



UGANDA

June 12, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION AND FOURTH REVIEW OF THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS¹

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

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

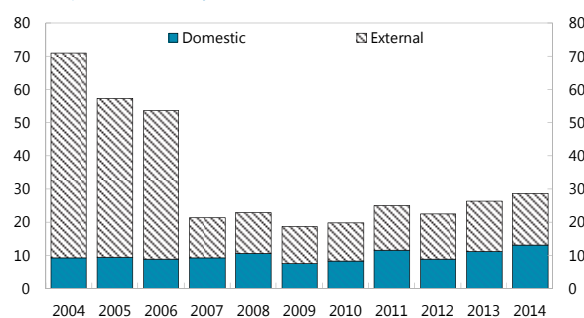
¹ The last Debt Sustainability Analysis update was conducted at the time of the third PSI Review in December 2014 (IMF Country Report No. 14/344). A full joint DSA is expected to be prepared once every three years for PRGT-eligible IDA-only countries, according to the Staff Guidance Note on the Application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

BACKGROUND AND RECENT DEVELOPMENTS

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

Chart 1. Uganda: Public Debt

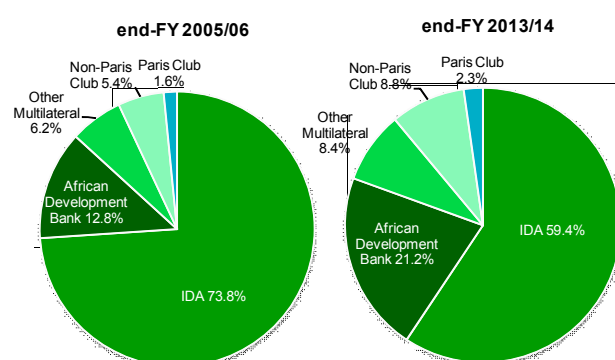
(In percent of GDP, fiscal year)



Sources: Ugandan authorities and IMF staff calculations.

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

Chart 2. Uganda: Composition of PPG External Debt



Sources: Ugandan authorities and IMF staff calculations.

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

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

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

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

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

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

Underlying Macroeconomic Assumptions

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

- *Growth* is projected at 6½ percent on average over the medium term, mainly supported by public investment. The successful completion of infrastructure investment would help sustain private sector development and boost the economy, bringing Uganda to middle-income status as envisaged in the authorities' National Development Plan. Therefore, the non-oil long-term growth assumption of 5¼ percent is anchored by the average per-capita growth among middle-income countries from 1990-2012 and UN's population growth projections.
- *The current account deficit* is projected at 12 percent of GDP on average over the medium term, reflecting Uganda's structurally high deficits and large import demand associated with the construction of large infrastructure projects. Project financing partly include foreign direct investment, while PPPs are treated as contingent liabilities to the government. Once the projects are completed, import demand would decline while export receipts would increase on account of potential energy surpluses and better road and railway infrastructure, in addition to crude oil exports

and reduced fuel imports. As a result, the current account deficit is projected, on average, at 4 percent of GDP in the long term.

- *The fiscal deficit* is projected to widen to an average of 6½ percent of GDP in the medium term, peaking at 7 percent in FY2016/17. This increase reflects the scaled-up investment, while current spending is assumed to broadly stabilize in terms of GDP. The amount of investment is higher than the previous DSA, leading to a higher overall deficit. After completion of the investment scale-up, the fiscal deficit long-term average is expected to come down to 1½ percent of GDP.
- *The envisaged NCB* under the PSI would increase over the medium term. The original \$2.2 billion will finance part of the construction of the Karuma and Isimba dams, a road project, and industrial substations with transmission lines. The NCB is expected to be broadly \$3.0 billion at end-December 2015. The additional \$0.8 billion will finance the Entebbe Airport rehabilitation, purchase of road construction equipments, and other electricity and rural electrification projects. Over the medium term, NCB is projected to increase to about \$8 billion (cumulative from June 28, 2013), reflecting projects currently in the pipeline.

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

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

Source: IMF staff projections

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

Box 1. Assumptions on Envisaged Oil Production

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

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

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

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

EXTERNAL DEBT SUSTAINABILITY

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

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

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

Text Table 2. PPG External Debt Thresholds

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

PUBLIC DEBT SUSTAINABILITY

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

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

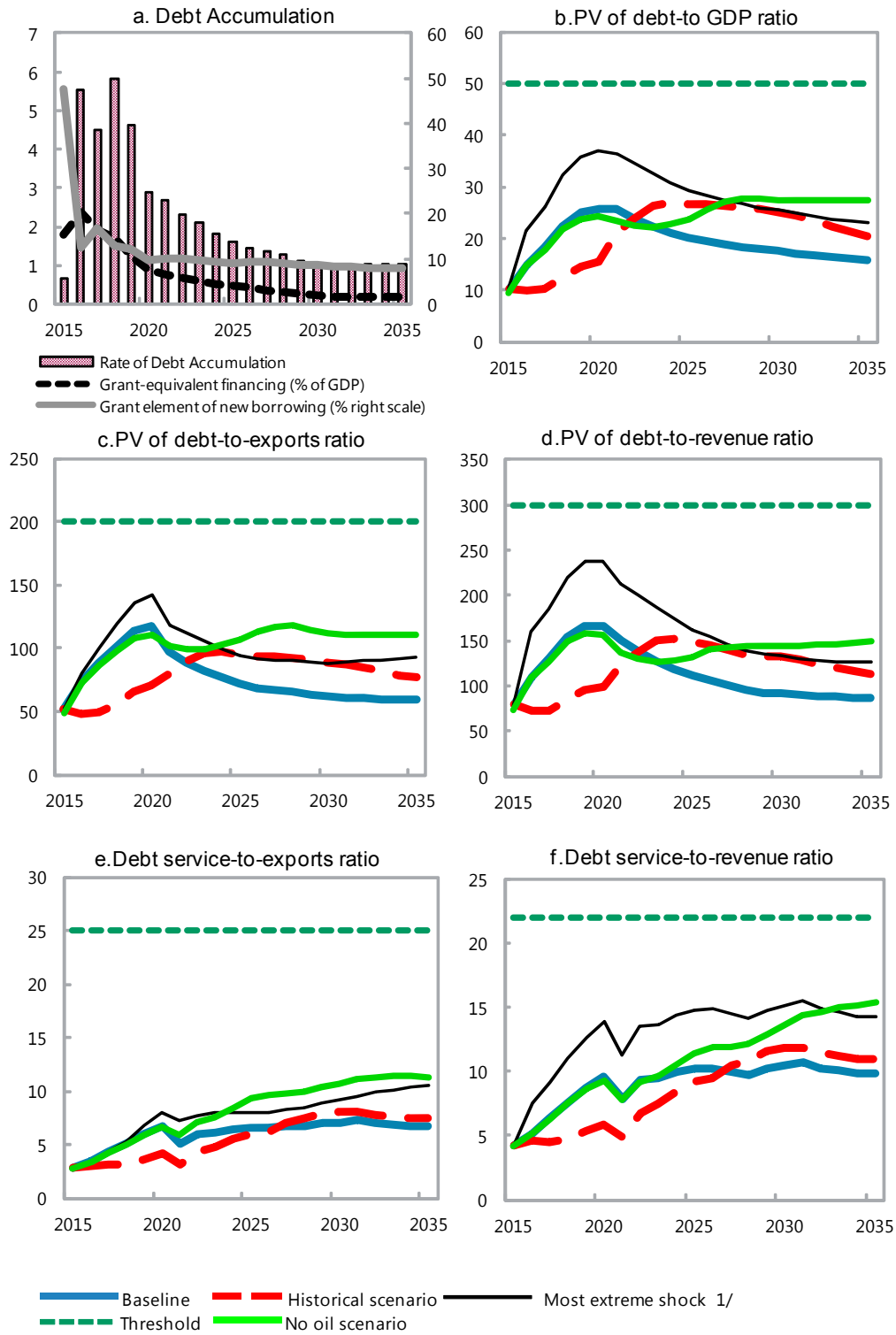
CONCLUSION

13. Uganda's risk of external debt distress remains low. The government's ambitious plan to scale up public investment remains consistent with debt sustainability, because the authorities have cautiously retained borrowing space after they received debt relief, and have started the planned improvement in tax

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

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

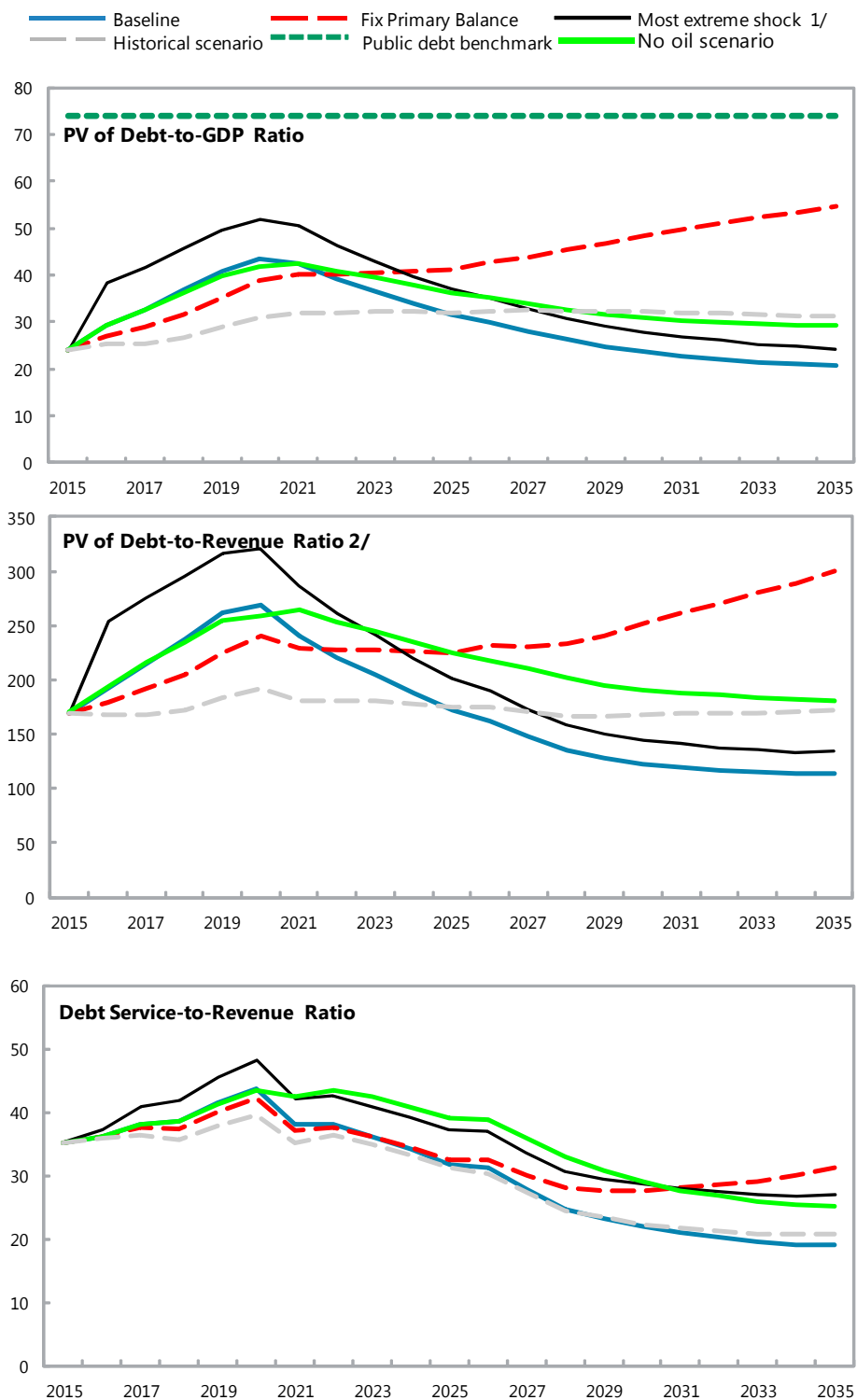
Figure 1. Uganda: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–2035



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

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

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



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

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

(In percent of GDP, unless otherwise indicated)

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

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

1/ Includes both public and private sector external debt.

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

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

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

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

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

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

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

Table 2. Uganda: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–2035

(In percent of GDP, unless otherwise indicated)

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

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

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

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

3/ Revenues excluding grants.

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

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

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

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

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

(In percent)

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

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

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Uganda: Sensitivity Analysis for Key Indicators of Public Debt 2015–2035

(In percent)

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

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

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

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

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

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

Program Performance

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

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

Recent Economic Developments and Outlook

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

Inflation has remained subdued mainly due to low food and import prices. However, this trend has more recently reversed with inflation gradually rising to 4.9 percent in May 2015. Although the recent oil price decline lowered the import bill, this was partially offset by the

exchange rate depreciation, in part due to global strengthening of the US dollar. The exchange rate pass-through and strengthening economic activity are expected to exert further upward pressure on consumer prices over the medium term. The annual core inflation is now projected to rise to 8 – 10 percent by the end of 2015/16, an increase of 1 percentage point compared to the April 2015 forecast. Consequently, the Bank of Uganda (BOU) increased the Central Bank Rate (CBR) by 1 percentage point to 13 percent on June 16, 2015, to ensure that medium term inflation converges towards its policy target of 5 percent. BOU will remain vigilant and take necessary monetary policy actions should the inflation outlook deteriorate.

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

Fiscal Policy

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

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

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

made amendments to clarify VAT applications in the oil, gas and mining industry to facilitate investments.

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

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

Monetary and Financial Sector Policies

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

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

Structural Reforms and Competitiveness

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

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

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

Conclusion

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