite index of economic activity, to provide advance indications of trends in economic activity. The business tendency indicator improved significantly in the period from February to June 2016. However, in the four month period up until September 2016, there was a gradual deterioration, with the indicator declining to 55.5. Similarly, the rate of increase in the composite index of economic activity also declined during the first quarter of the year (see Figure 2).

**The developments described above had their most significant impact on the manufacturing and trade services sectors. By contrast, the poor performance of the agricultural sector was largely due to adverse weather conditions.** According to UBOS quarterly data, the construction sector grew by 9.2 percent during the first quarter of FY 2016/17, significantly higher than the 4.7 percent recorded in the same period of the previous year, and also reversing the decline recorded during the last quarter of FY 2015/16. This good performance was mainly driven by the increase in construction activity on recently started government projects. By contrast, the manufacturing sector declined by 4.7 percent during this period, reversing the recovery that had been recorded during the second half of FY2015/16. The agro-processing sub sector recorded the largest decline, mainly driven by the shocks to the supply of raw materials from the agricultural sector. Similarly, the rate of growth of the trade sector decelerated to 0.7 percent, significantly lower than the 1.5 percent recorded in the first quarter of FY 2015/16. The agricultural sector performed poorly as a result of harsh and unpredictable weather conditions related to the el nino and la nina phenomena. During the first quarter of FY 2016/17, the sector declined by 1.1 percent, continuing the downward trend observed in the previous half-year. Cash crops recorded the most severe decline, at 5.5 percent. The sustained decline in food production has had a significant impact on the welfare of the poor. By October 2016, a significant proportion of the population in number of districts were facing hunger and starvation, with around 80 districts calling for food relief assistance from the Government.

Figure 3: Sectoral Annual GDP Growth Rates are Volatile but Generally Low Recently



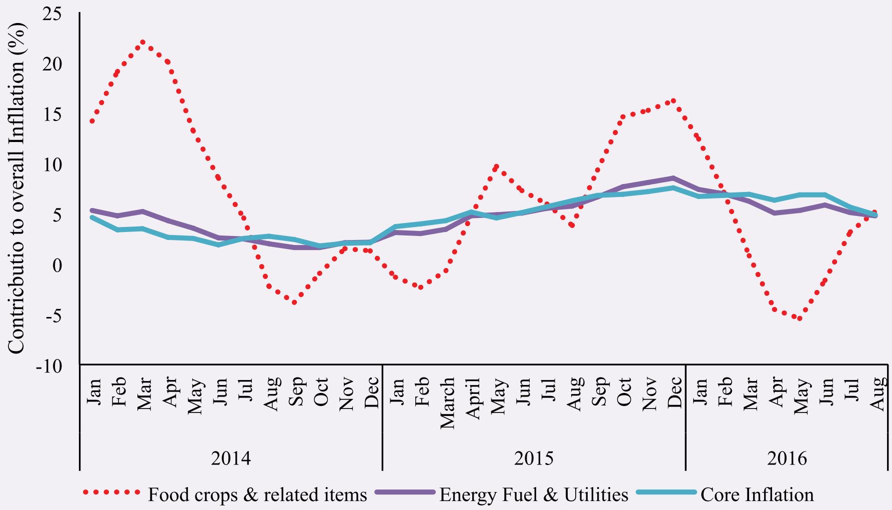

*Source: Uganda Bureau of statistics*

**Overall, economic activity in Uganda declined by 0.2 percent, a stark contrast to the positive growth rate of 0.6 percent realized in previous quarter and a reversal of the recovery that had started after the February 2016 elections**. With this subdued performance expected to have continued into the second quarter of the year, the Ugandan economy may not be able to achieve a growth rate higher than 4.5 percent in FY 2016/17. While this rate is roughly the same as has been recorded in recent years, it is still significantly lower than the average rate of it 6.5 percent recorded over the past two decades and by regional peers.

## 1.2 Low inflation and sustained monetary policy easing but no stimulus on credit

**Uganda has continued to record low inflation close to the targeted level of 5 percent.** This is significantly lower than the average rate of 22 percent recorded in the nine-month period following the 2011 elections. In the period from March to June 2016, food prices declined as agricultural supply continued to benefit from earlier good weather. After July, this trend was reversed, largely due to the deterioration in weather conditions. However, the increase in food prices was modest, being fully offset by a decline in the prices of electricity, fuel, and utilities and in the overall non-food inflation rate, due mainly to the falling cost of imported oil. Another factor was the relatively stable value of the Ugandan shilling. The value of the shilling stabilized as market sentiments regarding domestic policies improved. However, actual gains from the dramatic decline in global oil prices were lower than the potential, on account of exposure to the decline in other commodity prices and depreciation in the value of the currency. During the first quarter of FY 2016/17, average annualized inflation stood at 4.7 percent, with pass-through from poor weather conditions in agriculture still limited.

Figure 4: Inflation has remained low and stable, in spite of volatile food prices



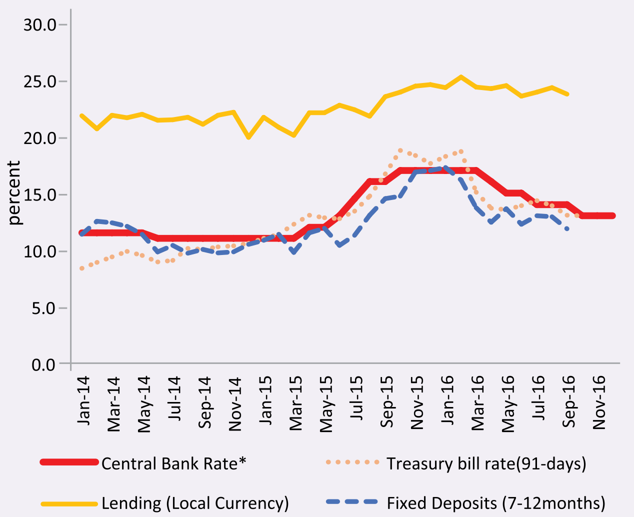

*Source: Uganda Bureau of Statistics*

**With expectations that inflationary pressures will remain low, the Central Bank has continued to implement looser monetary policies in order to stimulate economic growth.** The Central Bank foresees a further reduction in the output gap, depending on the level of adherence to the fiscal budget; food price inflation developments; and the external environment. The CBR was further reduced to 12 percent in December 2016, following a lowering to 15 percent at the end of FY 2015/16.

> GROWTH IS MAINLY DRIVEN BY PUBLIC INVESTMENTS, AS PRIVATE INVESTMENTS STRUGGLE TO OVERCOME TIGHT LIQUIDITY CONDITIONS AND THE HOST OF SHOCKS INCLUDING WEATHER, SOUTH SUDAN CONFLICT AND GLOBAL UNCERTAINTY

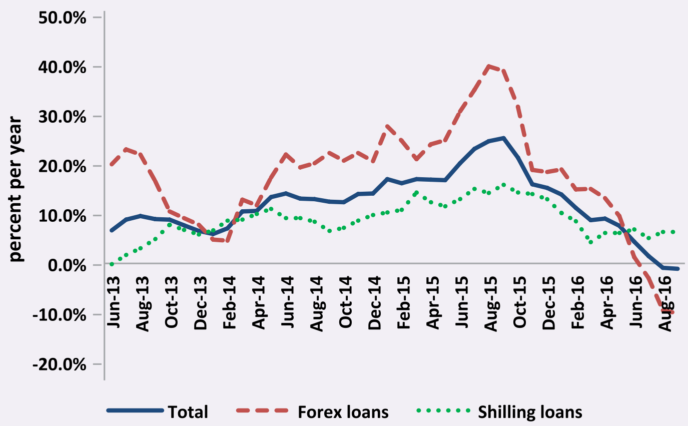
**While interest rates on both treasury bills and deposits in commercial banks have been responsive to monetary policy signals, commercial banks have revised their lending rates only slowly, maintaining high interest margins.** With commercial banks becoming aware that the CBR had reached peak levels in February 2016 (the month of the elections), banks began to reduce their fixed deposit rates, leading the policy curve by about two months. In subsequent months, the rates for fixed deposit and treasury bills were also reduced. Indeed, for the six-month period ending in September 2016, both treasury bills and fixed deposit rates declined by 5 percentage points in each case, compared to the decline of three percentage points in the CBR. However, commercial lending rates declined to a far lesser extent, with a significant time lag (see Figure 5). By October 2016, these rates had declined to only 23.9 percent, compared to the rate of 24.7 percent recorded in December 2015. This asymmetrical behavior is reflected by commercial banks' persistently high interest margins, as has been discussed in previous editions of this Update, and is further investigated in the second part of this report.

Figure 5: Lending rates not declining as quickly as other interest rates




*Source: Bank of Uganda*

Figure 6: Private sector credit has decelerated since October 2015




*Source: Bank of Uganda*

**Despite the looser monetary policies, liquidity conditions[4] have remained tight, and the rate of growth of private sector credit has declined persistently over the past year.** The year-on-year growth rate for private sector credit declined to -1.6 percent by September 2016 (see Figure 6). The commercial banks declined to adjust lending rates downwards, partly to enhance their risk management practices and to tighten lending standards, especially in the case of loans of foreign currency. This behavior was necessitated by the deterioration in the quality of loans and the increased recognition of foreign exchange risks. As a result, commercial banks have drastically reduced foreign currency denominated lending, with the stock of these loans 10.1 percent lower than the levels recorded a year ago (as of the end September 2016). With the revaluation of these loans to eliminate the effect of depreciations in the value of the currency, the decline is even more significant. This has had major implications to liquidity, given that credit denominated in foreign currency still accounts for more than 40 percent of the total loans.

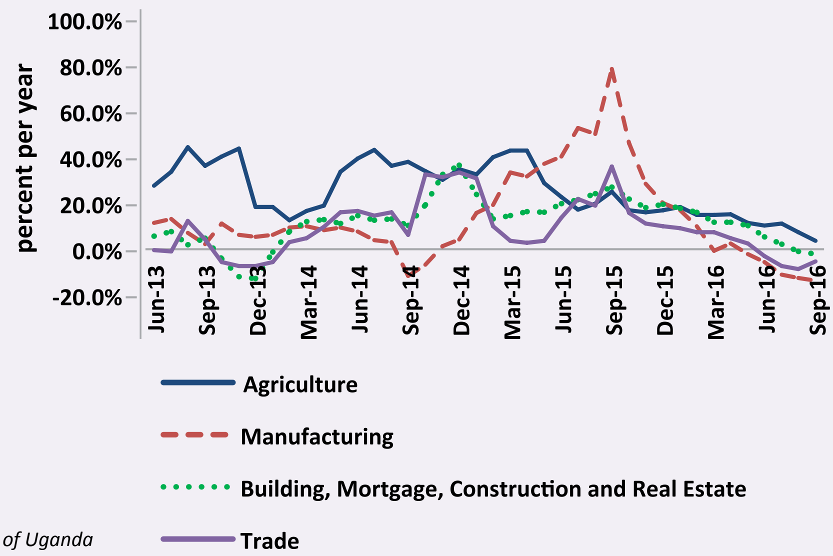
**Also contributing to cash flow strains, the Government has accumulated a significant volume of arrears for goods and services supplied by the private sector.** This, in addition to the high cost of credit and the feared exchange rate exposure, has made it difficult for some firms to honor their bank loans on schedule. In fact, during the first quarter of FY 2016/17, it was reported that a number of firms were under financial distress and required a government bail-out to a value of around US$ 386 million. This financial distress was partly attributed to the high cost of financing from commercial banks and partly to the high level of government arrears, with the total value of these arrears standing at around US$ 446 million. Additional contributing factors to complaints from the corporate sector were the congested, costly public services that have rendered the business environment uncompetitive.

**In the 12-month period to September 2016, the rate of growth of credit to all sectors declined, despite the gradual unwinding of tight monetary policy.** Across the different sectors, loans to building and construction, trade, manufacturing, and the personal and household sectors continue to account for the bulk of private sector credit, comprising more than 70 percent of the total stock. In the building and construction sector, which currently accounts for the largest proportion of private sector credit (22.5 percent of total), the volume of loans declined by 2.4 percent from the level recorded in September 2015. In the trade sector, these loans declined by 6.9 percent over the same period. In this sector, the impact of the exchange rate volatility jeopardized business activities by raising the cost of importation, and subsequently the price of imported goods on the domestic market and operational costs. These key components are mostly denominated in dollars, while business revenues

4. Liquidity conditions can be defined as the ability of firms, individuals or households to access money for day to day transactions

are denominated in shillings. The decline in the volume of loans to the manufacturing sector was even more dramatic, at 13.7 percent, deepening the declines recorded in the five months prior to this period (see Figure 7). Instability in South Sudan severely affected both trade and manufacturing activities, given that South Sudan was a key business outlet for a wide range of trade activities and a key market for goods manufactured in Uganda. These developments mainly affected the large borrowers as banks reduced their exposure due to resultant non-performing loans. However, there was also a significant drop in the volume of loans to the business services sector, which largely consists of SMEs, which are deemed to be relatively high risk customers. Only in the case of the personal and household sector has there been a sustained positive growth rate, reaching 9.5 percent.

Figure 7: Deceleration in credit across all sectors




*Source: Bank of Uganda*

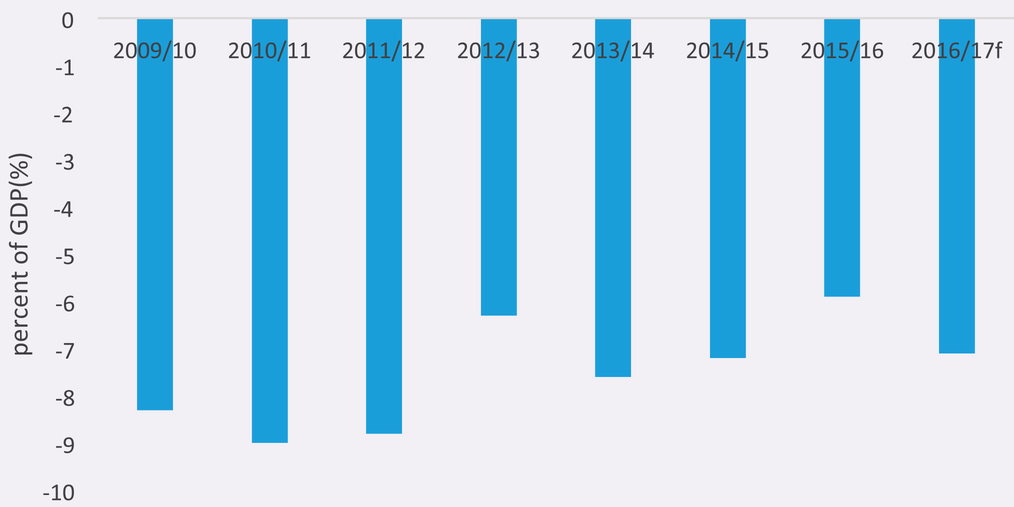
## 1.3 A weakening external position deflated activity in sectors with external links

**In recent years, the most significant causes of distress to Uganda's external resource flows has been the South Sudan crisis and remaining uncertainties about oil.** By 2013, South Sudan had become the largest destination for Ugandan exports. However, this market has since become extremely unpredictable as a result of the outbreak of serious unrest in that country and of the resulting intermittent blocking of trade routes to Uganda. In addition, the external environment continues to be very unfavorable to Uganda, with the global economy remaining weak, constraining demand for Uganda's exports and the flow of foreign direct investments, especially into the oil sector. While global prospects began to improve during the current financial year, with a consequent increase in commodity prices, this was followed by significant uncertainties related to the Brexit referendum and the US presidential elections. In addition, the severe drought has had an impact on the production of agricultural commodities for export, particularly maize and beans.

**In the context of these developments, Uganda's current account has remained very weak.** The current account sustained a deficit of an average value of 7.1 percent of GDP in the period from FY 2011/12 to FY 2015/16. In the period from FY 2013/14 to FY 2015/16, Uganda's current account balance improved slightly, declining from a deficit of 7.6 percent of GDP to 5.7 percent. This was mainly the result of a deceleration in the growth of imports of goods and services as Uganda benefitted from the low international oil prices and the declining FDI reduced the country's project-related imports. In addition, while tourism receipts declined on account of election-related uncertainties, the value of secondary income, the bulk of which is private transfers, increased steadily from US $ 1,204 billion during FY 2013/14 to US$ 1,543 billion by

FY 2015/16. For FY 2016/17, there are indications that the current account deficit could increase to a value above seven percent of GDP, with South Sudan markets remaining risky or completely closed; global oil prices continuing to increase and therefore exerting upward pressure on the import bill; the Government investment program accelerating; the tourism receipts reducing in response to new developments including the Kasese clashes in western Uganda and avian flu outbreak; and transfers declining as a result of global uncertainties. Therefore, the value of imports is expected to increase from 18 percent of GDP in FY 2015/16 to 20.4 percent in FY 2016/17, while a deceleration in the growth of exports will see these inflows paying for only 55 percent of the import bill. Already, during the first quarter of FY 2016/17, the trade and services deficits worsened to US$ 395 million and US$ 255 million respectively, largely because of these factors.

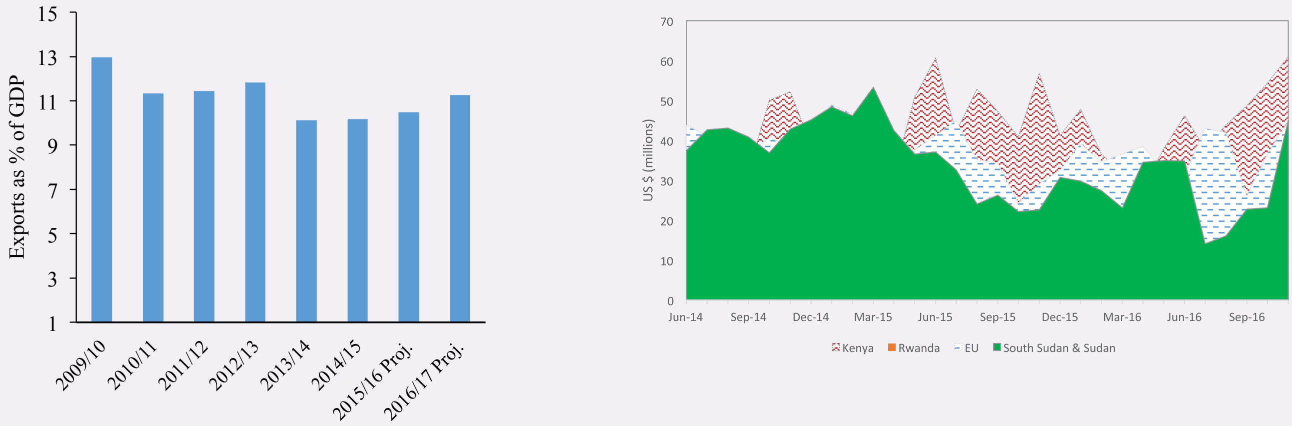
Figure 8: Improvement in External Current Account in recent years is expected to be reversed




**The poor performance of exports is largely the result of the failure to diversify exports into higher productivity goods that are less sensitive to commodity price movements.** In the period from FY 2011/12 to 2015/16, the average value of exports stood at 10.9 percent of GDP. This was far lower than the average value of 12.4 percent of GDP recorded in the previous five-year period. Traditional export commodities such as coffee and tea still constitute around 30 percent of the total value of exported goods. Due to weak global demand, these exports have not performed well. Rather, growth was driven by an increase in the value of non-traditional exports, including metal and plastic products, bottled water, and rice. Markets for these non-traditional exports are mostly located within the region. During FY 2015/16, the value of exports to regional markets grew by only 3.1 percent, mainly attributable to the reduced demand from South Sudan. The resurgence of unrest in South Sudan around July 2016 was followed by a steep decline in the volume of exports, with the value declining by at least 72 percent, from US$25 million to US$7 million in the period from June to July 2016.

UGANDA HAS CONSISTENTLY INCREASED ITS HEADLINE FISCAL DEFICIT OVER THE PAST THREE YEARS, WITH THIS DEFICIT EXPECTED TO REACH A VALUE IN EXCESS OF 6.0 PERCENT OF GDP

Figure 9: Exports Grew Marginally as Some Markets Closed

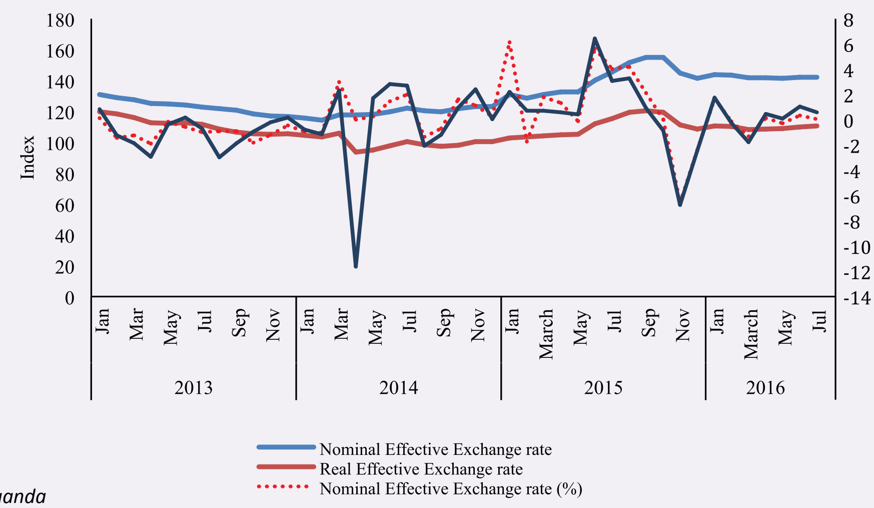



*Source: Bank of Uganda*

**With FDI declining over the past three years, the financial account has also remained weak.** In FY 2013/14, the total value of FDI inflows stood at around a billion dollars. In FY 2015/16, the value of these inflows had almost halved to US$ 512 million, equivalent to only 2 percent of GDP. According to the FDI survey conducted by the BoU, FDI continues to primarily take the form of investments in the natural resource sectors, such as oil exploration and tourism. It remains a challenge for Uganda to stimulate efficiency-seeking investments outside the natural resources sectors and to generate broader linkages within the economy, including through the promotion of intra-regional FDI. The value of disbursements on concessional external loans to the Government increased only modestly from US$ 322 million to US$ 436 million, but reversed the decline recorded in FY2011/12. Therefore, it was the non-concessional borrowing, which increased from US$ 81 million to US $ 371 million, and hence closed the funding gap over this period.

**The value of the shilling remained relatively stable throughout most of FY 2015/16, largely due to the tight monetary policy stance that remained in place throughout most of the year.** The currency depreciated by 5.3 percent over FY 2015/16, with much of this loss in value occurring during the first half of the year, particularly in the period from June to September 2015. After some months of appreciation and a few blips in the daily rate in the period around the February 2016 elections, the value of the shilling remained quite stable, recording only a marginal depreciation of 0.5 percent over the six months leading to September 2016. The stable exchange rate suggests that the adjustment to the weakening external sector was conducted through the implementation of a tight monetary policy stance and a reduction in forex reserves, which declined from 4.9 months of import cover to 4.6 months in the period from FY 2014/15 to 2015/16. With much of the loss in value resulting from the

Figure 10: A Gradual Depreciation of Shilling is Consistent with Weak External Position




*Source: Bank of Uganda*

strengthening of the US dollar against other currencies, the depreciation of the nominal effective exchange rate was much lower, standing at 1.4 percent, then appreciating by 1.8 percent during this year.

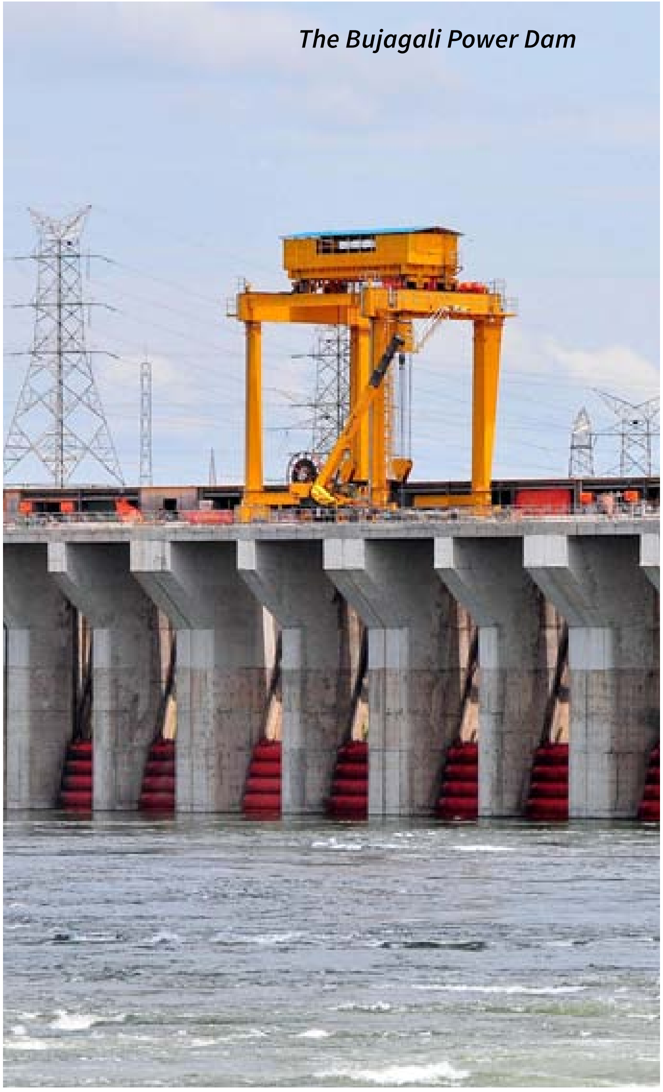
**However, the currency has recently become increasingly volatile as a result of the ongoing weakness in the external sector.** The value of the shilling depreciated by 0.4 percent in the period from June to September 2016, with further depreciation from November 2016 pushing the exchange rate to levels in excess of Shs 3600 per dollar. By end December 2016, the value of shilling was 7 percent below the level recorded 12 months earlier. Uncertainties related to both local and external events, including the freezing of new loans by the World Bank and the impact of the results of the Brexit referendum and the US presidential election being the most significant causes of this uncertainty. This is notwithstanding the fact that the Government has contracted balance of payments support credit from PTA Bank to provide the BoU with sufficient resources to prevent spikes in the foreign exchange market when the need arises.

## 1.4 The large investment program keeps fiscal deficit high, yet spending pressures are rising

**Uganda has consistently increased its headline fiscal deficit over the past three years, with this deficit expected to reach a value in excess of 6.0 percent of GDP during this year.** This is consistent with the implementation over the past several years of an investment-driven fiscal policy intended to stimulate economic growth. The FY 2016/17 National Budget envisaged that the total value of expenditure would increase from the level of 22.1 percent of GDP recorded in FY 2015/16 to 22.4 percent, with the construction of key infrastructure projects intended to address constraints on private investments and to enhance the productive capacity of the economy continuing. Consistent with this objective, the value of resources allocated to the transportation sector was raised to 19 percent of the total budget, from 15 percent in FY 2015/16. The allocations to the energy sectors also remained sizeable, at 12 percent of the total budget, even though it was lower than the figure of 15 percent recorded during the previous year.

**Meanwhile, in a bid to enhance human capital, skills development and health outcomes, 12 percent of the budget was allocated to the education sector and 7 percent to the health sector.** The allocations to the education and health sectors increased by 44 percent and 26 percent respectively relative to allocations in FY 2015/16. A significant proportion of the expenditure in the educational sector has been allocated to facilitating the transition of graduates from formal education into productive economic activities through strengthening the capacity of Business Technical and Vocational Education Training (BTVET) in skills development. Health expenditure has been directed towards strengthening interventions aimed at enhancing the availability of healthcare workers at health centers and reducing maternal and infant mortality. Increased regional security and terrorism concerns necessitated significant increases in the allocations to the

*The Bujagali Power Dam*

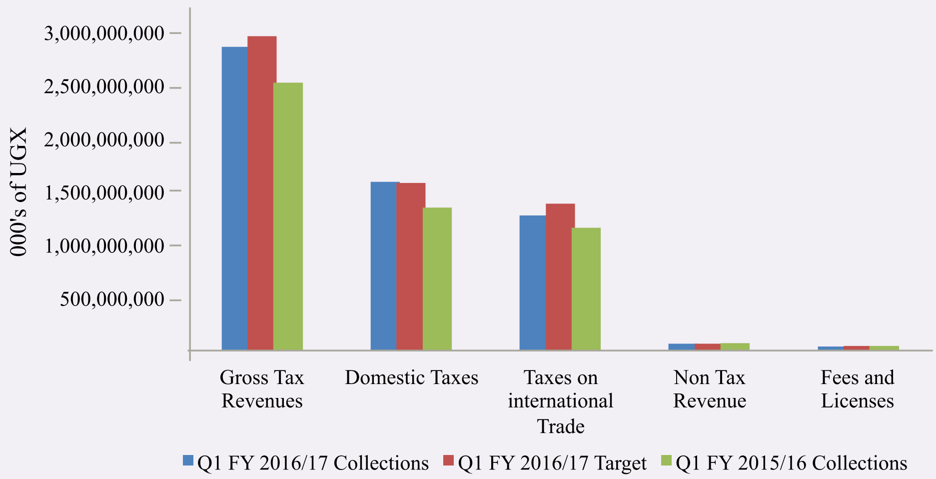


*Morgan Mbabazi, 2016*

*Uganda has consistently increased its headline fiscal deficit over the past three years, with this deficit expected to reach a value in excess of 6.0 percent of GDP* security sector, with these allocations increasing to 8 percent of the total budget. Allocations to agriculture were increased to 4 percent of the total budget in an attempt to increase productivity growth in the sector. Public administration and interest payments had been budgeted to reduce their share in the budget. With domestic revenues forecast to increase to 14.4 percent of GDP, the fiscal deficit was expected to reach to reach 6.4 percent of GDP in FY 2016/17, with more than 80 percent of the fiscal deficit funded through external borrowing, the bulk of which was to be derived from commercial sources (non-concessional loans).

**However, both the lower than expected domestic revenues and the decline in the value of aid inflows have complicated the implementation of the FY 2016/17 budget.** As a result of decelerating growth and disruptions to trade, the Uganda Revenue Authority did not collect the level of revenues targeted at the beginning of the year, with the resulting shortfalls requiring the Government either to source alternative financing or to reduce expenditures. In the first quarter of FY 2016/17, the value of collected tax revenues amounted to Shs 2.86 trillion, representing a shortfall of about 3.2 percent relative to the targeted level, largely due to the lower than expected level of international trade taxes. Specifically, VAT on imports fell short of the target by 15 percent; import duty by eight percent; excise duty on imports by 34 percent; and withholding tax collections by 41 percent. Together, the total value of the gap between the revenues collected and the targets amounted to Shs 157 billion. The value of collected revenues was also lower than in the corresponding period of FY 2015/16. The collection of direct domestic taxes was also lower than the targeted level during this quarter, as a result of shortfalls in corporate taxes (34 percent), presumptive taxes (97 percent) and withholding taxes (19 percent). Overall, domestic revenue mobilization is projected to reach 14 percent of GDP, which is 0.4 percentage points lower than the original target. Uganda's revenue collection performance continues to significantly lag those of its peers in the EAC.[5] While external grants may reach the targeted levels of 1.8 percent of GDP by the end of the year, they too have so far not performed as well as expected, with disbursements of only Shs 142 billion, a value equivalent to only 0.1 percent of the expected annual value of Shs 1.718 billion. The amounted disbursed is also much lower than the figure of Shs 483 billion recorded in the same period in the previous year.

Figure 11: The value of domestic revenue collected during the first quarter was below target




*Source: Uganda Revenue Authority*

**So far, the revenue shortfalls have been absorbed exclusively through under-execution of the development budget.** However, recurrent expenditures also remain under pressure. During the first half of FY 2016/17, 50.2 percent of the approved recurrent budget had been released, almost equally spread across the sectors. This is in line with the efforts to continue to contain non-wage recurrent expenditures. For instance, public training and workshops are now required to be conducted through public training institutions such as Uganda Management Institute, rather than being conducted in hired out space at hotels. However, in the post-election period, when there are pressures to honor election pledges, the Government found it difficult not to increase recurrent expenditure, particularly since most of this expenditure consists of the wage bill for teachers and civil servants, and for public administration. Moreover, during the first half of the year,

5. In FY 2015/16 domestic revenue as a share of GDP stood at 23 percent in Kenya, 17.6 percent in Tanzania, 14.3 percent in Rwanda and 14.8 percent in Burundi.

Uganda has faced a number of shocks, with some implications to fiscal operations. The drought increased the need for expenditure on food relief.[6] During this part of the year, lecturers of Makerere University also conducted strike action due to non-payments of their allowances, a development which led to the indefinite closure of the university and the establishment of a commission to investigate the issue. In addition, there was agitation from some health professionals due to the non-payment of salaries and allowances; demands by school teachers for better pay; and an outbreak of hostilities in the Kasese region in western Uganda, leaving more than 100 dead and heightening security concerns in the area. These events are likely to result in supplementary expenditures.

**In terms of development expenditure, whereas releases for the first half of the year were in excess of 50 percent of the budgeted total, the actual execution of key projects is still being affected by delays.** The construction of the Karuma and Isimba hydroelectric projects, both funded by Exim Bank of China, seems to be accelerating, as both implementing agency and contractors move up the learning curve.[7] For other externally funded projects, including those in the road sector, the World Bank's cancellation of one project and the suspension of the transport component in two others due to lack of attention to social safeguards has slowed down activity in that sector and resulted in delays to the disbursement of funds by external financiers. This has resulted in a slowdown in the rate of execution in a sector where the average disbursement rate did not exceed 60 percent in FY 2015/16. The domestically funded projects did not perform much better in terms of execution. For example, the agriculture sector absorbed only 52 percent of the funds released, mainly on account of the poor performance of the National

Table 1: Recurrent expenditure increasing gradually under weight of interest and non-wage expense

| In percent of GDP | FY2013/14 | FY2014/15 | FY2015/16 | FY2016/17 App. Budget | FY2016/17 Proj. |
|---|---|---|---|---|---|
| Revenues and grants: | 12.6 | 14.2 | 14.9 | 16.2 | 15.9 |
| **Domestic revenues** | **11.6** | **13.0** | **13.5** | 14.4 | **14.0** |
| o/w Tax revenues | 11.1 | 12.3 | 12.8 | 13.6 | 13.3 |
| **External Grants** | 1.0 | 1.2 | 1.4 | 1.8 | 1.8 |
| | | | | | |
| **Total expenditure** | **16.6** | **18.5** | **19.7** | 22.5 | **21.9** |
| Recurrent | 9.5 | 9.9 | 10.8 | 10.4 | 10.4 |
| Development | 7.1 | 6.7 | 6.9 | 9.8 | 9.6 |
| Domestic Development | 4.4 | 4.2 | 4.1 | 4.7 | 4.5 |
| Externally Financed Projects | 2.7 | 2.5 | 2.8 | 5.1 | 5.1 |
| Net Lending & Investment | 0.0 | 1.6 | 1.8 | 1.9 | 1.6 |
| o/w Hydro-power Project | 0.0 | 1.3 | 1.8 | 1.9 | 1.6 |
| Other (e.g. Clearance of domestic arrears) | -0.5 | 0.3 | 0.2 | 0.4 | 0.3 |
| | | | | | |
| **Overall balance** | **--3.5** | **-4.4** | **--5.2** | **-6.2** | **-6.0** |
| | | | | | |
| External Financing | 1.3 | 1.2 | 2.9 | 5.4 | 5.3 |
| Domestic Financing | 2.2 | 3.2 | 2.2 | 0.9 | 0.7 |
| o/w Petroleum Fund withdrawals | 0.2 | 2.1 | -0.1 | -0.1 | -0.1 |
| *Memorandum items:* | | | | | |
| Nominal GDP (Shs billions) | 70,458 | 77,845 | 84,907 | 92,878 | 93,939 |

*Source: Ministry of Finance, Planning and Economic Development, IMF, and World Bank*

6. By mid-November2016, Government had received alerts for food support from 80 out of the 112 districts and estimated that up to seven million people were in urgent need of food, a situation that was expected to extend to March 2017. The most affected areas are in the cattle corridor zone. Nonetheless, it was anticipated that if the September-December planning season failed too, then the situation was to become a catastrophe for a larger part of the population.

7. Since the Karuma project started in FY 2013/14, the rate of disbursement has been gradually increasing (from 1% in FY 2013/14, to 41% in FY 2014/15 and to 53% in FY 2015/16), as the different parties involved in the process appreciate the requirements, while also the issues related to insurance, compensation, and management fees have also been resolved.

Agriculture Advisory Development Secretariat (NAADS), which absorbed only 33 percent of its Q1 FY 2016/17 release. With this underperformance during the first half of the year, it is expected that total development expenditure will reach a value equivalent to only 9 percent of GDP, almost a percentage point lower than the budgeted level.

**Despite these factors, the fiscal deficit will still increase relative to the previous year as a result of the many competing demands on the budget and the sluggish revenues available to the Government.** Total expenditure is expected to reach 21.9 percent of GDP, only half a percentage point lower than projected in the budget. However, due to the increase in recurrent expenditure and the lower than targeted revenues, the fiscal deficit is still projected to reach six percent of GDP. This would be 0.2 percentage points lower than targeted in the approved budget, but still one of the largest fiscal deficits in Uganda for more than a decade. Consistent with the plans set out in the budget, more than 85 percent of this deficit is to be funded by drawing on external resources, with the authorities endeavoring to minimize domestic borrowing. During the three years prior to FY 2015/16, the high level of domestic financing had increased the level of vulnerability of public debt, given its short-term nature, and increased the risk of crowding out the private sector, with increases in interest rates increasing the cost of credit.

**THE VALUE OF THE SHILLING REMAINED RELATIVELY STABLE THROUGHOUT MOST OF FY 2015/16, LARGELY DUE TO THE TIGHT MONETARY POLICY STANCE THAT REMAINED IN PLACE THROUGHOUT MOST OF THE YEAR.**

*Morgan Mbabazi, 2016*

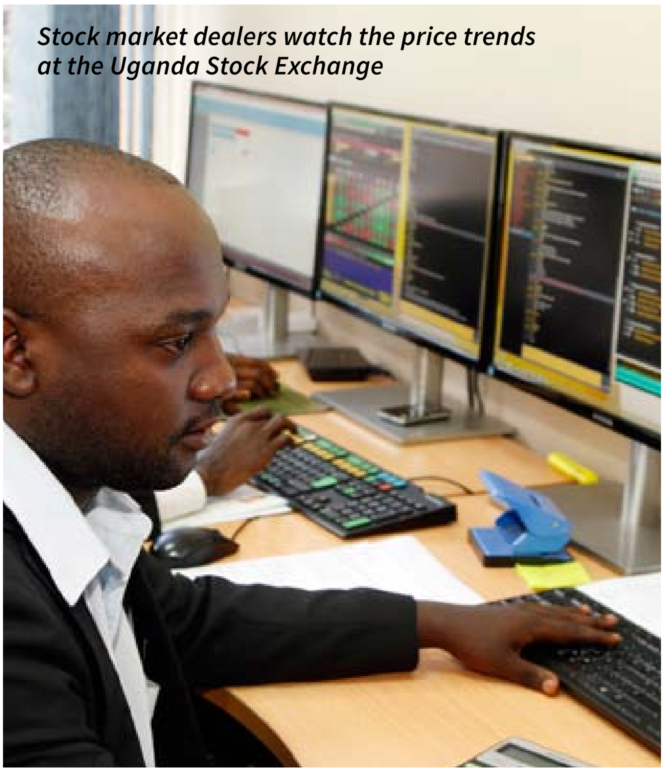
*Organizing finances at a village savings association*

## 2.0 Economic Outlook

*Uganda's economy is expected to grow at less than 5 percent during FY 2016/17, accelerating gradually to about 6 percent in the subsequent two years. These relatively low rates are due to a number of shocks, including much lower trade with South Sudan, the low credit from the financial system, bad weather, and an uncertain global economy. With these shocks particularly affecting private investment, it is expected that public investments intended to address infrastructure constraints and prepare Uganda for oil production will continue to be the main driver of growth. The main risks include those related to fiscal management in the face of huge spending pressures and to the possibility that the investment program will not result in higher levels of growth if it is not properly implemented, potentially leading to unsustainable levels of debt. If the financial system fails to provide sufficient credit to support increased private investment, Uganda may remain trapped in a long-term low growth cycle.*

### 2.1 New shocks dampen expectations for accelerated growth

**The World Bank forecasts that the Ugandan economy will grow at the rate not higher than 5 percent in FY 2016/17, with this growth rate remaining roughly unchanged in FY 2017/18.** With the economy adjusting to a number of shocks; with the financial system remaining jittery on account of the high level of non-performing assets and the resolution of issues related to the Crane Bank; with sporadic clashes in South Sudan; with anticipated effects of the news of a breakout of avian flu in Uganda on tourism, production and export of poultry products; and with an uncertain global economy, it is unlikely that there will be a dramatic acceleration in the rate of growth in the second half of the year.[8] The looser monetary conditions and reduced domestic borrowing by the Government to finance large public investments will create a more conducive environment for the private sector, with an increased availability of credit as a result of the reduction in the crowding out of private investment that has occurred in recent years. However, as discussed in Section 1.2, commercial banks have recently tightened their lending standards; authorities have made capital requirements more stringent; and banks are becoming increasingly reluctant to grant loans given the recent deterioration in the quality of their loans portfolio. These factors will constrain growth, despite the persistent gains from low global energy prices and from the strengthening of the construction boom. In addition, the construction boom may decelerate if resources are re-allocated from a number of on-going infrastructural projects towards recurrent expenses aimed at mitigating the evolving humanitarian crisis attributed



*Stock market dealers watch the price trends at the Uganda Stock Exchange*

*Morgan Mbabazi, 2016*

*With the economy adjusting to a number of shocks; with the financial system remaining jittery; with sporadic clashes in South Sudan, and an uncertain global economy, it is unlikely that there will be a dramatic acceleration in the rate of growth in the second half of the year*

8. The IMF too concluded the 6th PSI review on November 2016, revising its growth forecast for FY 2016/17 to 5.0 percent

to the severe drought. Therefore, the overall rate of growth for the year is expected to remain at roughly the same level as in FY 2015/16. It is still expected that this growth outcome will continue to reduce poverty by an estimated 0.7 percentage points per year over 2016-2018, although this could mainly be recorded in the central and western regions, widening regional spatial disparities.

**It will be necessary to implement monetary policy in a manner that maintains the delicate balance between stimulating the economy and continuing to control inflation.** In the next few months, the monetary authorities may be inclined to tighten monetary policy to curtail inflationary pressures resulting from food price increases and the depreciation in the value of the currency. Moreover, if international oil prices continue to increase, the domestic prices for many imported goods may also rise, hence contributing to inflation. Once policy rates start to increase, commercial banks will have a justification to tighten credit further. In this context, it can be expected that the level of private investment will remain low, or at least will increase only gradually. In terms of the public sector, if efforts to improve the implementation of World Bank projects are sufficiently successful to justify lifting the freeze on new lending, it may have spill-over effects that will enable public investments to remain the key driver of investments for the next few years.

**With an acceleration of implementation of major public investment projects, the economy should grow at a slightly higher rate in FY 2017/18, reaching the level of around 5.2 percent.** The economy will also derive some benefits from low energy prices, particularly if investors take advantage of the associated low cost of imported inputs. Economic activity, particularly in oil-related activities, could also intensify, given the progress that has been made with the arrangements for this industry. In this respect, the Government has already issued the long-awaited exploration agreements, which could accelerate FDI inflows, infrastructure development, employment and the development of local industries. If this occurs, it is expected that the stimulus effects of an increase in the economic activities in the construction sector, driven by Uganda's significant investments in public infrastructure projects, will offset the effects of a weak external sector on the Ugandan economy. These effects could be expected to carry on through to FY 2018/19, when economic growth is expected to increase to about 6 percent.

**The pattern of growth can be expected to remain the same as in the past decade, with the predominant source of growth being increased economic activity in the construction and services sectors, with the manufacturing sector also continuing to expand, albeit from a very small base.** Though still only contributing to a small proportion of GDP, the mining and quarrying sector could be a significant source of further growth in coming years, as the sector's proven potential starts to attract increased attention from investors. Growth in the output of the agricultural sector will continue to be subdued due to supply-side constraints, a development which further reduces prospects for faster poverty reduction.

**The very uncertain global outlook will continue to have a negative impact on exports, especially to the USA and the EU. It will also have an impact on foreign direct inflows and on private transfers.** These effects will exacerbate the already adverse effects of the protracted political crisis in South Sudan, which until recently was Uganda's fastest growing export market. These developments, in combination with an increase in imports for infrastructure projects, will result in a further widening of the external current account deficit to a value in the range of 8-10 percent of GDP in FY 2017/18 and FY 2018/19. The capital balance should remain roughly unchanged, unless the expected decline in official aid transfers following the freeze of new loans by the World Bank is offset by a higher level of FDI, particularly in extractive activities. In the short run, the planned increase to public investments will most likely curtail a build-up of international reserves beyond the current levels of about 4.0 to 4.5 months of import cover.

**Fiscal policy will continue to be used as the principal instrument to stimulate economic activity.** During FY 2017/18, total expenditure can be expected to remain high, at around 21 percent of GDP. However, at this level, it will still be lower than the figure of 21.9 percent of GDP recorded in FY 2016/17. It should be noted that this level is still high by regional standards. The major driver of this increase in expenditure is the acceleration of construction works on the Karuma and Isimba hydroelectric plants. Once completed, these projects are expected to double Uganda's power generation capacity. According to the FY 2017/18 National Budget Strategy, accelerating infrastructure development to hasten the realization of investment returns is an important means to improve productivity in the primary sectors. Total expenditure is expected to decline to about 19 percent of GDP following the completion of key one-off investment projects.

**With only limited improvement to revenue mobilization, increased public expenditure is expected to be funded through borrowing.** While revenues are expected to increase by an average annual rate of 0.5 percentage points, these rates are too low to cover increased expenditure. As a result, the deficit will increase to reach 6.0 percent of GDP, before declining to 4.9 percent in the subsequent year. Uganda's authorities had planned to finance the increasing deficit through external borrowing. This followed the realization that the increased issuance of domestic securities to finance the budget risked crowding out private investments. As a result, up to 88 percent of the fiscal deficit will be financed through external loans, with the value of these loans almost doubling to 5.3 percent of GDP during FY 2016/17, before declining slightly to 4 percent of GDP during FY 2017/18.

Table 2: Summary Assumptions for the Medium Term Outlook, Baseline Scenario

| | 2013 | 2014 | 2015 | 2016e | 2017 f | 2018 f |
|---|---|---|---|---|---|---|
| **Real GDP growth, at constant market prices**[,d] | 3.6 | 5.2 | 5.1 | 4.8 | 4.5 | 5.2 |
| Private Consumption | -0.5 | 3.6 | 12.6 | 4.6 | 8.7 | 8.8 |
| Government Consumption | 2.1 | 0.1 | 12.4 | 5.6 | 3.3 | 2.5 |
| Gross Fixed Capital Investment | 9.7 | 2.5 | -0.5 | 8.0 | 7.0 | 10.0 |
| Exports, Goods and Services | 6.7 | 0.2 | -3.5 | 6.9 | 4.0 | 9.0 |
| Imports, Goods and Services | 0.0 | -5.8 | 16.5 | 8.2 | 16.2 | 16.0 |
| **Real GDP growth, at constant factor prices**[,d] | 3.4 | 3.9 | 4.8 | 4.5 | 4.5 | 5.2 |
| Agriculture | 1.8 | 3.0 | 2.3 | 3.2 | 3.3 | 4.0 |
| Industry | 4.3 | 3.9 | 7.8 | 3.0 | 5.0 | 9.0 |
| Services | 3.9 | 4.3 | 4.8 | 5.7 | 6.6 | 5.1 |
| **Prices: Inflation** | | | | | | |
| Inflation (GDP Deflator) | 6.1 | 3.4 | 5.1 | 4.0 | 5.1 | 4.8 |
| Inflation (CPI period average) | 5.0 | 5.2 | 3.0 | 6.6 | 5.4 | 5.0 |
| **Current Account Balance (% of GDP)** | -6.3 | -7.6 | -7.2 | -5.9 | -7.1 | -8.2 |
| **Financial and Capital Account (% of GDP)** | 6.1 | 7.4 | 8.1 | 7.2 | 8.3 | 9.6 |
| Net Foreign Direct Investment (% of GDP) | 5.9 | 6.1 | 3.2 | 2.1 | 4.6 | 4.7 |
| **Fiscal Balance (% of GDP)** | -3.2 | -3.5 | -4.4 | -5.2 | -6.0 | -5.3 |
| **Debt (% of GDP)** | 25.9 | 28.3 | 31.8 | 34.5 | 38.6 | 41.5 |
| **Primary Balance (% of GDP)** | -2.1 | -2.6 | -2.7 | -2.8 | -3.6 | -2.3 |
| **Poverty rate ($2.5/day 2005 PPP terms)**[a,b,c] | 34.6 | 34.3 | 33.9 | 33.5 | 33.0 | 32.4 |
| **Poverty rate ($5/day 2005 PPP terms)** [a,b,c] | 65.0 | 64.7 | 64.3 | 64.1 | 63.6 | 63.0 |

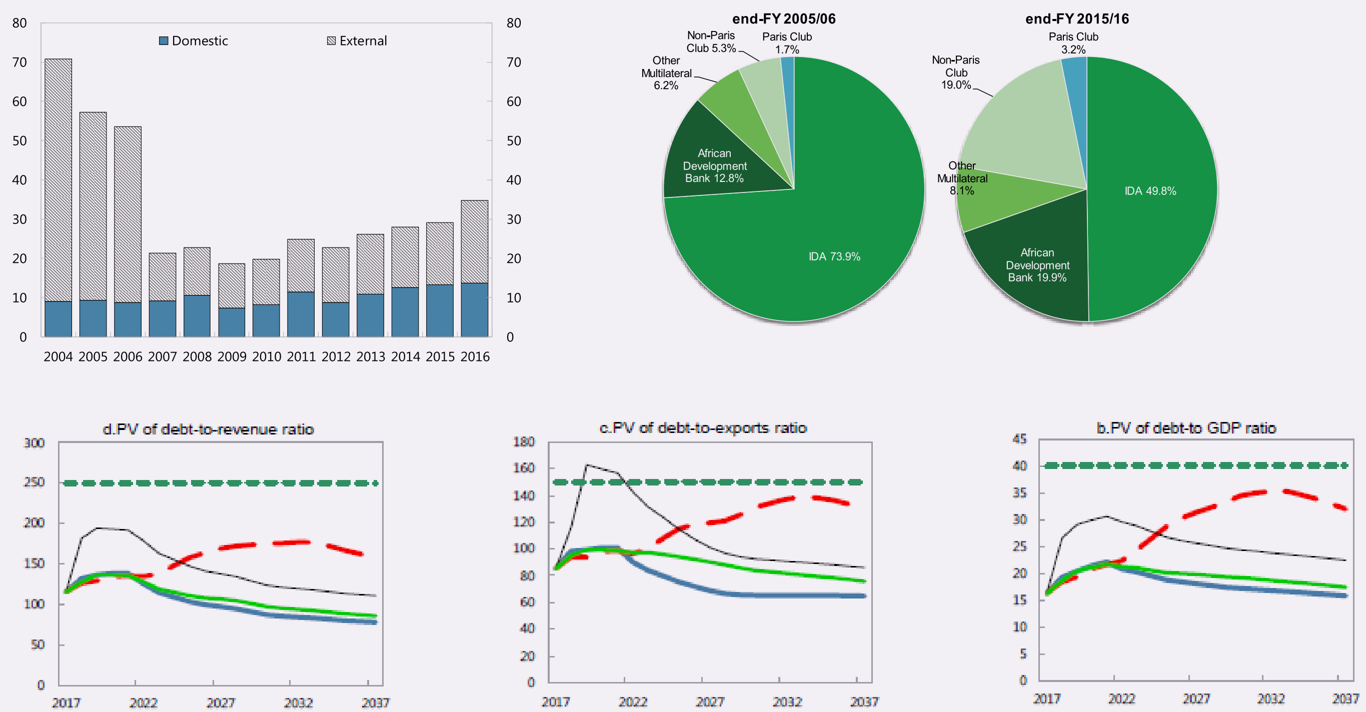
*Sources: World Bank Staff projections*

*Notes: f = forecast*
*(a) Calculations based on 2009-UNHS and 2012-UNHS.*
*(b) Projection using annualized elasticity at the regional level with pass-through = 1 based on GDP per capita constant PPP.*
*(c) Actual data: 20162. Projections are from 2013 to 2018*
*(d) Actual GDP series revised in line with revised numbers from UBOS, after rebasing of the Consumer Price Index.*

## 2.2 Downward risks abound

**The economic outlook faces a number of risks, the most immediate and critical of which relate to domestic developments and the way fiscal management can accommodate them in the context of the low revenue base and to increased spending pressures, both of which could have implications for financing the investment program and the level of debt.** Private investments could stagnate or even decline if Uganda's fragile regional markets are distorted further in the event the tensions in the Democratic Republic of Congo deteriorates into civil unrest following the failure by the Congolese Government to conduct presidential elections, or that the upcoming elections in Kenya are followed with a disruption of trade with Uganda as was the case around the 2007 elections. On the other hand, the financing of public investments is highly dependent on volatile external financing, given that for now, the utilization of domestic resources is limited by the shallow capital market. If the large investment program does not result in improved growth or if projects are delayed significantly, as has been the case with several energy projects, this could also result in rapid increases to the debt-to-GDP ratio, most likely to a level in excess of the threshold of 56 percent of GDP, the present value debt threshold for medium CPIA performers. According to an update to the Joint World Bank/IMF Debt sustainability analysis conducted in November 2016, Uganda continues to be at a low risk of debt distress with the present value of public debt-to-GDP ratio projected to peak at about 36 percent in FY2021.[9]

Figure 12: Evolution of debt historically and in the future




*Sources: Joint Debt Sustainability Assessment by IDA and IMF, December 2016*

9. Under the Country Policy and Institutional Assessment (CPIA), Uganda is classified as a medium policy performer, with a CPIA score of 3.73 (3-year average, 2013–15). All data refer to fiscal years running from July to June (e.g., FY2016 covers July 2015 to June 2016, abbreviated as 2016 in the figures and tables). External debt is defined as foreign-currency denominated debt for purposes of the DSA.

**Uganda's debt sustainability remains vulnerable to a number of variables, a fact that has led to downgrading of the country's long term debt risk by some credit rating firms.** These variables include: (i) the rate at which the shilling depreciates, which affects the cost of servicing external debt; (ii) the rate of GDP growth, fiscal revenue, and exports, which affects the ability to service debt; and (iii) the strength of the institutions, which affects the thresholds for assessing debt sustainability. In particular, the continued failure to collect adequate levels of revenue in the context of a rapid fiscal expansion has contributed to an increase in the risk of debt distress. In November 2016, under its recent assessment of Uganda's credit rating, Moody's downgraded the long-term issuer rating of the Government of Uganda from B1 to B2 but changed the outlook to stable from negative. This was based on what Moody's believed to be the sustained erosion of fiscal strength and rapid increase in the debt burden to 33 percent of GDP, with increases projected to continue towards 45 percent of GDP by 2020. Indicators of reduced debt affordability include a rise in the debt to revenue ratio, which is expected to exceed 250 percent, while interest payments are expected to consume 16 percent of revenues by 2018. The latter far exceeds the median level for B-rated countries, which stands at eight percent. Nonetheless, the stable outlook reflects the fact that Uganda's credit fundamentals will stay at roughly the same level as peers in the B2 category.

**In addition, the share of domestic debt has increased from 8 percent of GDP in FY 2009/10 to 14 percent in FY 2015/16, and is expected to increase to 16 percent in FY 2016/17.** While this may assist in the development of the capital market, it risks crowding out private sector investment, as higher interest rates increase the cost of borrowing. In recent times, with the increasing development of longer term markets, the market has preferred Treasury bonds to Treasury bills. Increased government borrowing has increased the cost of domestic borrowing, with the share of interest on the domestic debt in total interest payments on all debt increasing from 81 percent and 87 percent in the period from FY 2014/15 to FY 2015/16.

**Uganda remains vulnerable to a number of exogenous shocks, including shocks related to fluctuations in the prices of its main exports and imports, regional security, and volatile climatic conditions.** Volatile commodity prices and financial distress in industrialized countries can have adverse effects on Uganda's external position, exacerbating domestic inflation and complicating the financing of its budget. Uganda's trade prospects are also influenced by the security situation in its fragile region, notably South Sudan and DRC. Uganda remains vulnerable to risks associated with volatile climatic conditions and food prices, particularly given the limited implementation of mitigation measures involving irrigation systems. With agriculture remaining the primary source of livelihood for more than 69 percent of the population, supply disruptions resulting from change in weather patterns could have significant negative effects on consumption and livelihoods and could complicate the management of inflation.

## 2.3 What will drive Uganda's growth acceleration?

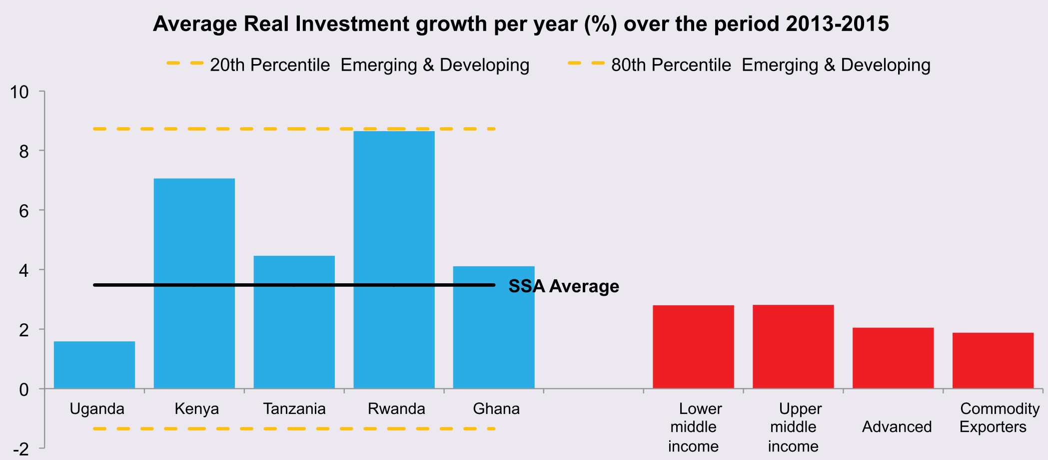
**Uganda's past periods of high growth benefitted from strong capital accumulation, driven by high levels of private investment. T**he total value of private investments increased to an average of 18 percent of GDP during the first decade of 2000s, compared to the average annual figure of 11 percent recorded in the 1990s. However, private investment growth has been subdued and volatile since 2009. In the public sector, the total average annual value of investments has stood at about 6 percent of GDP, allowing capital accumulation to increase to 24.5 percent of GDP by FY2012/13, compared to the levels of less than 6 percent of GDP recorded in the 1980s.

In the period from FY 2012/13 two FY 2014/15, Uganda's gross capital formation increased at an average of 1.7 percent per annum. This was far lower than increases recorded by neighboring countries, including Rwanda (8.3 percent) and Tanzania (6.2 percent), and less than half the average for sub-Saharan African countries, which stood at 4.7 percent per annum. This is in spite of the fact that this was a high public investment period, with a large proportion of investments being financed by a significant inflow of foreign savings through grants and transfers.

**For Uganda to sustain faster growth rates, it would need to accelerate and sustain high levels of investments that can support accumulation of both human and physical capital.** There is no doubt that increased public capital spending and the improved effectiveness of public services could support capital accumulation. However, this may be a transitory effect, with sustainable capital accumulation arising only from private investment, as has been demonstrated by experiences of the overwhelming majority of high growth countries. Therefore, the rapid increase in public investments envisaged in the medium term will have to be supplemented with, and then substituted by, a significantly increased growth in private investment.

**But how can faster factor accumulation be achieved with a shallow financial system struggling to intermediate resources to investment at affordable cost and resulting in limited inclusion of a large proportion of the population in the financial system?** On one hand, Uganda's low level of savings has also undermined its capacity to invest. International experience shows that no country has achieved sustainable growth without reasonably high levels of domestic savings. On the other, there are enormous challenges to intermediation of resources to all types of economic activity, with the bulk of this task, being done by the commercial banks. As a result, domestic credit to the private sector is estimated to amount to less than 15 percent of GDP, leaving individual savings and informal sources to finance the rest of economic activity generated by the private sector.

Figure 13: Real Growth Capital Formation in Uganda far lower than comparators over FY 2012/13- FY 2014/15




*Source: World Development Indicators*

**Overall, Uganda suffers from a mismatch between the respective level of access of different sectors to finance and each sector's respective role in the economy.** The public sector has considerable access to domestic and external finance, but its continued struggles with the execution of investment projects have limited the developmental impact of finance on the economy, both in terms of stimulus from investment and productivity gains from the increases to public capital. The large corporate sector can access the formal banking system, but only at a premium on the real interest rate available to the Government, which is already high. Small firms and households rely heavily on alternative financial services such as cooperatives and mobile payments – but due to lack of confidence and severely asymmetric access to information, this type of access is prone to credit rationing and not available to those who most need it. The stresses experienced by the economy in the last two years, as a result of factors including election uncertainty, exchange rate depreciation, drought and the crisis in South Sudan, have exposed weaknesses in the financial system, manifested by rising NPLs, tightening credit, sluggish implementation of investment projects, and difficulties for the poor to manage consumption risks. Uganda urgently needs to develop a deeper financial sector to facilitate the achievement of higher rates of growth and the more effective functioning of its social institutions. In the following chapter, this Update describes current status of the financial sector, with a focus on its contribution to economic growth, stability, and inclusion, and outlines the key first steps necessary to strengthen the financial market infrastructure.

**In spite of the progress being made in financial intermediation, new threats to sustained access to credit and growth and stability of the financial system will need to be closely monitored and addressed quickly and effectively.** While at the aggregate level, the banking system remains sufficiently capitalized, liquid and profitable, the quality of loans has recently declined severely, with the NPL ratio steadily increasing. With the exception of one bank, all banks met the core capital requirements as of June 2016. By this time, the value of core capital held by the banks was above 8 percent of the risk-weighted assets (RWA). If, they maintain the same level of capital, banks would still meet the requirement after it is raised to 10 percent of RWA and a capital conservation buffer is applied. However, NPLs increased from approximately 4 percent in June 2015 to more than 8 percent in the current year. This deterioration of loan quality underscores the need to closely monitor credit risk within Uganda's commercial banking system (see Box 1). Indeed, the stress tests conducted as part of the 2011 Financial Sector Assessment Program (FSAP)[10] had warned of the need to closely monitor developments in this area.

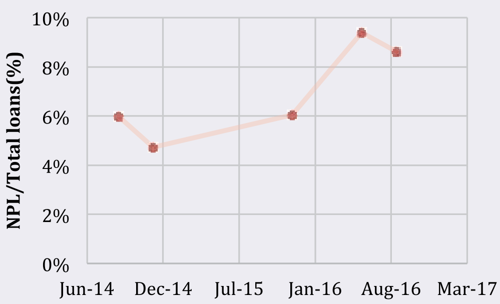
## Box 1: Non-performing assets rose significantly across the banking system

*Up until 2013, the banking system recorded a strong performance, attributable to the high quality of banks' loan portfolios. In the context of a high level of non-performing loans (NPLs) in the 1990s, the banking system had since adopted a cautious approach to lending and hence managed to maintain a very low level of non-performing assets over the last decade. In the period from December 2007 to December 2011, the ratio of NPLs to total loans stood at an average level of 2.95 percent.*

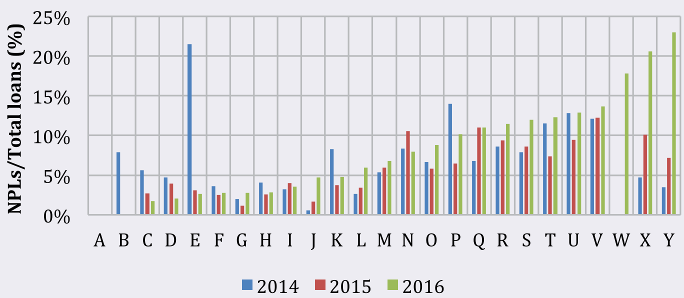
*However, in the recent past, the quality of loans has deteriorated and associated credit risk within Uganda's banking system increased. Specifically, the ratio of NPLs to total gross loans increased from 2.2 percent in December 2011 to 6 percent in December 2013. While this ratio had improved between 2014 and 2015, it rose again during 2016 to reach 8 percent by June 2016. In recent times, the high credit risk exposure is attributed to the after-effects of high credit growth and the economic slowdown in 2015 and 2016, which continued to negatively impact the quality of the sector's loan portfolio. In addition, a large portion of the NPLs has been related to loans denominated in US dollars, implying that the risk of high level of default resulting from exchange rate fluctuations materialized this year.*

*The increasing volume of NPLs in 2015 and 2016, was particularly evident in the manufacturing sector. This has been mainly because of the reduced volume of trade with South Sudan, which had been the largest destination for Ugandan manufactured goods. By June 2015, the proportion of NPLs in this sector had reached 17.5 percent. Overall, the level of NPLs increased from 6 percent by June 2013 to 8 percent by June 2016. Trade and commerce account for the largest share of NPLs, with a share of 39 percent, followed by the building and construction sectors, with a share of 29.5 percent. The share of NPLs in the case of the manufacturing sector has increased, reaching the level of 17 percent by June 2016.*

Box Figure 1a: Non-performing loans have increased between 2014 and 2016




Box Figure 1b: Non-performaning loans vary across banks




10. International Monetary Fund and World Bank, 2012, "Uganda: Financial Sector Assessment Program Update" (June 2012) June 2012

*One cause of the high ratio of non-performing assets was the high level of exposure to foreign currency loans in the context of the volatile value of the shilling especially between April and November 2015, with this effect being particularly significant in the case of the real estate sector. For traders, currency volatility jeopardized the business environment by increasing both the cost of importation and operational costs. Even where such goods and services are purchased locally, the effect of imported inflation spilled over into domestic prices and into the cost of rented business space, with most rentals denominated in foreign currency. Other sources of vulnerability include sporadic episodes of instability in South Sudan, a key business outlet for a wide range of economic activities in Uganda. This has had the effect of disrupting income streams for many businesses, thereby constraining their ability to meet their debt obligations.*

*Across the different banks, NPAs are not distributed evenly, suggesting that bank-specific management factors may have been partially responsible for the overall rise in NPLs. As stated earlier, the BoU took over the management of Crane Bank in October 2016 because this bank was determined to lack sufficient capital and to pose a risk to the stability of Uganda's financial system. Prior to the takeover, its non-performing assets had risen to constitute more than 20 percent of its loan portfolio, which left it significantly undercapitalized. Several other banks have also experienced a surge in NPLs in recent months. As at June 30, 2016, five other banks had a ratio of NPLs in excess 10 percent. However, it is notable that some banks continue to maintain a low ratio of NPLs, in the range of 2-3 percent, and many banks are more than adequately provisioned.*

**The increase in credit risk for a significant part of the banking system had to be contained to avoid a self-perpetuating vicious cycle of loss of confidence and financing interruption.** By June 2016, up to 10 out of the 25 banks (40 percent of the banking system) had NPLs in excess of 10 percent of total loans on their books, but the NPLs for the remaining 60 percent of the banking system are more comfortable. Crane Bank had the highest ratio of NPLs of any bank, standing at 23 percent at the time of its takeover, undermining its capital base (Box 2). Indeed, this bank had the highest ratio of NPLs of any bank, standing at 23 percent at the time of its takeover. Even with containment of the distress in the banking sector, the combined effects of these factors on the quality of credit and the tightening of financing conditions by commercial banks has resulted in the emergence of a self-perpetuating cycle.

## Box 2: Central Bank resolves problematic Crane Bank

*On October 20, 2016, Bank of Uganda (BoU) announced that it had taken over the management of Crane Bank and suspended its Board of Directors, upon a determination that Crane Bank Limited was a significantly undercapitalized institution as defined by law, posed a systemic risk to the stability of the financial system and that the continuation of Crane Bank's activities in its existing form was detrimental to the interests of its depositors because this bank was deemed to lack sufficient capital and to posed a risk to the stability of Uganda's financial system. By taking over Crane Bank, BoU was fulfilling one of its key mandates, which is to ensure the stability of the financial system and the safety of the depositors. Indeed, in the past, BoU has implemented a number of actions to achieve these objectives. For instance, over the past half-decade, it closed the National Bank of Commerce in 2012, and Global Trust Bank Uganda Limited in 2014, while it carefully managed the resolution of issues related to the management Imperial Bank Uganda Limited after its majority shareholder in Kenya had been put under receivership. All these interventions achieved the purpose of ensuring the stability of the financial system, even when major institutions had had problems.*

*Crane Bank, Uganda's fourth largest bank in terms of assets and fifth in terms of deposits at the time BOU's intervention, had been on the BoU watch list since 2015. Crane Bank was part of a financial conglomerate with almost 500,000 accounts and 46 branches across Uganda. It was therefore one of the most systemically important institutions in Uganda's banking system. A key cause of Crane Bank's distress was the poor quality of its loans, as the ratio of NPLs to loans had risen to 23 percent of its loan portfolio. Moreover, in the weeks preceding its takeover, rumors regarding its weakness and a possible closure by BoU, prompted depositors to withdraw their deposits due to speculation regarding the bank's future. This run on the bank resulted in a significant erosion in the value of its deposits. As the same time, the shareholders failed to raise enough capital to quickly recapitalize the bank to curtail further deterioration.*

*BoU issued reassurances that it intended to resolve the issues related to Crane Bank in a manner which preserves its core functions and services to customers. Crane Bank remained open to customers and BoU did not institute limits on how much customers can deposit or withdraw, as it tried to operate the bank as smoothly as possible while an in-depth audit was being carried out.*

*Upon completion of the audit, BOU confirmed that Crane Bank liabilities exceeded its assets and that it was insolvent. On January 27, 2017, BOU progressed the nature of the takeover of Crane Bank from statutory management to receivership and transferred all Crane Bank's liabilities (including deposits) and assets, to DFCU Bank Limited Uganda. The BoU further issued reassurance that it will continue to protect the depositors' interests and to maintain stability of the financial sector.*

*Source: BoU*


Morgan Mbabazi, 2016

*Insurance providers display their services at the 2016 Insurance Expo*

**CRANE BANK, UGANDA'S FOURTH LARGEST BANK IN TERMS OF ASSETS AND FIFTH IN TERMS OF DEPOSITS, HAD BEEN ON THE BOU WATCH LIST SINCE 2015**

# PART 2

## DEEPER FINANCE CAN UNLOCK GROWTH ACCELERATORS

- Slightly more than half (52 percent) of Uganda's adult population has access to an account at a formal financial institution, compared to 28 percent recorded in 2009.
- At present, 28 percent of Ugandans hold bank accounts, a significant increase from the figure of 21 percent recorded in 2011, but still lagging behind that recorded by regional and global peers.
- With more than 7 million active users in 2016, the financial service most commonly used by Ugandans was mobile money, with the increase resulting from the widespread embrace of new technologies by consumers, who have been attracted by the potential of this service to effect financial transactions easily.
- Despite the increase in the level of access to financial services, only a very small proportion of Ugandan businesses and households have access to a bank loan and/or a line of credit. Consequently, domestic credit has financed only 13 percent of GDP over the past decade.
- The most significant constraint on financial inclusion is cost, with Uganda ranking in 120th place out of 138 countries in the area of the affordability of financial services, according to the Economic Forum Global Competitiveness Report (2016-2017).
- Inclusion is constrained by the low level of public confidence in financial institutions; by the undeveloped state of long-term savings products such as pensions and insurance; and by the undeveloped state of credit and mobile service infrastructure.
- Reducing the cost of credit requires a comprehensive, long-term effort to increase levels of competition and to improve the credit infrastructure. In the short-term, effort must be focused to addressing information asymmetries, strengthening the financial infrastructure, building capacities in the sector.
- To raise savings mobilization, there is need to build confidence by ensuring financial institutions are safe and efficient, raising awareness through consumer education, and strengthening regulations.
- For Uganda's financial system to raise more savings and to lower the cost of finance, it must encourage more competition between banks and with other non-bank financial institutions including insurance and pensions.

Members of Kamwe Kamwe Savings and Loans Society balance their books at their monthly meeting

Morgan Mbabazi, 2016

## 3.0 Uganda's Financial System has made strong advances, but not inclusively

**Successful emerging countries that have achieved rapid, equitable economic growth have been characterized by their ability to develop deep financial systems that effectively mobilize savings and intermediate resources to productive activities.** Access to financial services enable individuals, households, and businesses to efficiently balance income and expenses over time, to manage shocks, and to invest in the development of their human and physical capital. Most critically, efficient intermediation encourages savers, eases access to credit for borrowers and lowers the costs of credit, which in turn reduces the overall transaction costs for enterprises, making them more competitive. Therefore, a well-functioning financial system encourages the emergence of new businesses, supports the growth of existing businesses, and ensures business sustainability. Similarly, a well-functioning financial system will encourage households to save and to engage in income generating activities in the form of investments, hence smoothing consumption and accelerating poverty reduction. The financial system also provides a strong basis for the settlement of payments, which is fundamental to the functioning of the economy. The critical questions are: To what extent has Uganda been able to develop a financial system that fulfils these functions? How can it address the constraints that continue to affect this development? This section of the Ugandan Economic Update attempts to address these questions.

### 3.1 Who in Uganda is offering financial services?

**Uganda's financial system has emerged in the context of a broader set of market-oriented policy reforms that involved liberalization of the financial sector in the 1990s.** It has also been significantly influenced by rapid developments in information and communications technologies (ICTs) over the past decade. Before the commencement of the reforms in 1988, Uganda's financial system was highly regulated, consisting of only a few banks, with interest rates and credit limits tightly controlled by the Government, and with these banks serving only a small proportion of the population. The reforms that have been implemented since then were intended to improve efficiency and to enable the emergence of more varied institutions to provide a greater range of financial services to a broader proportion of the population.

**At present, Uganda's financial sector consists of a range of different types of financial institutions, a proportion of which accept deposits, with those doing so under the broad supervision of the Bank of Uganda (BoU).** Institutions providing financial services include banks, credit institutions (CIs), microfinance depository institutions (MDIs), savings and credit cooperative organizations (SACCOs), insurance companies, and pension schemes. Commercial banks, CIs, and MDIs belong to the first three tiers of the financial system and are regulated by the BoU. The fourth tier of financial institutions includes SACCOs, NGOs, for-profit MFIs, and informal institutions such as ROSCAs, VSLAs and burial societies. They are not regulated and supervised by the BoU[11], but are either regulated through other means or through self-regulation. A range of non-bank financial institutions also offer financial services, with these institutions including insurance companies, pension funds, securities industry, mortgage institutions and development banks.

Figure 14: Financial Sector Institutions as of November, 2016


*Source: Bank of Uganda, Insurance Regulatory Authority figures and estimates for Tier IV institutions*

**There are now 25 banks in Uganda, a dramatic increase since the reform started, which has also been accompanied by de-concentration of the banking system.** Nonetheless, price competition remains limited. The evolution of the Herfindahl Index of Uganda's banking sector shows a decline in concentration from 2004 to 2013. In 2004, the value of the index was almost 1,700 but it experienced a significant decline over the years, down to 939.7 in June 2013[12] , indicating gradual decline in concentration within the sector. Entrance of new players into the market has played a significant role in that: since the expiration of a moratorium on new bank licenses in 2007, the number of commercial banks in Uganda increased from 14 to 25 in 2014. Nevertheless, there is still significant potential for further decline in concentration. Competition has driven down returns on equity which are now less than half the levels in the first half of the 2000s. However competition has generally not taken the form of price competition; instead banks have competed for customers by opening new branches – the number of branches is now six times the level in the early 2000s – which suggests that the banks do not believe that customer demand for financial services is very price sensitive.

**In aggregate, the banking system in Uganda is well-capitalized with an average Tier 1 capital adequacy ratio of 19 percent in June 2016, well above the regulatory minimum level of 8 percent.** The average level of Return on Assets (ROA) stood at 2.2 percent in June 2016, a rate that was below the level of 2.8 recorded a year earlier. Return on Equity (ROE) declined significantly over the two points, from 17.7 percent in June 2015 to 13.8 percent in June 2016. While the banking system is characterized by generally well-performing loan portfolios, the proportion of NPLs has increased recently (see discussion in Section 2.3 of this report).

**In terms of inclusion, the development of other deposit-taking financial institutions, such as credit institutions and microfinance deposit-taking institutions, has been significant, because these institutions generally have a wider geographical scope and are more orientated to serving low-income clients.** As might be expected, the CI and MDI sectors are relatively very small, holding less than four percent of the banking system's total value of loans and two percent of deposits in 2014. These institutions are prudentially


*Airtel service centre registers customers for mobile money*

*Morgan Mbabazi, 2016*

*Uganda's financial sector consists of a range of different types of financial institutions, a proportion of which accept deposits, with those doing so under the broad supervision of the Bank of Uganda (BoU)*

11. One exception is large SACCOs which will fall under supervision BoU following the passage of the Tier IV Microfinance Institutions and Moneylenders Act (2016). The threshold is voluntary savings in excess of Shs 1.5 billion and capital above Shs 0.5 billion.

12. BoU Financial Stability Report (2013)

regulated by the BoU, and could therefore play a more expansive role in providing financial services.

**Tier IV institutions, including VSLAs, SACCOs, and NGO micro-finance institutions, are particularly active providers of financial services in the rural areas.** According to the Finscope survey (2013), 51 percent of the population still hold their savings in cash; 29 percent use Rotating Savings and Credit Associations (ROSCAs); 18 percent use Village Savings and Loans Associations (VSLA); 9 percent use banks and MDIs; 7 percent use MFIs and SACCOs; and 3 percent use mobile accounts. In the same survey, 53 percent of respondents reported that access to financial services through VCLAs had improved in the period from 2009 to 2013, while the proportion of respondents reporting access to financial services through SACCOs stood at 27 percent. For access through MDIs and Cis, the proportion of respondents indicating that access had improved was much smaller, at only 8 percent.

**SACCOs play an important role in Uganda's financial system.** There are more than 1900 registered SACCOs, serving a combined total of around 1 million clients. The Uganda Cooperative Savings and Credit Union (UCSCU), a national apex organization for SACCOs, estimates that for the 1,707 SACCOs for which data was available in 2013, the combined total membership of these institutions 913,572 members; members; the combined total value of their deposits stood at US$ 39 million; the combined total value of their share capital stood at US$ 33.7 million; and the combined total value of their loan portfolio stood at US$ 70 million. This category of financial services received a boost with the implementation of the Rural Financial Services Strategy (RFSS), with its stated commitment to the establishment of SACCOs in every sub-county in the country.

**The rural financial sector has faced a tradeoff between the pace of expansion and soundness.** To facilitate the achievement of rural access, the government-owned Micro Finance Support Centre[13] supported the establishment of 600 new SACCOs and provided support to 735 existing SACCOs to improve their services and expand their outreach. Unfortunately, while well intended, to some extent this public intervention undermined the stability of the SACCOs. The intervention had the effect of converting many SACCOs into distributors of subsidized loans, while the industry lacked regulation, oversight and supervision. Similarly, while NGOs and microfinance companies may have played a valuable role in expanding the availability of microfinance services throughout the country, they are also characterized by similar weaknesses.

**In order to protect the savings of the depositors, to limit predatory lending practices, and to build confidence in the system and thereby to promote financial inclusion, Parliament recently enacted the Tier 4 Microfinance Institutions Act and Moneylenders, 2016.** The legislation places large and medium-sized SACCOs and all non-deposit taking MFIs under the supervision of the newly-established Uganda Microfinance Regulatory Authority (UMRA). It also requires the periodic monitoring of smaller SACCOs by the Department of Cooperatives. Although UMRA has been established as an independent agency, it will come under Ministry of Finance, Planning and Economic Development (MoFPED), with its board consisting of representatives of the MoFPED, the Ministry of Trade, Industry and Nominal Cooperatives (MTIC) and BOU, in addition to private and civil society stakeholders. To support the implementation of this act, the Government has been required to formulate a strategic framework that included a process for the establishment of UMRA, for the provision of capacity building support for Tier IV financial institutions, and for the establishment and regulation of agencies and associations that support these institutions.

**The number of non-bank financial intermediaries has also been expanding, with these intermediaries including pension funds, insurance companies and securities markets.** Despite this growth, their overall contribution to the financial sector remains limited. The largest pension scheme, the National Social Security Fund (NSSF), recorded an increase to the value of its asset base to Shs 5.6 trillion by December 2015. Together with other smaller retirement benefits schemes, the total value of the assets held by pension sector is equivalent to around 12 percent of GDP. The total value of assets held by insurance operators reached Shs 1.14 trillion by the same point.

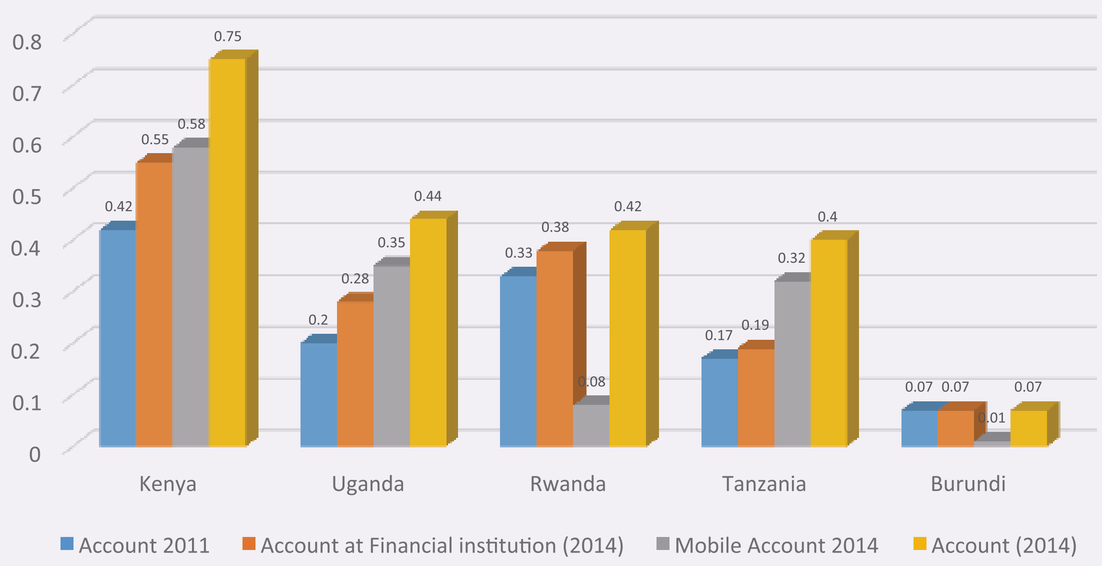
**The introduction of mobile money to Uganda in 2009 has facilitated a number of significant changes to the financial system.** Technological advances have enabled mobile network operators to offer financial services through mobile telephones, with significant implications for outreach and inclusion. By December 2015, Uganda had a total of six mobile money service providers, these being MTN, Airtel, Uganda Telecom, Africell, M-Cash and EzeeMoney.

13. Microfinance Support Centre is the state-owned entity established as part of the rural finance services program (RFSP) in 2006 to provide wholesale finance to SACCOs and MFIs as part of the government's rural outreach strategy.

## 3.2 How do Ugandans use financial Services?

**In recent years, Uganda has achieved significant gains in the extent of financial inclusion and the degree to which various groups (e.g., the poor, rural population, women) are included in the formal financial systems, according to systematic indica¬tors derived from several datasets that allow for international comparison.** Finscope Surveys show that 54 percent of Uganda's adult population now has access to an account at a formal financial institution, compared to 28 percent recorded in 2009. Similarly, Global Findex shows that the use of an account in Uganda increased from 20 percent in 2011 to 44 percent in 2014- growth matched only by Tanzania within the EAC countries (Figure 15). This represents an impressive increase, which was driven by the extensive use of mobile money by consumers, who have been attracted by the potential of this service to effect financial transactions easily.

Figure 15: Account Penetration in EAC Countries




*Source: Global Findex Survey, 2014, World Bank*

**In terms of the number of mobile money transactions, Uganda has become a world leader with respect to the proportion of value of these transactions to GDP and the number of registered accounts.** The proportion of Ugandans using mobile money is greater than for any other financial services, with more than 7 million active users in 2016 (even though this number may include multiple line users that could have resulted into double counting). The rate of usage is significantly higher than in many other countries, even when these countries have also been characterized by widespread acceptance (see Table 3). In terms of the number of mobile money transactions, the value of these transactions in proportion to GDP, the number of registered accounts, and other statistics, Uganda is among the world leaders. The high rate of usage of mobile money is the result of a number of factors, including the relatively low rate of usage of the formal banking system, consumers' willingness to adopt new technologies, and the pressing need for payment systems by consumers. The main constraints to further expanding the use of mobile money in Uganda is that 55 percent of adults do not own a mobile phone, with a larger proportion having a poor command of English or being illiterate, with only 40 percent of users being able to use SMS with a good level of proficiency.

Table 3 : Top Countries by Mobile Money Use (2015)

| Economy | Mobile money accounts: active | Mobile money accounts: active per 1,000 adults | Mobile money accounts: registered | Mobile money accounts: registered per 1,000 adults | Mobile money agent outlets: registered | Mobile money transactions: number | Mobile money transactions: number per 1,000 adults | Mobile money transactions: value ( %of GDP) |
|---|---|---|---|---|---|---|---|---|
| Bangladesh | 12,792,905 | 113 | 34,098,760 | 300 | 628,671 | 1,156,600,880 | 10,182 | 10 |
| Botswana | 713,382 | 464 | 1,190,952 | 774 | 1,736 | 11,481,936 | 7,463 | 2 |
| Cambodia | 147,593 | 14 | 443,156 | 42 | 3,629 | 61,729,982 | 5,794 | 68 |
| Indonesia | | | 34,314,795 | 184 | | 535,580 | 3 | 0 |
| Kenya | 31,642,400 | 1,183 | 31,642,400 | 1,183 | 143,946 | 1,114,176,700 | 41,650 | 45 |
| Lesotho | 210,914 | 155 | 1,064,028 | 780 | 3,479 | | | |
| Madagascar | 544,402 | 39 | 2,498,600 | 177 | 10,826 | 28,728,048 | 2,034 | 7 |
| Nigeria | | | 10,771,193 | 106 | 21,086 | 43,933,362 | 430 | 0 |
| Pakistan | 6,241,579 | 51 | 15,322,171 | 125 | 301,823 | 374,541,000 | 3,050 | 7 |
| Philippines | 6,437,217 | 94 | 9,351,971 | 136 | 23,781 | 327,224,000 | 4,775 | 3 |
| Rwanda | 2,522,096 | 369 | 7,663,199 | 1,120 | 40,467 | 168,612,455 | 24,638 | 19 |
| Tanzania | 19,006,176 | 649 | 53,843,917 | 1,838 | 270,974 | 1,387,854,759 | 47,363 | 53 |
| Tonga | 53,523 | 797 | 37,049 | 552 | 129 | 51,760 | 771 | 3 |
| Uganda | | | 21,102,851 | 1,042 | 109,458 | 693,558,390 | 34,230 | 44 |
| Zambia | 250,108 | 29 | 4,917,204 | 561 | 19,249 | 2,838,650 | 324 | 0 |
| Zimbabwe | 4,752,287 | 522 | 8,430,888 | 925 | 38,745 | 228,202,695 | 25,044 | 33 |

*Source: IMF FAS Survey*

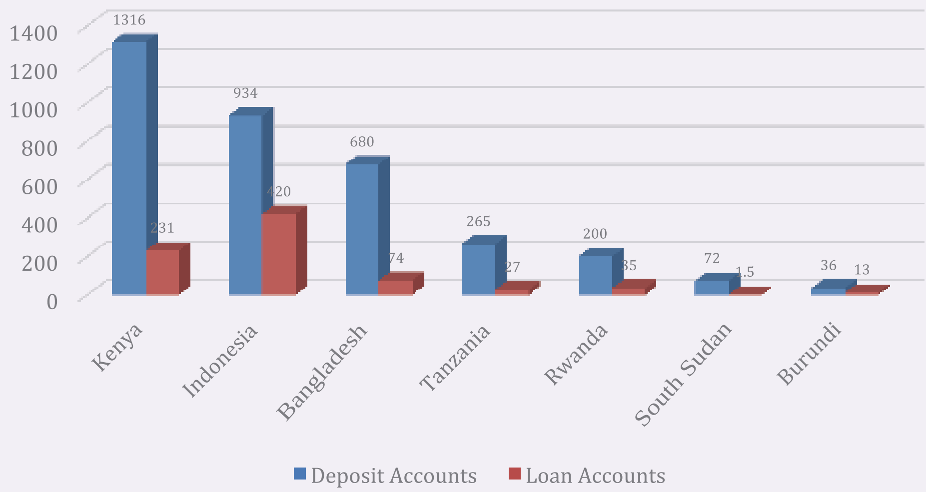
**The expansion in the range of services, the adoption of new technologies, and the increased outreach have all contributed to greatly improved access, especially for deposit accounts, but many gaps remain.** Compared to the figures recorded in 2011, the number of Ugandans holding bank accounts has increased dramatically. Nonetheless the rate of usage is still low compared to the rates recorded by regional and global peers. Global Findex results show that the proportion of adults holding at least one bank account increased from 21 percent in 2011 to 28 percent in 2014. While this is a significant increase, it is still relatively low compared to the levels recorded by comparator countries. This is further confirmed by the IMF Financial Access Survey (FAS) (2015), which in addition shows that there was a large gap in the proportion of the population holding a deposit account and that holding a loans account at commercial banks. By 2015, for deposit accounts, the figure stood at 230 accounts per 1,000 adults, but at only 25 accounts per 1,000 adults for loans. While it is usual for there to be a greater proportion of the population holding deposit accounts than loans accounts, a number of regional and international comparators have recorded greater proportion of loans accounts relative to deposit accounts (see Figure 16). Moreover, the 2016 Intermedia Survey for Uganda shows that a larger part of the population is yet to transition from basic mobile money transfers to more advanced mobile financial services and a wide spectrum of financial services available at banks and other financial institutions.

*Morgan Mbabazi, 2016*

*Ruhiira SACCO serves customers*

*A high proportion of Uganda's adult population engages in savings but are significantly more likely to use informal mechanisms than formal mechanisms to do so*

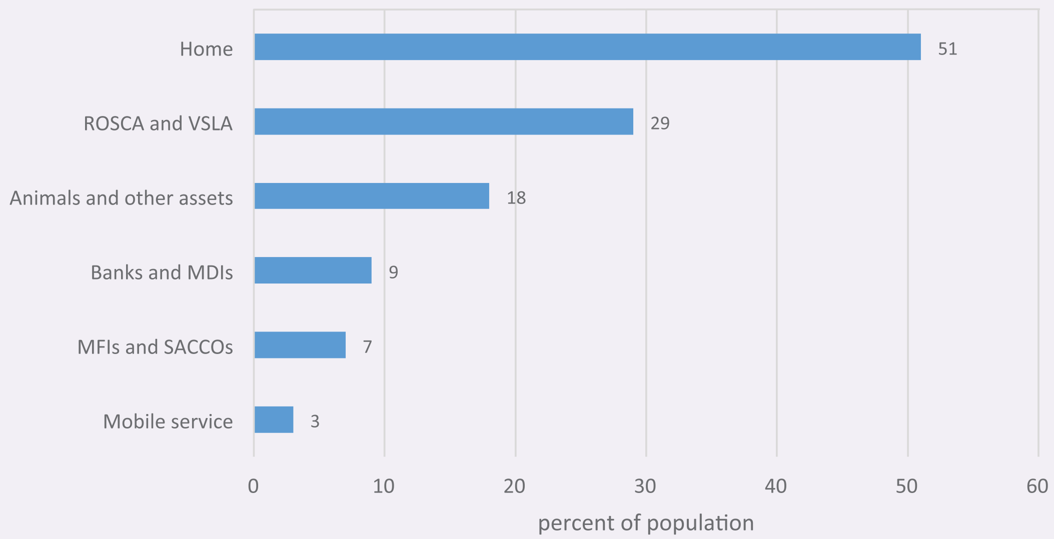
Figure 16: Deposit and Loan Accounts at Commercial Banks per 1,000 Adults, 2015




*Source: IMF Financial Access Survey (FAS) (2015*

**While a high proportion of Uganda's adult population engages in financial savings, they are significantly more likely to use informal mechanisms than formal mechanisms to do so.** In total, it has been estimated that while 68 percent of the adult population engages in savings, only 16 percent conduct savings through formal channels such as banks, deposit-taking microfinance institutions, or deposit-taking SACCOs. This limited use of formal financial institutions affects not only the safety of consumers' funds, but also the ability of formal institutions to intermediate and provide credit to MSMEs in order to promote their growth and productivity. Most commonly, adults keep their financial savings at home, followed by their use of village savings and loan associations (VSLAs) and rotating savings and credit associations (ROSCAs) (see Figure 17). By contrast, Ugandan firms are very likely to hold money in a checking or savings account, with more than 86 percent of surveyed firms stating that they held accounts of this sort.

Figure 17: Mechanism Used for Savings in 2013



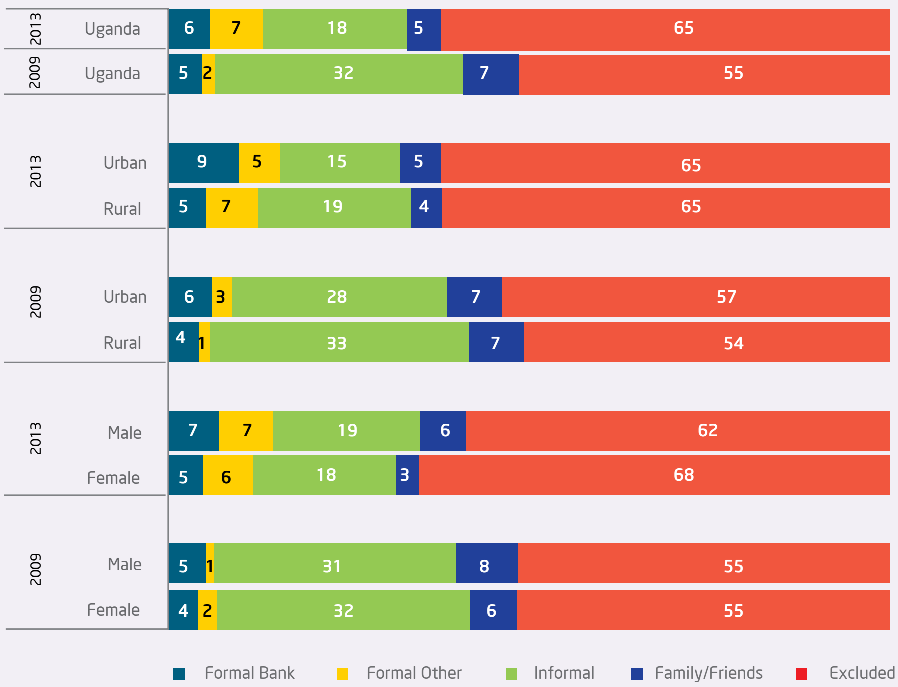

*Source: FinScope Survey 2013*

**The use of pensions as a saving vehicle is also limited, with only 2.1 percent of the population and less than five percent of the workforce participating in or being covered by a pension scheme.** The most important pension schemes are the National Social Security Fund (NSSF) and the Public Sector Pension Fund (PSPF). In addition, there are around 60 occupational retirement benefit schemes. FinScope 2013 indicates that only two percent of adults participated in formal insurance schemes, down from the level of three percent recorded in 2009. However, 43 percent of adults utilized informal insurance schemes, mainly for burial services. The most significant barriers to participation in formal insurance schemes are a lack of knowledge and information regarding their benefits and high costs.

**Ugandans display a high degree of caution when it comes to borrowing. According to Finscope 2013, 35 percent of adults had active loans at the time of the survey, a decrease from the level of 44 percent recorded in 2009.** The most commonly cited reasons for accessing credit included to pay for education (20 percent) and to manage emergencies (15 percent). Most individuals stated that the main reason they did not participate in loans was their fear of being in debt.

**Finscope 2013 also shows that there is a significant difference between household preferences in urban and rural areas in terms of their preferences for credit providers.** While the overall rate of usage of formal credit from both bank and non-bank providers is very low (13 percent in 2013), households in rural areas uses non-bank formal providers to a relatively greater extent, while the opposite is true for those in urban areas. Within rural areas, the Uganda Poverty Assessment[14] showed that financial institutions are almost completely absent in northern Uganda. Overall, 65 percent of the population does not have access to formal credit, with the use of informal mechanisms actually increasing in the period from 2009 to 2013. Women are relatively disadvantaged in terms of access to formal credit, with 68 percent of women unserved in 2013, compared to 62 percent of men (see Figure 18).

Figure 18: Credit and Borrowing Strands by Gender and Location (2013)




*Source: FinScope Survey 2013*

14. World Bank 2016, The Uganda Poverty Assessment Report: Firms, Cities and Good Fortune – Assessing Poverty Reduction in Uganda from 2006 to 2013

**Data from household surveys also suggests that there are significant variations in the source of finance and the purpose to which it is put between urban and rural areas in Uganda.** For example, up to 25 percent of households in urban areas obtain financing from formal financial institutions such as banks, credit institutions, and micro-deposit taking institutions, with this proportion falling to only 10 percent for households in rural areas. Across time, the largest evolution in sources of funding for households has involved the rate of usage of SACCOs, which now provide 52 percent of financing to households in rural areas and 47 percent to households in urban areas. Family and friends are still a significant source of financing for enterprises.

Table 4: Source of Credit for Households in Uganda 2012/13

| Source of Credit for Households in 2012/13 | Share | Purpose of Loan (2012/13) | Share | Source of Enterprise Start-Up (Informal Sector Survey 2012/13) | Share |
|---|---|---|---|---|---|
| Relatives and friends | 32% | Expansion of Enterprise | 29% | Own Saving | 92% |
| Formal Financial Institutions e.g. bank, Credit institution, MDFI | 14% | | | | |
| SACCOs NGO / Cooperative society | 47% | Education & Health | 27% | Loan from Family / Friends | 4% |
| Community / group | 13% | Agricultural Inputs | 24% | Loan from Money Lender | 1% |
| Government agency | 12% | Consumption | 17% | Loan from Bank or Financial Institution | 1% |
| Firm/employer/money lender | 6% | Housing | 3% | Other | 1% |
| Banks | 2% | | | | |

*Source: Uganda National Household Surveys*

**A very small proportion of Ugandan firms and businesses have a bank loan and/or line of credit, with those obtaining these facilities paying high costs and having to comply with stringent collateral requirements.** Over the ten years to 2015, Uganda's credit to GDP ratio stood at an average of only 15.1 percent.[15] This ratio is very low compared to the ratio recorded by regional neighbors such as South Africa and Kenya, and even lower than that recorded in other regions, such as Europe, Central Asia, East Asia and the Pacific.

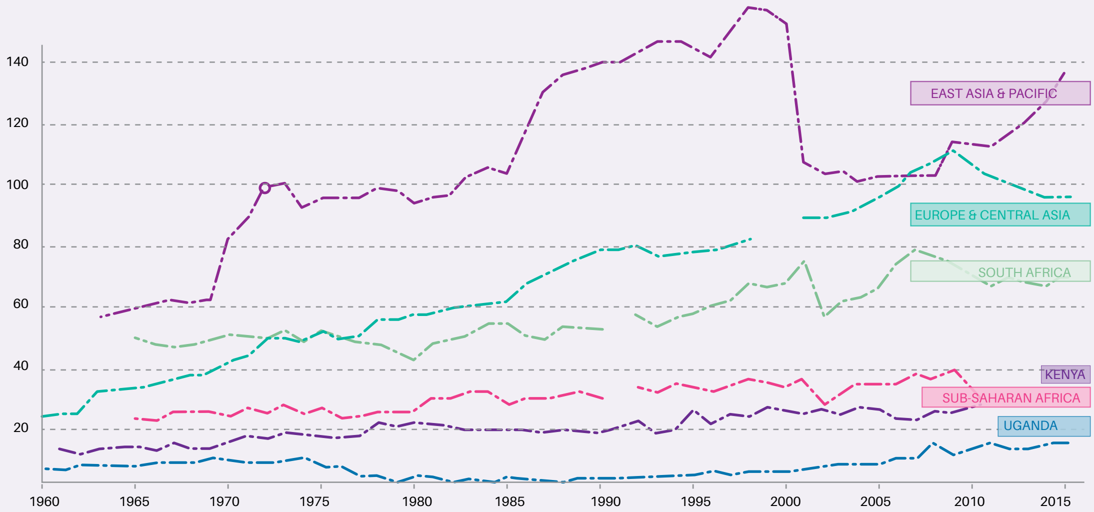
**The low level of access is explained by both supply and demand side challenges.** While financial institutions have not been successful in developing credit products meeting the needs of enterprises, the lack of financial literacy among enterprises, failure to keep financial records and to design viable projects have also greatly contributed to the low volume of credit to the private sector.

*Morgan Mbabazi, 2016*


*A very small proportion of Ugandan firms and businesses have a bank loan and/or line of credit*

15. International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates

Figure 19: Domestic Credit to Private Sector by Banks (% of GDP)




*Sources: Enterprise Survey (2013), International Monetary Fund, International Financial Statistics and data files, and World Bank and OECD GDP estimates*

**According to the Enterprise Survey in Uganda (2013), limited access to credit is reported as being the most significant constraint to doing business in Uganda.** Only 9.8 percent of firms in Uganda have a bank loan and/or line of credit from a bank, compared to the average figure of 23.8 percent recorded in sub-Saharan Africa and 36.5 percent worldwide. Borrowers in Uganda are required to provide a lower value of collateral for a loan than the world average, but the proportion of loans requiring collateral is higher. As a result, very few firms in Uganda use bank loans to finance investments (3.3 percent in Uganda compared to 10 percent in sub-Saharan Africa and 16 percent worldwide (see Table 5).

Table 5: Indicators of Access to Credit in Uganda and Comparator Regions

| Indicator | Uganda | SSA | All Countries |
|---|---|---|---|
| Percent of firms with a checking or savings account | **86.7** | 88.1 | **88.2** |
| Percent of firms with a bank loan/line of credit | **9.8** | 23.8 | **36.5** |
| Proportion of loans requiring collateral (%) | **86.4** | 79.7 | **77.3** |
| Value of collateral needed for a loan (% of the loan amount) | **159.4** | 175.2 | **182.2** |
| Percent of firms not needing a loan | **41.9** | 34.1 | **40.9** |
| Percent of firms whose recent loan application was rejected | **7.7** | 15.3 | **14.5** |
| Proportion of investments financed internally (%) | **79.5** | 78.3 | **69.2** |
| Proportion of investments financed by banks (%) | 3.3 | 9.9 | 16.3 |
| Proportion of investments financed by supplier credit (%) | 3.2 | 3.9 | 5.1 |
| Proportion of investments financed by equity or stock sales (%) | 13.0 | 3.7 | 5.0 |
| Percent of firms using banks to finance working capital | 21.7 | 23.5 | 31.0 |
| Proportion of working capital financed by banks (%) | 7.0 | 9.9 | 12.6 |
| Proportion of working capital financed by supplier credit (%) | 3.5 | 7.2 | 10.8 |
| Percent of firms identifying access to finance as a major constraint | 20.2 | 43.0 | 30.8 |

**In terms of a breakdown by sectors, the smallest proportion of credit is provided to the agricultural sector, despite its significant contribution to Uganda's economy.** The agricultural sector receives less than 10 percent of the total of all credit provided through Uganda's financial system, 90 percent of which is provided by commercial banks. About 57 percent of this credit is provided to finance processing and marketing activities. With the bulk of this credit going to large-scale farmers, small-scale farmers, who collectively constitute more than 90 percent of the agricultural system, have very limited access.

**Despite pervasive difficulties in accessing credit, simply increasing access to a savings account has potentially beneficial effects on household income of the poor.** According to the Uganda Poverty Assessment 2016, the gap in terms of access to savings accounts between the bottom 40 percent and the rest remains significant. In 2011, 12 percent of all households had at least one member with savings account with formal financial institution, while it was only 4 percent for the bottom 40 percent of households. Empirical analysis suggests that having a savings account with formal institutions increase non-agricultural income, and the impact is stronger than credits. This result is consistent with empirical findings from many countries that savings has relatively positive welfare impacts than credit. (Stewart, Van Rooyen et al. 2012). It may be because investment in non-agricultural businesses is often made out of savings. Thus, improving access to savings accounts has a great potential to increase non-agricultural income. Mobile money is a promising way to promote financial inclusion in Uganda, especially as half of the users of mobile money services are unbanked.

**Financial sector inclusion is also associated with rural-urban migration, a critical part of structural transformation of the economy.** At the household level, rural households that include at least one member who has migrated to an urban area are 13 percentage points more likely to have a formal loan than households that do not (28 percent compared to 17 percent), and 15 percentage points more likely to have a savings account with a formal institution (29 percent compared to 15 percent). Having a formal loan and a formal savings account increases the likelihood of becoming a migrant-sending household by 3 and 6 percentage points respectively. The results suggest that facilitating households' access to these savings and credit products could help them overcome liquidity constraints to migration, making households less dependent on agriculture and fragile rural livelihoods.

## 3.3 What constrains Financial Credit Inclusion in Uganda?

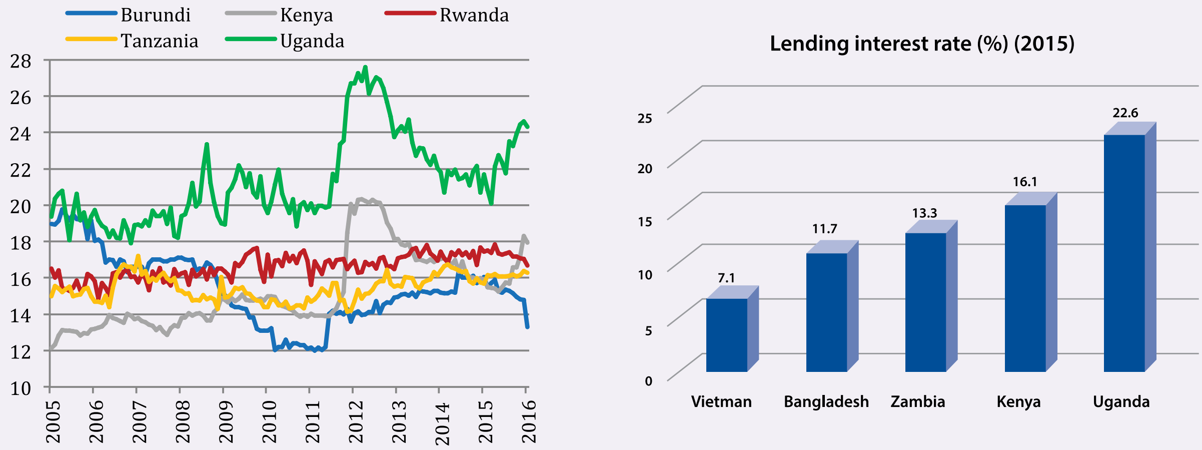
**Uganda must save more, however, more serious problems lie in the fact that not enough of this saving is provided as lending to private sector borrowers that can expand production and generate employment.** A range of both supply- and demand-side factors constrain the accessibility of financial credit in Uganda. These factors range from individual preferences to hold savings in form of non-financial assets, to the underdeveloped state of non-bank financial system making it difficult for firms and household to access long term finance, and keeping competition with banks services very low. The most critical among these constraints involve issues related to the cost of the services, limited infrastructure, and the low confidence levels.

### 3.3.1 High cost of financial services

**In Uganda, the cost of finance is relatively high compared to other countries in the region and around the world.** Average lending rates have been in excess of 20 percent since mid-2011, currently standing at 23.5 percent, compared to deposit rates, which are hovering around 4.1 percent.[16] In 2015, Uganda's average lending rate was almost 15 percentage points higher than that recorded in Vietnam and 12 percentage points higher than in Zambia (see Figure 20). Thus, Uganda's rates are high, even in comparison to relatively high regional levels. In real terms, Uganda's lending rates are even higher relative to those of its neighbors. Although it is difficult to assess the degree to which a particular level of lending rates is justifiable, surveys of clients, including households and enterprises, find that the high cost of finance and the stringent collateral requirements are a significant barrier to enterprise growth and operation, particularly in the case of small and medium enterprises.

16. Bank of Uganda, June 2016.

Figure 20: Uganda's lending rates nominally stand higher than many other countries




*Source: IMF International Financial Statistics and World Development Indicators (2015)*

**The proximate cause of high lending rates in Uganda is a high-cost operating environment, compounded by various forms of market segmentation.** According to the Economic Forum Global Competitiveness Report (2016-2017), in terms of the affordability of financial services index, Uganda ranks in 120th place out of 138 countries, with a steady decline in its position over recent years. The high interest rates seem to be largely the result of a lack of competition and high overheads, lack of qualified professionals, high costs of expansion, especially in rural areas, and the high costs associated with conducting due diligence in an environment where information is unreliable and difficult to obtain. The high rates also reflect the high-risk premium. Therefore, the level at which financial institutions set lending rates depends on a host of factors, with the most significant of these factors relating to the cost of mobilizing deposits. Commercial banks in emerging markets source most of their funds from consumer deposits, often having to compete with government securities. The decomposition of the difference between the interest paid on deposits and the rate at which they lend these savings, called the interest rate spread, can help quantify the magnitude of these factors (see Box 3).

*Morgan Mbabazi, 2016*


*Mobile money joints ease access to financial services even in urban areas*

*In terms of the affordability of financial services index, Uganda ranks in 120th place out of 138 countries, with a steady decline in its position over recent years. The proximate cause of high lending rates in Uganda is a high-cost operating environment, compounded by various forms of market segmentation*

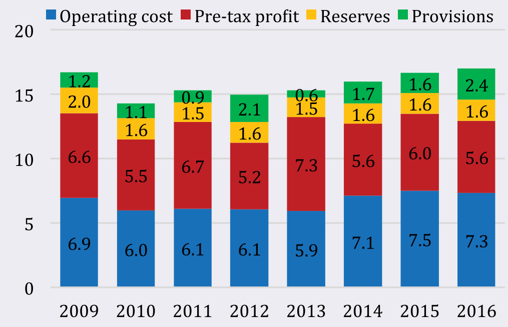
## Box 3: Understanding determinants of interest rate spreads in Uganda

***According to bank-level financial statement data, lending rates and spreads increased to a moderate extent in the period from 2009 to 2016.*** *The average effective interest rate spreads[17] increased from more than 16 percent in 2009 to around 17 percent by mid-2016. However, these spreads declined in the period from 2009 to 2012. Effective lending rates (interest income on loans divided by net loans) for most banks increased modestly in the period from 2009 to mid-2016. On the other hand, effective deposit rates (interest expense on deposits divided by deposits) declined slightly during this period. So, the widening in effective spreads is due to a slight increase in lending rates and a small decrease in deposit rates. The level of spreads in Uganda is higher than that of any other country in East Africa over the last five years.*

*The high operating costs and profits attribute significantly to the spreads in Uganda. The decomposition shows that on average, operating costs and profits accounted for 80 percent or more of the overall banking system spread in Uganda in the period from 2009 to 2016. A similar tendency is observed in peer countries, where profits and operating costs also contribute to a large proportion of the spreads.*

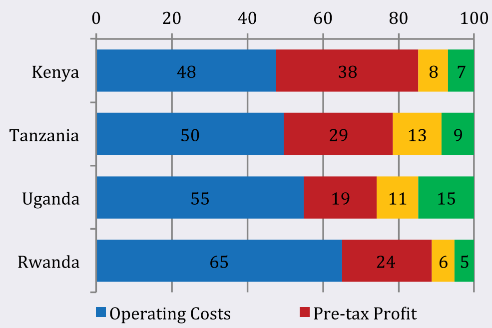
### Box Figure 3a: Interest Rate Spread Decomposition in Uganda and EAC

***Spreads in Uganda (2009 - 2016)[18]***




*Source: BoU*

***Components as a share of the spread (2014)[19]***




*Source: Bankscope, Bureau van Dijk*

***Reserve requirements and loan loss provisioning contribute to a relatively small proportion of the spreads, but they are essential for financial sector stability.*** *Reserves and loan loss provisioning increase bank resilience to shocks from sudden deposit withdrawals and loan defaults. The level of provisioning can depend on bank-specific and macroeconomic factors. For instance, banks with high-risk loan profiles may provision more than banks with lower risk loan profiles, while lower GDP growth tends to be associated with higher provisioning. In addition, the loan loss provisioning component of the spread increases as asset quality deteriorates, signaling a rise in default risk.*

***The most significant component of operating costs is staff remuneration costs, with the scarcity of skilled staff contributing to these high costs.*** *On average, staff salaries represented 42 percent of total operating costs across all banks in the period from 2009 to mid-2016. High salaries for financial sector professionals in Uganda are an important contributing factor to high lending rates. The high cost of skilled staff can be primarily explained by the scarcity of qualified professionals. High operating costs in Uganda can also be explained by relatively low levels of efficiency in the banking sector. In 2014, Uganda's ratio was one of the highest in the EAC and it was also much higher than the median ratios of low and upper middle income countries. In addition, a bank's business model and customer outreach have an important effect on operating costs. For banks that target MSMEs and low-income consumers, the costs of conducting due diligence on borrowers can be relatively high, particularly in an environment characterized by difficult access to reliable information on retail borrowers. In addition, banks with a large branch network incur higher operating costs and the requirements for opening branches in Uganda make it very expensive to expand into rural areas. For the most part, the costs of rent, electricity, staff etc. outweigh the financial benefits for banks,*

17. Effective or ex-post spread defined as the difference between the effective (ex-post) lending and deposit rates calculated using financial statement data.
18. All data points use financial data from end of December with the exception of 2016, which uses financial data from the end of June 2016.
19. Source data is from Bankscope to ensure comparability across countries. So, the calculations for Uganda maybe show different shares than decomposition calculations generated using Bank of Uganda data. Note data from Burundi was not available.

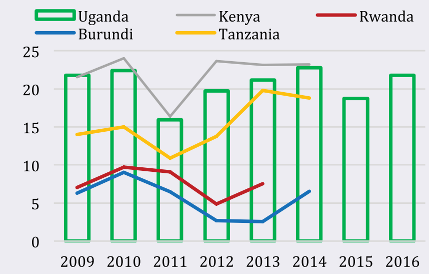
*as the numbers of customers served and the volume of transactions is often low in rural areas. Lastly, structural challenges in developing countries elevate the costs of doing business. In general, banks in developing countries cite high operating costs as one of the main reasons for the high lending rates. Gaps in physical infrastructure, unreliable electricity supply, and expensive IT and telecommunication services, all of which are commonplace in these economies, contribute to high operating costs and, in turn, to high lending rates and spreads.*

***Overall, there is a high rate of variation between the lending rates and spreads of different banks in Uganda.*** *For instance, in June 2016, lending rates ranged from about 32 percent to about 9 percent, while spreads ranged from more than 25 percent to as low as 7 percent. These differences are generally the result of diverse range of bank business models and strategies. The decomposition of spreads also varies across the different banks. Operating costs contribute to the largest portion of spreads in about half of the banks. These banks are generally smaller, less efficient, with weak balance sheets, and with a small market share. More efficient banks have lower operating costs, although they tend to set their interest rates in line with less efficient banks to increase their profitability. As a result, profits contribute to the largest portion of spreads in the other half of banks. These banks are mostly larger, well-established institutions with significant market power. Provisions contributed to a relatively small proportion of spreads for most of the banks over the period of analysis. This is surprising, considering the differences in the different banks' target market segments and the deterioration in asset quality experienced by some banks.*

***Bank investments in government securities also have an effect on interest rate spreads.*** *African banks tend to invest in government securities to a greater extent than do other developing countries in other regions. While this is partly due to the limited opportunities to invest in the real economy, the returns on these "risk-free" investments tend to be relatively high in Africa. Therefore, bank investments in securities can be highly profitable compared to lending operations, which inherently incur a higher level of expense and which carry more risks. In Uganda, bank holdings of government securities in Uganda are comparable to other EAC countries, remaining on average relatively stable in spite of rising yields (see Box Figure 3b). The share of government securities held by Ugandan banks is higher than the share held by any other EAC country with the exception of Kenya. In the period from 2009 to mid-2016, the average share has remained steady, fluctuating around the level of 21 percent of total assets.*

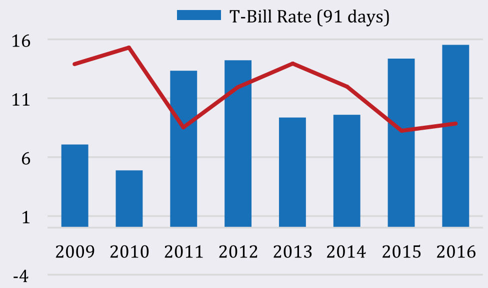
**Box Figure 3b: Bank Holdings of Government Securities and Treasury-bill yields**

***Share of Government Securities to Total Assets (in percent)***




*Source: BoU, Bankscope, Bureau van Dijk*

***Average Short term T-Bill Rates and Lending risk premiums (in percent)***




*Source: BoU*

***The level of development of financial infrastructure is another significant driver of high lending rates and spreads.*** *In countries with well-developed financial infrastructure, information asymmetries and risk premiums are relatively low, which leads to lower spreads. Lenders have ready, reliable access to information by which to assess their borrowers and their pledged collateral, which significantly lowers the costs of conducting due diligence. On the other hand, in countries with an underdeveloped financial infrastructure, the costs of conducting due diligence are much higher and credit risks are poorly assessed, which means that borrowers are relatively more likely to pay the same rates as bad borrowers. As a result, lending rates and interest rate spreads in these countries tend to be higher to compensate lenders for the much higher level of risk and operating costs.*

### 3.3.2 Limited financial infrastructure and requisite collateral

**The limited level of development of financial infrastructure and access channels, especially in rural areas, limits the degree of financial inclusion and partly explains low savings rates.** The highly-dispersed population limits the effective market size, as the provision of financial services outside urban centers is not cost-effective if traditional banking business models are utilized. Financial institutions report that the costs of establishing and opening physical bank branch offices in rural areas of Uganda are often prohibitive. Agent banking, which could alleviate this constraint, was only recently permitted under current legislation. The physical requirements for opening a branch are high and infrastructure is inadequate. Since the volume of transactions in rural areas is generally small, opening branches in rural areas is often economically unviable. As a result, while performance in terms of geographical outreach indicators has been increasing, it has been doing so at a very slow pace. The IMF's Financial Access Survey of 2014 shows that Uganda had 2.9 branches per 100,000 adults, a significantly lower ratio than that recorded by neighboring countries, with the exception of Tanzania, where the ratio stood at 2.56. By comparison, Burundi recorded a ratio of 3.13; Kenya a ratio of 5.56; and Rwanda of 5.98.

**A robust credit infrastructure enables the better use of borrowers' property and reputational capital to overcome asymmetric information and lowers the cost of providing finance.** Unfortunately, in this area, Uganda falls short. The limited availability of high-quality collateral, particularly in the form of properly registered land, contributes to the limited access to bank loans and to their high cost. As was discussed in the sixth edition of the Uganda Economic Update,[20] only 20 percent of Uganda's land is registered, most of which is mailo land, which cannot be used as collateral because banks cannot liquidate it, as the rights of the landowners overlap with those of legally recognized tenants, who enjoy inheritable and transferrable rights as landlords. The low rate of land registration in Uganda compares unfavorably with the rate recorded in Rwanda (60 percent) and even more unfavorably with that recorded in Western European countries (95 percent). However, it compares favorably with the average sub-Saharan African country. Measures to accelerate land registration and to develop the capacity of institutions responsible for resolving land disputes needs to be prioritized given the extent to which land tenure insecurity constrains economic growth in Uganda. It has been estimated that land disputes in Uganda reduce annual agricultural production by 5–11 percent.

**Additionally, the inability to use movable property as collateral restricts access to formal loans, especially for SMEs and farmers.** At present, there is no unified legal framework for secured transactions which extends to creation, publicity and enforcement of functional equivalents to security interests in movable assets in Uganda. Uganda scores a 6 out of 12 in terms of the legal rights index for the World Bank's Doing Business (2017) Indicators. Financial institutions require high levels of collateral, given the issues related to the lack of land tenure security and to the lack of a framework for enforcing against movable property. Enterprise surveys shows that on average, Uganda's banks require collateral to a value of up to 160 percent of the value of the loan, with 87 percent of loans to firms requiring collateral, significantly higher than the average level for sub-Saharan Africa, which stands at 79 percent.

**These challenges are even more pronounced within the agriculture sector, for which the structure of economic activity contributes to constraining access to credit.** Agriculture is made up mainly of smallholder farmers with low and irregular average incomes, making their risks difficult to assess, while the costs of reaching them are high. Without agriculture specific insurance, the risks of drought and flooding are quite significant, contributing to lack of bankable projects. Without a supportive legal and regulatory framework for leasing, it is not easy to use that instrument to tap long term capital, especially for machinery and agricultural equipment.

**There are many mechanisms in place to increase finance to the agricultural sector, but their development impact is difficult to assess.** Evaluating these different mechanisms to identify strengths and weaknesses and opportunities for refinements would be as important as identifying new interventions. The new interventions could include offering targeted training to financial institutions on specific topics, introducing agriculture insurance, promoting the financing of smallholders indirectly through aggregators to minimize costs and share counterparty risk, carrying out programs to address the significant technical and managerial skills gap of agricultural entrepreneurs, and others.

20. World Bank, 2015, Searching for the "Grail": Can Uganda's Land Support its Prosperity Drive? Uganda Economic Update (6th Edition) September 2015.

**Uganda has made significant progress towards the development of its credit reporting system in recent years, accompanied by enactment of a number of regulations and the implementation of other measures to support its effectiveness.**[22] This is a significant development, as a well-functioning credit reporting system is an essential measure to reduce information asymmetry and to enable lenders to make informed choices. A World Bank report on Credit Information Sharing Reforms on Banking Financing (2014) finds that following the establishment of a credit bureau system, the level of access to finance increases; interest rates decline; average periods of maturity lengthens; and the share of working capital financed by banks increases.

**In spite of the establishment of the credit bureau system, the majority of consumers are still not included in that system, with this lack of inclusion limiting their level of access to financial services.** This is because data in the credit bureau is predominantly based on information provided by banks, with most Tier IV institutions not involved in the provision of data. In the future, in order to increase the benefits of the credit reporting system for both lenders and borrowers, it will be necessary to increase both the number of data providers and the proportion of the population covered. According to the World Bank's Doing Business (2017) report, Uganda's credit bureaus only cover 6.6 percent of the population, compared to the figure of 67 percent recorded in OECD countries. Uganda does not have a credit registry.

**In Uganda, the limited ability of different systems utilized by the financial sector to interact seamlessly (interoperability) and the still limited outreach of mobile financial services means that expanding access to consumers at the bottom of the pyramid will be more challenging.** At present, MDIs and deposit-taking SACCOs still do not have access to the payment system. This prevents these organizations from offering modern, affordable payment solutions to a greater proportion of consumers. In addition, the lack of a mechanism to clear and settle payments between the financial conventional financial sector's electronic clearing system and mobile network operators limits cross sector functionality.

**Deposit accounts, pensions, and insurance services are perhaps the most significant potential tool to enable consumers to accumulate and protect their assets, but the uptake of these products is limited.** However, as of 2013, a greater proportion of adults utilized informal financial services than utilized the formal banking system (31 percent versus 16 percent). In addition, FinScope 2013 found that men were more than twice as likely to save at formal institutions as were women, indicating a significant difference in patterns of behavior between the genders. Women utilize informal financial services in Uganda to a greater extent than do men. While there are benefits to using informal services, the associated risks can be high, with consumers having little protection in the face of bad lending practices or loss of savings.

### 3.3.3 Past lapses in sector governance still undermining confidence in system

**As the discussion above suggests, Uganda's financial system has failed to effectively mobilize and intermediate finance.** The low interest rates on deposits in the banking system are accompanied by high fees on deposit accounts and other banking transactions. This creates disincentives to savers, who still prefer to hold their savings in the form of physical assets such as land and livestock. It has also been observed that competition for deposits has intensified following the removal of the moratorium on the entry of new banks in 2007 and the transfer of deposit accounts held by donor agencies from commercial banks to the central bank in early 2005. However, these measures seem to have benefited only a small segment of the market, particularly those that can hold fixed deposits, thus having only a limited impact on attracting new savers.

**In addition, the proportion of the population holding savings accounts at formal institutions is limited by the generally low level of confidence that consumers have in such institutions, particularly due to moral hazard at the base of the pyramid.** This lack of confidence is largely due to the large number of closures and cases of fraud involving financial institutions, particularly SACCOs, during their period of rapid growth over the past decade. Since 2006, the Government has attempted to harness the potential of these institutions to facilitate the achievement of higher levels of financial inclusion, providing significant support to strengthen and expand their outreach. Unfortunately, this public intervention has undermined the stability of the SACCOs, many of which began to act as distributors of subsidized loans. At the same time,

21. With the goal of establishing an appropriate legal and regulatory environment for credit reporting in Uganda, the CRB Regulations were developed and gazetted in 2005. The purpose of these Regulations is to regulate the licensing and operation of CRBs licensed under the FIA (2004) and the obligations of MDIs with regard to CRBs under section 46 of the MDIA (2003).

the overall sector remained weak due to a lack of regulation, oversight and supervision. While NGOs and microfinance companies have contributed significantly to increasing the level of access to microfinance services in the country, they are also characterized by similar issues that affect the SACCOs. While BoU has devoted significant effort to safeguard the stability of the financial system and fostering trust of the population, these efforts have to be intensified to overcome public perception formed over any negative occurrence within the system, even in the case of the formal financial channels. The most recent of such negative developments culminated in the takeover of Crane Bank by BoU, but a number of other, similar events and even closures in the 1990s also had an impact on consumer confidence in banks. This has resulted in a more general lack of confidence in financial institutions, with a spillover effect on the level of deposit mobilization of other financial intermediaries.

## 4.0 Exploring options for closing the gaps in Financial Credit Inclusion

**The issues constraining increased levels of financial inclusion in Uganda are multifaceted.** Thus, increasing these levels requires a multifaceted approach. The overarching objective must be to comprehensively strengthen the financial system, particularly as inclusion involves institutions other than the standard deposit taking institutions, financial service users comprising of individuals, households and firms, and durations of finance ranging from short to long term finance. Building public confidence in the financial system to raise more financial savings; adopting more cost effective modes of providing credit; and ensuring good governance through more comprehensive and up-to-date regulatory and supervision frameworks, are the most important areas to ensure the financial sector supports the much needed growth acceleration. These are elaborated below.

### i) Mobilizing more savings

**In order to mobilize a higher level of savings at financial institutions and to get a higher proportion of individuals, households or firms to demand for credit from them, consumers must have greater confidence in the safety and integrity of these institutions.** They must also have ease of access to points of service, which could be facilitated through agent banking[22] or through an expansion of mobile money services. The general level of confidence in informal financial institutions will increase when a large proportion of consumers experience good, efficient and reliable service over time. Expanding both the scope of coverage and the usage of mobile financial services could involve technological solutions and new innovations to increase financial access and usage across the spectrum. Beyond the deposit taking institutions, increasing the general propensity to engage in long-term savings is key to protecting consumers against financial vulnerabilities and to providing safety nets. Additionally, strengthening pensions and insurance markets could catalyze growth by matching long-term investors to borrowers and creditors.

This underscores the need to comprehensively strengthen the financial system. To increase coverage of insurance, especially in the case of lower income households, policy actions could aim to expand the current awareness campaign to better communicate the benefits of insurance products; strengthen the regulatory enforcement of compulsory insurance products; and use banking agents as distribution channels for insurance products.

**As was also emphasized in the fourth edition of the Uganda economic update23 , the main function of the pension sector must be to encourage long term savings.** Measures must be put in place to ensure that pension savings are invested well to provide a good return to savers whilst minimizing potential risks. In this respect, the proposed Pensions Liberalization Bill to strengthen the capacity of pension funds to meet their liabilities, to improve the administration of the sector, and to provide a policy and legal framework to increase participation in retirement savings schemes, is a move in the right direction. Once enacted, it can allow for the expansion of the coverage of pension schemes to include self-employed workers and those in the informal sector.

22. Recent amendments in the Financial Institutions Act have removed prohibitions to use of agent banking.
23. World Bank, 2014, “Reducing Old Age and Economic Vulnerabilities: Why Uganda Should Improve its Pension System” Uganda Economic Update, 4th Edition; June 2014.

## ii) Making Finance more Affordable

**Reducing the cost of finance in a sustainable manner requires a sustained effort to overcome a number of structural challenges.** Addressing these challenges requires long-term investments and major structural reforms to fundamentally lower the cost of doing business in Uganda, with these reforms involving a restructuring of the economy and the banking system. However, there are measures to address the factors contributing to high lending rates and spreads that could help in the short to medium term. These measures include addressing existing information asymmetries; strengthening financial infrastructure; institutionalizing the development of financial sector skills; and developing payment systems. To be effective, these measures need to be combined with efforts on other fronts, including efforts to maintain macroeconomic stability, reduce the cost of doing business and to improve the business environment more generally.

**Strengthening credit infrastructure is particularly critical for MSMEs, as lenders usually possess very scare information on them and are highly risk-averse when lending to this segment.** To help banks and borrowers better and quicker assess these borrowers, policy actions could focus on strengthening the credit reporting system and the secured transactions and insolvency frameworks. As a means to increasing the coverage of credit bureaus and to enable them to play a more meaningful function, they need to have access to a wider range of sources of credit information and to include a greater range of users to develop more complete and deeper credit profiles.

**The generally high interest rates imposed by financial institutions are the result of a number of factors, including factors outside the control of those financial institutions.** Therefore, it is not productive to drive these rates downwards merely by capping interest rates by fiat. To effect change in the short term, some governments have implemented interest rate controls and regulations. While interest rate controls signal a high level of government commitment to reducing the cost of finance, such measures do not address the underlying cause of the high interest rate and therefore often have counterproductive effects (see Box 4).

*Morgan Mbabazi, 2016*


***Nakato waiting for customers at Nakasero market***

*Strengthening credit infrastructure is particularly critical for MSMEs, as lenders usually possess very scare information on them and are highly risk-averse when lending to this segment*

### Box 4: Interest Rate Caps: Experiences from around the world

***Around the world, there are numerous examples of governments and regulatory agencies imposing controls on interest rates on loans.*** *These controls have been justified for a number of reasons, from supporting specific sectors in the economy in cases where there is a market failure in the financial sector, to protecting borrowers from exploitation and increasing the level of access to finance. At present, roughly 20 countries in sub-Saharan Africa have interest rate caps on loans. Most recently, Kenya enacted regulations on lending rates, with these regulations coming into effect in September 2016, effectively reintroducing caps that had previously been eliminated in July 1991.*

***Available empirical evidence shows that interest rate caps have had varying degrees of effectiveness.*** *Helms and Reille (2004) and FAI (2010) show that interest rate caps reduce price transparency and do not prevent the exploitation of borrowers. Maimbo (2014) analyses the available empirical research to conclude that the interest rate control has been predominately ineffective. However, in the case of the United States, a few studies have demonstrated positive outcomes.*

***There is ample evidence that interest rate caps can indeed have unintended negative consequences.*** *These may include the withdrawal of financial services from the poor or from specific segments of the market, an increase in illegal lending, a decrease in the licensing of new lending institutions, an increase in the total cost of loans through additional fees and commissions, and a decrease in product diversity.*

*Documented experiences with interest rate controls in SSA include:*

- ***South Africa: Some financial institutions evaded caps by charging credit life insurance and other services, which reduced the transparency of the total cost of credit.***
- ***WAEMU: The imposition of interest rate caps on microfinance loans caused microfinance institutions to withdraw their services from poor and more remote areas and to increase average loan sizes to increase the level of efficiency and returns, because the interest rate ceiling made serving poor in remote areas unfeasible.***
- ***Zambia: Interest caps, introduced in 2013, were removed with immediate effect at the end of 2015. Studies showed that these caps limited access to finance, particularly for SMEs. Micro-finance institutions considered that the rate caps did not enable them to reach the breakeven point, causing a number of entities to exit the sector. In addition, as Treasury bill rates increased, these caps on commercial bank lending became increasingly binding.***

*Sources:*

***Helms, Brigit, and Xavier Reille. 2004. "Interest Rate Ceilings and Microfinance: The Story So Far." CGAP Occasional Paper 9, Consultative Group to Assist the Poor, Washington, DC.***

***Maimbo, Samuel. 2014, "Interest Rate Caps around the World: Still popular; but a blunt instrument." World Bank Mimeo.***
***Financial Access Initiative (FAI, 2010); "Interest Rate Policy"; Policy Framing Note 4***
***World Bank, AFR Financial Monitor, various editions.***

**For the longer term, several of the required policy measures to reduce cost also relate to measures to promote savings in general, but key among which is a continued effort to increase completion.** It is essential to promote a higher level of competition between banks in the upper tiers; to facilitate the consolidation of banks in the lower tier; and to strengthen non-bank institutions, including financial intermediaries such as SACCOs and MDIs. Additionally strengthening pensions and insurance markets could increase competition and catalyze growth by matching long-term investors to borrowers and creditors.

### iii) Promoting good governance through stronger regulatory capacity and oversight

**While over recent years, the BoU has built and expanded its regulatory and oversight capacities significantly, a stronger and more encompassing regulation and supervision role would be necessary for the stability and deeper financial inclusion.** BoU has already conducted a number of measures to strengthen the legal, regulatory, institutional and supervisory framework of Uganda's financial sector. In particular, it advocated and facilitated amendments to the Financial Institutions Act (FIA) 2004 in January 2016. These amendments set out a path for the implementation of agent banking, Islamic banking, bancassurance, the revision of capital requirements, and the creation of a standalone Deposit

Protection Fund (DPF). Effective December 2016, commercial banks are also required to hold more capital, with this increase in capital requirements meant to strengthen the banking sector. BoU is also implementing measures to strengthen the identification of systemic risks. However, given the recent increase in non-performing assets across the banking sector, there is an urgent need for strengthening oversight of financial institutions. In addition, there are gaps particularly with respect to the adequacy of the existing deposit protection system meant to mitigate the impact of bank failures that result in contagious bank runs, and in the regulatory oversight of Tier IV institutions.

**Earlier reforms to the depositor protection system have permitted a good practice separation of regulation and supervision from deposit insurance.** Before the amendments to the FIA (2004), the responsibility for banks and MDIs deposit protection arrangements was mandated to the BoU. A key element of amendments was a major restructuring of the deposit protection framework. Two existing funds under the management of BoU were merged and the DPF was established as an entity, with contributing institutions including commercial banks, credit institutions and MDIs. The DPF is governed by a board consisting of seven members, including representatives of the Ministry of Finance, the BoU, and a number of other public and contributing financial institutions. The coverage level is now determined directly by the Minister of Finance, rather than the BoU, as previously. The Board is responsible for decisions related to the payment of protected deposits. In addition, the amendments enable the DPF to be appointed as a receiver or liquidator of a financial institution by the BoU. The appointment of members to the DPF's managing board is now almost complete. This is a step towards the establishment of the DPF as a standalone entity with clarity about roles and the cost of any interventions. However, as with any deposit insurance framework, governance issues in the banking sector have to be closely monitored to ensure that systemic risks have not increased due to moral hazard.

**Policymakers should also focus on measures to strengthen the regulation and oversight of the Tier IV financial institutions.** These institutions are not covered by the 2003 MDI Act, but rather are regulated by a range of authorities under a number of different laws. A significant step forward has been the enactment of the Tier 4 Microfinance Institutions and Moneylenders Act, 2016, by Parliament. It is now essential to establish and operationalize UMRA and to build the capacities of Tier IV financial institutions and of the agencies and associations that support them.

**Lastly, increasing savings and access to affordable financing requires addressing challenges outside of the banking sector.** Developing the Government debt market in a manner that supports financial inclusion and the expansion of financial services, as this market can have a significant impact on the pricing behavior of banks.  In addition, formulating and implementing a sound debt management policy, with a regular issuance policy that reduces the volatility of the returns on risk-free assets to transform the interest rate structure. Overall, implementing sound macroeconomic policies to reduce the level of volatility and risk premiums, with a high level of predictability in terms of macroeconomic performance being a significant factor. Frequent spikes in inflation and depreciation make it more likely that banks will hedge against unpredictability through the imposition of higher rates and spreads.

## iv) Prioritizing among the many priorities to deepen the financial system

**In view of the many policy actions, authorities ought to prioritize to start with those that are feasible and will make a significant impact.** As the above section indicate, the required actions are numerous, ranging from measures to ensure that the consumers of the services are aware of the benefits and costs to installing infrastructure that can reduce costs (see Table 6). In terms of priority, with the aim of generating the largest impact on the financial sector, the authorities should focus on the following:

i) Allow entrance of new strong banks that can challenge current market leaders, while consolidating banks in the lower tier by further increasing minimum capital requirements,  to stimulate competition within the banking system

ii) Stimulate the development and strengthen the capacity and oversight of non-bank financial intermediaries, to mobilize more savings and increase completion in the system.

iii) Expand coverage of individuals and businesses by credit bureaus and increase the spectrum of data contributors, strengthen the legal and regulatory framework governing secured transactions and creditor rights, and establish a centralized movable collateral registry, in order to strengthen the credit infrastructure.

iv) Strengthen the legal, regulatory, institutional and supervisory framework of Uganda's financial sector to be able to support a deeper financial system.

v) Promote sound debt management policies and macroeconomic policies to avoid Government borrowing crowding out credit to private sector.

vi) Stimulate the demand side by conducting financial literacy programs, improve consumer protection practices and foster trust of the population in the financial system to achieve better deposit mobilization and extension of the maturity of the deposit base.

**The measures described above would play a significant role in strengthening the Government's strategy to ensure that a far greater proportion of Ugandans have access to a broad range of high-quality, affordable financial services.** Increased financial inclusion will facilitate higher levels of productivity and enable both households and businesses to mitigate against the impact of shocks. A framework to achieve this already exists in the form of the National Financial Inclusion Strategy (NFIS), which was developed through a multi-stakeholder consultative process, with the support of both the private and public sectors, under the stewardship of the MoFPED and the BoU. Increased access to financial services is intended to enable the self-employed to become more productive and resilient, to generate increased economic activity, and to facilitate the achievement of higher levels of equality and inclusion. To achieve these goals, more than 50 countries around the world have committed to increasing the level of financial inclusion as part of their broader national development plans.

**The next update will explore more closely options for increasing availability of longer term finance.** If Uganda is to achieve its aspirations of increased growth and shared prosperity, it should maintain and expand its commitment to increasing access to financial solutions both for short and long term uses. That way, the country will ensure that a greater proportion of its population can benefit from and contribute to sustainable, long-term economic growth.

Table 6 : Policy Actions to increase financial inclusion

**A. Mobilizing savings**

**Building consumer confidence in formal and non-bank deposit taking institutions.**

- Accelerate the implementation of amendments to the FIA Act to improve the deposit insurance system
- Conduct financial literacy programs
- Building the capacities of CIs, MDIs and SACCOs through a number of measures, including institutionalizing the development of financial sector skills through the establishment of an industry-wide curricula for professional banking, MFI, and SACCO practices;
- Promoting a more robust prudential system of regulation and supervision of SACCOs by operationalizing UMRA through a number of measures, including issuing related regulations for licensing, regulation, consumer protection and prudential norms;
- Strengthening and increasing consumer awareness of existing deposit protection mechanisms;
- Developing effective complaints units within BoU, UMRA, and the IRA to enable consumers to report issues related to their rights within the formal sector;
- Improving consumer protection practices in MFIs, mobile financial service providers, banks, SACCOs, and insurers;
- Creating a more conducive environment to enable consumers to access deposits, effect savings, and take up other services, such as insurance, especially in remote and hard-to-reach areas through measures to develop, maintain and regulate an agent banking infrastructure;
- Utilizing innovative technologies to further develop linkages between informal and small financial institutions, such as VSLAs, and the formal sector, to achieve higher levels of financial inclusion for a greater number of women and rural households.

**Increase coverage of insurance, especially in the case of lower income households**

- Expand the current awareness campaign to better communicate the benefits of insurance products;
- Strengthen the regulatory enforcement of compulsory insurance products;
- Use banking agents as distribution channels for insurance products.

**Ensure that pension savings provide a good return to savers whilst minimizing potential risks**

- The enactment of the Pensions Liberalization Bill to strengthen the capacity of pension funds to meet their liabilities, to improve the administration of the sector, and to provide a policy and legal framework to increase participation in retirement savings schemes;
- The expansion of the coverage of pension schemes to include self-employed workers and those in the informal sector.

**Enable mobile service providers to offer more innovative, efficient, safer, and cheaper mobile accounts**

- Conducting a pricing review of mobile financial services and supporting the Uganda Communications Commission to review the need for structural changes or other actions to promote competition in the market;
- Developing linkages and connections between mobile financial service providers and established financial system.

**B. Reducing the cost of finance**

**Promoting a higher level of competition in the upper tier of the banking sector and consolidating banks in the lower tier.**

- the entrance of strong banks which can challenge current market leaders,
- consolidation of banks in the lower tier by further increasing minimum capital requirements, and
- Stimulating the development and strengthening capacity and oversight of other types of financial intermediaries, including MDIs and Tier IV institutions.
- Promoting the development of other types of financial intermediaries, including savings and credit cooperatives.

**Strengthening financial infrastructure, particularly the credit reporting system and the secured transactions framework.**

- Increase depth and breadth of credit information by expanding coverage of individuals and businesses and increasing the spectrum of data contributors;
- Strengthen the legal and regulatory framework governing secured transactions, creditor rights and establish a centralized movable collateral registry. Encouraging the sharing of information between banks and other credit providers.
- Establish and maintain an efficient collateral registry and effective creditor rights framework.
- Modernize the payment systems.

**Addressing the high costs associated with expansion and establishment of new branches, especially in the rural areas**

- Leveraging technological innovations and other mechanisms to deliver innovative banking services. This could include measures to promote agent banking, now that regulatory amendments to remove the prohibitions on this form of banking services.

**Strengthening and institutionalizing the development of financial sector skills.**

- Establishing commonly accepted, industry-wide curricula for the training of professional banking staff and implementing a mandatory certification program to ensure a minimum standard of professional skills.
- Strengthening and institutionalizing available training at financial institutions; at the BoU; and at other financial sector regulators.

**Stimulating demand for financial services in rural areas**

- Conduct financial literacy programs,
- Improve consumer protection practices

**C. Improving regulatory oversight of financial**

- Accelerate the implementation of amendments to the FIA Act to improve the deposit insurance system
- Conduct financial literacy programs
- Improve consumer protection practices
- Tier IV regulation

*Organized farming can only survive on registered land*

*Morgan Mbabazi, 2016*

# STATISTICAL ANNEXES

### Table A1: Key Macroeconomic Indicators

| Indicator | Indicator | Indicator | Indicator | Indicator | Indicator | Indicator | Indicator | Est. Indicator | Proj. Indicator |
|---|---|---|---|---|---|---|---|---|---|
| Population | Millions | 31.0 | 31.9 | 35.1 | 37.6 | 38.7 | 39.9 | 41.1 | 42.3 |
| GDP | USD millions | 20181.4 | 20262.5 | 23237.0 | 24993.0 | 27761.0 | 27531.0 | 24661.0 | 26549.0 |
| Per capita GDP | USD | 651 | 635 | 662 | 665 | 717 | 690 | 600 | 628 |
| GDP growth | % | 5.2 | 9.7 | 4.4 | 3.3 | 4.5 | 5.1 | 4.8 | 5.0 |
| Gross Domestic Savings | as % of GDP | 19.7 | 19.5 | 17..7 | 21.7 | 19.9 | 21.9 | 24.3 | 23.1 |
| Gross Investments | as % of GDP | 12.5 | 12.3 | 28.2 | 29.5 | 29.0 | 31.5 | 24.3 | 27.9 |
| Inflation (period average) | % | 9.4 | 6.5 | 23.4 | 5.8 | 6.9 | 2.7 | 7.7 | 5.2 |
| Exchange Rate (end-year) | UGX/USD | 2283.3 | 2623.2 | 2472.0 | 2593.0 | 2600.0 | 3302.0 | 3778.0 | 3278.0 |
| **External Sector** | | | | | | | | | |
| Exports, f.o.b. | Million USD | 2,317.0 | 2,298.0 | 2,660.0 | 2,912.0 | 2,706.0 | 2,738.0 | 2705.0 | 2865 |
| Imports - f.o.b. | Million USD | -4,117.0 | -4,680.0 | -5,241.0 | -5,035.0 | -5,074.0 | -4,988.0 | -4575.0 | -5,048 |
| Current Account Balance | Million USD | -1631.0 | -1984.0 | -2219.0 | -1582.0 | -2105.0 | -1971.0 | -1452.0 | -1884.0 |
| Balance of Payments (overall balance) | Million USD | 235.0 | -597.0 | 759.0 | 337.0 | 378.0 | -353.0 | 95.0 | 22.0 |
| Gross Foreign Reserves | Million USD | 2384.7 | 2044.0 | 2643.8 | 2912.3 | 3394.0 | 2895.0 | 2962.0 | 2980.0 |
| External Debt | Million USD | 2343.4 | 2904.9 | 3067.3 | 3742.9 | 4339.5 | 5103.1 | 7299.5 | 7541.6 |
| Foreign Direct Investment | Million USD | 693.0 | 719.0 | 1244.0 | 940.0 | 1096.0 | 870.0 | 512.0 | 567.0 |
| **Monetary Sector** | | | | | | | | | |
| Average Deposit Rate | % | 2.0 | 2.1 | 3.2 | 3.0 | 3.1 | 3.3 | 3.2 | 3.3 |
| Average Lending Rate | % | 20.7 | 19.8 | 24.6 | 24.8 | 22.1 | 25.2 | 23.7 | 24.4 |
| Growth in Money Supply (M3) | % | 23.6 | 25.7 | 26.1 | 6.6 | 17.4 | 15.9 | 7.7 | 5.8 |
| **Government Finance** | | | | | | | | | |
| Total Domestic Revenue | as % of GDP | 10.5 | 13.6 | 11.2 | 11.3 | 11.6 | 13.0 | 13.5 | 14.0 |
| Tax Revenue | as % of GDP | 10.3 | 10.9 | 10.3 | 11.0 | 11.4 | 12.6 | 12.8 | 13.3 |
| Non Tax Revenue | as % of GDP | 0.3 | 0.2 | 0.2 | 0.3 | 0.2 | 0.3 | 0.6 | 0.6 |
| Grants | as % of GDP | 2.1 | 1.9 | 1.9 | 1.4 | 1.0 | 1.2 | 1.4 | 1.8 |
| Total Expenditure and net lending | as % of GDP | 16.7 | 19.1 | 15.6 | 16.2 | 16.6 | 18.5 | 19.7 | 21.9 |
| Recurrent Expenditure | as % of GDP | 10.5 | 12.7 | 9.1 | 9.0 | 9.5 | 9.9 | 10.8 | 10.4 |
| Development Expenditure | as % of GDP | 6.1 | 6.1 | 6.1 | 6.5 | 7.0 | 6.7 | 7.0 | 9.7 |
| Fiscal Balance (overall) | as % of GDP | -4.0 | -3.6 | -2.5 | -3.5 | -4.0 | -4.3 | -5.2 | -6.0 |

*Source: Ministry of Finance, Planning and Economic Development, IMF and World Bank*

**Table A2: Growth and Structure of the Economy**

| Economic Activity | Economic Activity | Economic Activity | Economic Activity | Economic Activity | Economic Activity | Economic Activity | Economic Activity |
|---|---|---|---|---|---|---|---|
| Real GDP Growth Rates (%) | 5.2 | 9.7 | 4.4 | 2.7 | 5.2 | 5.1 | 4.8 |
| Agriculture | 3.2 | 2.9 | 1.1 | 1.8 | 3.0 | 3.0 | 2.6 |
| Industry | 7.8 | 11.4 | 3.0 | 4.4 | 3.9 | 7.9 | 3.1 |
| o/w manufacturing | 4.5 | 7.8 | 2.7 | -2.5 | 2.2 | 11.0 | 0.4 |
| o/w construction | 12.5 | 15.0 | 3.9 | 10.8 | 5.3 | 2.7 | 5.8 |
| Services | 5.9 | 12.4 | 3.9 | 4.1 | 4.3 | 5.3 | 6.8 |
| **GDP Shares (% of constant GDP)** | | | | | | | |
| Agriculture | 26.2 | 24.6 | 23.8 | 23.5 | 23.2 | 22.6 | 22.2 |
| Industry | 18.1 | 18.4 | 18.2 | 18.4 | 18.3 | 18.7 | 18.4 |
| o/w manufacturing | 8.5 | 8.4 | 8.2 | 7.8 | 7.6 | 8.0 | 7.7 |
| o/w construction | 5.8 | 6.0 | 6.0 | 6.5 | 6.5 | 6.4 | 6.4 |
| Services | 48.5 | 49.7 | 49.9 | 50.3 | 50.2 | 50.2 | 51.3 |
| FISM and net taxes | 7.2 | 7.3 | 8.1 | 7.9 | 8.1 | 8.1 | 0.0 |
| **GDP Shares by expenditure type (% of nominal GDP)** | | | | | | | |
| Final Consumption Expenditure | 83.2 | 84.2 | 86.6 | 82.2 | 83.0 | 86.7 | 92.9 |
| Households | 73.8 | 74.6 | 73.9 | 74.4 | 74.8 | 77.8 | 82.7 |
| Government | 9.4 | 9.6 | 12.7 | 7.9 | 8.2 | 8.9 | 10.2 |
| Gross Capital Formation | 26.9 | 26.8 | 28.5 | 27.5 | 26.4 | 23.9 | 26.5 |
| Gross fixed capital formation | 26.6 | 26.5 | 28.1 | 27.1 | 25.9 | 23.5 | 26.1 |
| Charges in inventories | 0.4 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 |
| Trade balance | -8.9 | -11.8 | -11.1 | -8.5 | -8.5 | -8.2 | -7.6 |
| Gross domestic saving (% of GDP) | 12.5 | 12.3 | 17.7 | 21.7 | 19.9 | 21.9 | 24.3 |
| Public | 2.9 | 3.3 | 2.4 | 3.1 | 1.4 | 1.5 | 2.3 |
| Private | 9.6 | 9.0 | 15.3 | 18.6 | 18.5 | 20.4 | 22.0 |

*Source: Uganda Bureau of Statistics*

**Table A3: Central Government Fiscal Framework (% of GDP)**

| | Outturn 2008/09 | Outturn 2009/10 | Outturn 2010/11 | Outturn 2011/12 | Outturn 2012/13 | Outturn 2013/14 | Outturn 2014/15 | Outturn 2015/16 | Budget 2016/17 | Proj 2016/17 |
|---|---|---|---|---|---|---|---|---|---|---|
| **REVENUES AND GRANTS** | **13.5** | **12.7** | **15.5** | **13.1** | **12.8** | **12.6** | **14.2** | **14.9** | **16.2** | **15.9** |
| Revenues | 11.0 | 10.5 | 13.6 | 11.2 | 11.3 | 11.6 | 13.0 | 13.5 | 14.4 | 14.0 |
| URA | 10.6 | 10.3 | 10.9 | 10.3 | 11.0 | 11.4 | 12.6 | 12.8 | 13.6 | 13.3 |
| Non-URA | 0.4 | 0.3 | 0.2 | 0.2 | 0.3 | 0.2 | 0.3 | 0.6 | 0.7 | 0.6 |
| Oil Revenues | 0.0 | 0.0 | 2.5 | 0.7 | 0.0 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 |
| Grants | 2.6 | 2.1 | 1.9 | 1.9 | 1.4 | 1.0 | 1.2 | 1.4 | 1.8 | 1.8 |
| Budget Support | 1.5 | 1.1 | 1.1 | 1.0 | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 |
| Project Support | 1.0 | 1.0 | 0.8 | 0.9 | 1.1 | 0.7 | 0.9 | 1.0 | 1.5 | 1.5 |
| **EXPENDITURE AND LENDING** | **15.0** | **16.7** | **19.1** | **15.6** | **16.2** | **16.6** | **18.5** | **19.7** | **22.5** | **21.9** |
| Current Expenditures | 9.5 | 10.5 | 12.7 | 9.1 | 9.0 | 9.5 | 9.9 | 10.8 | 10.4 | 10.4 |
| Wages and Salaries | 3.4 | 3.2 | 3.5 | 3.1 | 3.3 | 3.4 | 3.5 | 3.5 | 3.6 | 3.6 |
| Interest Payments | 1.0 | 0.9 | 0.9 | 1.0 | 1.4 | 1.4 | 1.6 | 2.0 | 2.2 | 2.3 |
| Other Recurr. Expenditures | 5.1 | 6.4 | 8.2 | 5.0 | 4.3 | 4.8 | 4.8 | 5.2 | 4.7 | 4.4 |
| Development Expenditures | 4.8 | 6.1 | 6.1 | 6.1 | 6.5 | 7.0 | 6.7 | 7.0 | 9.8 | 9.7 |
| Net Lending/Repayments | -0.2 | -0.1 | -0.1 | -0.1 | 0.6 | 0.0 | 1.6 | 1.8 | 1.9 | 1.6 |
| Domestic Arrears Repaym. | 0.8 | 0.2 | 0.4 | 0.5 | 0.1 | 0.0 | 0.3 | 0.1 | 0.1 | 0.2 |
| **OVERALL DEFICIT** | | | | | | | | | | |
| Overall Fiscal Bal. (excl. Grants) | -4.0 | -6.1 | -5.5 | -4.4 | -4.9 | -5.0 | -5.5 | -6.2 | 0.0 | -8.1 |
| Overall Fiscal Bal. (incl. Grants) | -1.5 | -4.0 | -3.6 | -2.5 | -3.5 | -4.0 | -4.3 | -5.2 | -6.2 | -6.0 |
| **FINANCING** | **1.5** | **4.0** | **3.6** | **2.5** | **3.5** | **4.0** | **4.3** | **5.2** | **6.2** | **6.0** |
| External Financing (Net) | 1.6 | 1.9 | 1.5 | 1.9 | 2.2 | 1.3 | 1.2 | 2.9 | 5.4 | 5.3 |
| Domestic Financing (Net) | 0.0 | 1.7 | 2.3 | 0.0 | 1.1 | 2.3 | 3.2 | 2.2 | 0.9 | 0.7 |
| **MEMORANDA ITEMS** | | | | | | | | | | |
| Nominal GDP (Shs billions) | 34504 | 40946 | 47078 | 59420 | 64758 | 70458 | 77845 | 84907 | 92878 | 93939 |

*Source: Ministry of Finance, Planning and Economic Development, IMF and World Bank*

**Table A4. Monetary indicators**

| | 2008/9 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | Est 2015/16 | Proj. 2016/17 |
|---|---|---|---|---|---|---|---|---|---|
| **Monetary Aggregates** | | | | | | | | | |
| M3 as % of GDP | 18.3 | 20.5 | 22.4 | 19.0 | 18.6 | 20.1 | 21.1 | 20.7 | 19.8 |
| M2 as % of GDP | 14.3 | 15.9 | 17.1 | 13.0 | 14.0 | 14.9 | 14.3 | 14.3 | 13.7 |
| M3 growth rate (%) | 25.0 | 33.2 | 25.7 | 7.2 | 6.6 | 17.4 | 15.9 | 7.1 | 5.8 |
| M2 growth rate (%) | 26.3 | 32.1 | 23.9 | -4.2 | 15.7 | 14.1 | 8.8 | 8.9 | 5.8 |
| **Domestic Credit** | | | | | | | | | |
| Total domestic credit (% of GDP) | 9.2 | 11.9 | 16.0 | 11.8 | 12.5 | 14.2 | 16.5 | 16.9 | 18.4 |
| Private sector credit (% of GDP) | 10.4 | 11.4 | 14.3 | 12.7 | 12.4 | 12.9 | 14.1 | 13.5 | 13.2 |
| Total domestic credit growth (%) | 64.1 | 54.7 | 54.1 | -6.5 | 13.4 | 21.9 | 32.3 | 10.8 | 8.9 |
| Private sector credit growth (%) | 31.3 | 29.8 | 44.1 | 11.6 | 6.0 | 14.1 | 20.3 | 4.2 | 8.3 |
| **Interest Rates Structure** | | | | | | | | | |
| Average TB rate (period average, %) | 8.4 | 5.3 | 7.6 | 17.2 | 10.3 | 9.3 | 12.0 | 16.1 | 14.1 |
| Average lending rate (%) | 20.9 | 20.7 | 19.8 | 24.6 | 24.8 | 22.1 | 21.6 | 23.8 | 22.7 |
| Average deposit rate (%) | 2.1 | 2.0 | 2.1 | 3.2 | 3.0 | 3.1 | 3.3 | 3.2 | 3.3 |

*Source: Bank of Uganda*

**Table A4. Monetary indicators**

| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 Est. | 2016/17 Proj. |
|---|---|---|---|---|---|---|---|---|
| Current Account (incl transfers) | -8.1 | -9.8 | -9.5 | -6.3 | -7.6 | -7.2 | -5.9 | -7.1 |
| Exports of goods | 11.5 | 11.3 | 11.4 | 11.7 | 9.7 | 9.9 | 11.0 | 10.8 |
| o/w coffee | 1.3 | 1.8 | 1.9 | 1.7 | 1.5 | 1.5 | 1.4 | 1.5 |
| Imports of goods | -20.4 | -23.1 | -22.6 | -20.1 | -18.3 | -18.1 | -18.6 | -19.0 |
| o/w oil imports | -2.5 | -3.4 | -4.1 | -4.1 | -3.9 | -3.4 | -2.6 | -2.8 |
| Services (net) | -2.1 | -3.4 | -1.7 | -1.6 | -1.2 | -2.5 | -2.7 | -2.2 |
| Trade balance | -8.9 | -11.8 | -11.1 | -8.5 | -8.5 | -8.2 | -7.6 | -8.2 |
| Income (net) | -1.7 | -1.7 | -2.0 | -2.1 | -2.2 | -1.6 | -1.7 | -1.7 |
| Current transfers (net) | 4.6 | 7.1 | 5.3 | 5.9 | 4.3 | 5.1 | 6.3 | 5.1 |
| Capital and Financial Account | 8.8 | 5.3 | 10.1 | 6.1 | 6.5 | 4.2 | 4.2 | 7.2 |
| Capital account | 1.0 | 0.8 | 0.8 | 0.1 | 0.3 | 0.4 | 0.5 | 0.5 |
| Financial account | 7.9 | 4.5 | 9.3 | 5.9 | 6.1 | 3.9 | 3.7 | 6.7 |
| o/w direct investment | 3.4 | 3.5 | 5.4 | 3.8 | 3.9 | 3.2 | 2.1 | 2.1 |
| o/w portfolio investment | 0.2 | 0.0 | -1.1 | -0.2 | 0.0 | -0.6 | -0.7 | 0.1 |
| Overall Balance | 1.2 | -2.9 | 3.3 | 2.1 | 1.1 | 1.5 | 2.9 | 5.2 |
| Gross International Reserves (million USD) | 2384.7 | 2044.0 | 2643.8 | 2912.3 | 3394.0 | 2895.0 | 2962.0 | 2980.0 |
| Gross international reserves in months of imports | 4.4 | 3.2 | 4.3 | 4.5 | 5.1 | 4.3 | 3.6 | 4.2 |

*Source: Bank of Uganda*

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