International Monetary Fund

Uganda and the IMF

Press Release:
IMF Executive Board Completes Fourth Review Under the Policy Support Instrument for Uganda
June 5, 2012

Uganda: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

May 18, 2012

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LETTER OF INTENT

Kampala, Uganda
May 18, 2012

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

Dear Ms. Lagarde:

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

Since the last review, tight monetary and fiscal policies have placed inflation on a pronounced downward trend. At the same time, growth appears to be weakening, both because of the policy stance and the slowing global economy. Government has steadfastly refused to succumb to the temptation to limit food prices by restricting exports, or by interfering with the exchange rate.

The attached MEFP sets out the Government's objectives and policies for remainder of this financial year and indicates our thinking for the medium term. No quantitative assessment criteria were missed for December 2011, and most of the structural benchmarks were achieved. We hereby request modification of assessment criteria for June 2012, establishment of new targets for December 2012, and completion of the fourth review. Formal targets for June 2013 will be set at the time of the 6^{th} review, with which we expect to request a successor arrangement to this PSI.

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

Sincerely yours,

/s/

Caroline Amali Okao (M.P)
MINISTER OF STATE/MICRO FINANCE AND ALSO HOLDING PORTFOLIO OF MINISTER OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

cc: Prof. Emmanuel Tumusiime-Mutebile, Governor, Bank of Uganda

Attachment I. Memorandum of Economic and Financial Policies

May 18, 2012

I. INTRODUCTION

1. The Government is committed to ensuring macroeconomic stability is maintained as the basis for sustainable economic growth and poverty reduction as set out in the National Development Plan (NDP). This Memorandum of Economic and Financial policies gives an update on economic performance for the first half of the current fiscal year, and lays out the policies Government is undertaking over the period ahead to reduce inflation and enhance growth.

2. We have taken firm measures through a combination of both monetary and fiscal policies to address our immediate priority of reducing inflation, which accelerated to unacceptable levels over the latter half of this year. Given the weak external environment, coupled with tight fiscal and monetary policies associated with the deflationary effort, our FY 2011/12 growth forecast has been cut from 5 to 4¼ percent. The Government will nonetheless persevere in its intention to reduce inflation to single digits by end of calendar year 2012, and to bring it down to the target level of 5 percent for core inflation by the middle of calendar 2013. The tight monetary and fiscal stance will continue into FY2012/13, but priority investment programs will be maintained and measures taken to further our structural reform agenda.

A. **Performance under the PSI**

3. All seven Quantitative Assessment Criteria (QACs) for end-December 2011 were met. The increase in net credit to the central government by the banking system was within target by Ush 86 billion. The ceiling on the increase in net domestic assets of the BOU was also observed, and international reserves increased by US$302 million, which was slightly more than programmed. Government incurred no external payment arrears, and borrowing on nonconcessional terms remained about US$300 million below the PSI three-year ceiling of US$800 million—although we expect our pressing infrastructure needs will easily fill this borrowing space by the end of the current PSI arrangement in May 2013. All oil revenues have been placed in a dedicated Petroleum Fund in the Bank of Uganda (BOU), and have been ring-fenced for construction of the Karuma Hydropower project. The over-performance on reserves was welcome—although it did had the effect of driving base money above its indicative program target, our inflation objective was in no way compromised.

4. Most of the structural benchmarks in the program were met. The names of beneficiaries of tax exemptions were gazetted and published, we produced regular quarterly reports on unpaid bills of nine Ministries, and have developed an index of high-frequency economic indicators. We have also submitted a strategy to cabinet for a rules-based methodology of ensuring power sector tariffs are adjusted to maintain full cost recovery. Government's net and gross position in the BoU is being reported, but we have not yet agreed with suppliers on the volume of residual subsidies needed in the power sector

(following January's tariff increase, which eliminates the need for subsidies going forward). We have published cash releases and actual payments for power and water obligations of spending ministries, although the sanctions applied to the accounting officers who allowed arrears to accumulate are not yet public.

II. ECONOMIC AND POLICY DEVELOPMENTS

A. Outturn in the First Half of FY 2011/12

Growth

5. Economic growth slowed in the first half of fiscal year 2011/12 to 1.8 percent, compared to 7.6 percent in the same period last year. For the year as a whole, the economy is expected to expand by 4¼ percent, lower than our previous projection by ¾ percentage points and 2½ percentage points lower than last year. Manufacturing and construction are leading the decline, with growth reduced to 2 and 4 percent this fiscal year from 8 percent in FY2010/11. The services sector is also projected to slow from 8.4 to 5.1 percent. However, agricultural growth showed a recovery in the first half due to a pick-up in cash crop production, and is expected to grow at an annual rate of 1.8 percent, up somewhat from the previous year.

Inflation

6. Inflation picked up sharply during the first half of fiscal year 2011/12, initially from higher food prices and the pass-through of exchange rate depreciation. However, by September, 2011, Government and the Bank of Uganda began to see signs that second round effects of this price shock were feeding through to underlying inflation. Non-food inflation rose significantly, as did core inflation. In consequence, the stance of monetary policy was tightened very sharply over the last four months of calendar 2011, with the BoU's benchmark central bank rate (CBR) rising by a cumulative 1000 basis points relative to July. Tighter monetary policy, combined with cautious fiscal policy, has begun to take effect. From a peak of 30.5 percent in October 2011, inflation has declined gradually to 21.2 percent in March 2012. Underlying price pressure is much reduced, with annualized monthly inflation now down to single digits.

Fiscal Performance

7. Revenue collections for the period July 2011 to February 2012 were lower than expected, even in nominal terms, despite inflation that was higher than forecast at the time the budget was approved. Direct taxes under-performed while indirect taxes were broadly as forecast in the budget. The major source of the underperformance was PAYE, where the shortfall was particularly marked in December 2011.

8. International trade taxes were below target despite exchange rate depreciation that would have been expected to raise the domestic currency value of revenue. Imports from EAC countries increased by 30 percent in the first half of the year compared to the same

period last year, while imports from the rest of the world declined by 10 percent. This resulted in a slight shortfall in revenue as imports from EAC partner states are covered by the customs union agreement.

9. Grant assistance from our development partners was broadly as expected, while loan disbursements were below programmed levels for the first half of 2011/12 by about 0.4 percent of annual GDP. Project loan disbursements underperformed by more than budget support, which was close to our forecast. It is expected that donor disbursements will be broadly on target for the year as a whole.

10. Overall expenditure for the first half of the fiscal year was about 8 percent below our original projection, mainly owing to lower externally-financed project loan disbursements. As a result, the overall deficit was somewhat lower than programmed.

11. Government will this year incur about 1 percent of GDP in supplementary expenditure in order to deal with unanticipated security threats in the region, and to cater for unforeseen expenditure priorities. However, these supplementaries will be financed mainly through suppression of lower priority expenditures and a modest widening of the budget deficit for the year as a whole. There is however some risk that the target for Poverty Alleviation Fund (PAF) spending will be missed by a small margin.

Balance of Payments

12. The current account deficit has continued to widen, particularly as a result of the trade balance. In the first half of FY 2011/12, the current account deficit stood at US$972 million compared to US$720 million in the same period last year. The import bill grew strongly, in part because of higher international commodity prices. The capital and financial account surplus registered a surplus of about US$1.18 billion from July-December 2011, owing mainly to private inflows and official lending from China compared to US$605 million in the first half of FY 2010/11. Gross international reserves increased by US$476.8 million to US$2.45 billion, which is equivalent to 3.6 months of future imports of goods and services by end-December 2011.

13. The Ugandan shilling experienced significant volatility over the past year, but recovered most of its losses by early 2012. Depreciation was related to the current account deterioration and broadly followed the inflation path, beginning in June 2011 and peaking at 24 percent in September. However, it began strengthening by October as tighter policy called forth substantial capital inflows and portfolio shifts towards domestic assets, so most of the depreciation was reversed by January 2012. With policy addressing the fundamental causes of the weakness of the shilling, BoU used direct intervention only to dampen the most erratic short-term fluctuations.

Monetary policy

14. The Bank of Uganda implemented a new monetary policy framework in FY 2011/12, termed Inflation Targeting "lite" (ITL). This framework proved effective in enhancing

monetary policy communication and anchoring inflation expectations. Its centrepiece is a monthly announcement of our CBR, which targets the 7-day interbank rate within a symmetric band. During the first 9 months of the fiscal year, markets began to respond to the new framework, and interest rates on government bonds and private sector loans have so far closely mirrored changes in the CBR. Moreover, observers have generally expressed satisfaction with the greater transparency of monetary policies in Uganda.

15. The BOU used its new framework to aggressively pursue a tight monetary policy stance during the first half of FY 2011/12, as it recognized that second round effects were beginning to feed through to underlying inflation. Nonfood inflation, in particular, had been very stable for a sustained period, but in August-October 2011 it rose significantly. The objective of the tight stance of monetary policy was to curb second-round effects and anchor medium-to-long-term inflation expectations on a trajectory consistent with the BOU's medium-term core inflation target of 5 percent. Up to February 2012, the BoU has had considerable ability to affect monetary conditions, and the growth of monetary aggregates has decelerated markedly. In the three months to February 2012, the annual growth rates of M1, M2 and M3 averaged 4 percent, 4 percent and 7 percent, respectively, compared to rates of 35 percent, 35 percent and 38 percent in the corresponding period of the previous year. Private sector credit growth is also more subdued, falling from 37 percent to 24 percent over a similar period. At the same time, tight monetary policies contributed to a strengthening of the exchange rate after September, which fed through to the price of traded goods.

16. With inflation established on a downward trajectory, the BOU began a cautious easing of its policy stance in February 2012. The policy rate was reduced by one percentage point in each of February and March, but then maintained in April at 21 percent owing to concerns about inflationary pressures over the coming months and to allow time for inflationary expectations to firm.

Financial sector

17. The Financial sector remained resilient in the first half of 2011/12, despite the sharp rise in inflation and interest rates. As noted in the FSAP of last year, the sector is well-capitalised and all banks are complying with capital adequacy requirements, registering a regulatory capital to risk-weighted asset ratio of 18.3 percent, which was well above the industry's benchmark of 12 percent. Asset quality however declined marginally in December 2011 relative to June, as the ratio of non-performing loans to total loans rose to 1.8 percent from 1.6 percent. But bank profitability has increased substantially with higher interest income, and the system remains solvent, liquid and profitable.

18. Development of the nonbank sector has proceeded rapidly, with savings and credit cooperative associations (SACCOs) expanding rapidly throughout Uganda. Government and BoU are preparing a regulatory framework for this segment of the financial market. At the same time, the pension sector regulatory authority is expected to be established shortly, after which Government will begin work on a draft bill to liberalize the pension sector.

III. OUTLOOK AND MEDIUM TERM POLICIES

A. Macroeconomic Objectives and Outlook

19. Government's macroeconomic objective over the near term is to ensure macroeconomic stability and growth. Growth is expected to slow to 4¼ percent in FY 2011/12 from 6.7 percent in the previous year, both because of weaker global demand and due to the tight macroeconomic stance needed to curb inflation. However, it should recover to 5.4 percent in 2012/13 and to an average of 7.0 percent over the medium term as macroeconomic stability is restored and investments take place in agricultural production and productivity, power and roads.

Fiscal Outlook for 2012/13

20. Fiscal policy will continue to support the disinflation effort in FY 2012/13, while promoting growth and development through infrastructure enhancement. Tax revenues will be boosted by more than ½ percentage points of GDP from additional tax policy measures (see below) and natural revenue buoyancy. However, we expect this impact to be largely offset by a decline in grants. With capital spending set to increase by 1 percentage points of GDP, significant fiscal savings will be needed from a compression of non-productive expenditure. Current spending is therefore to decline by 2 percentage points of GDP, an ambitious target even though two thirds will come automatically from the end of exceptional security spending and power sector-related payments. We have, therefore, prepared for the eventuality that effecting the necessary cuts in non-priority areas might prove problematic by establishing a contingency of 0.4 percent of GDP. Fiscal policy next year will therefore give priority to infrastructure investments aimed at boosting the productive capacity of the economy. In addition to the Karuma project, this will include improving agricultural productivity and value added, providing additional infrastructure in other areas, primarily roads, and re-skilling the labour force.

21. In light of significant infrastructure and social needs, there remains a pressing need for additional fiscal space, which we will address across a broad front.

- Tax policy measures will be introduced in FY 2012/13 to boost revenue and improve the efficiency of tax collection by streamlining exemptions. Specifically, Government intends to propose in the 2012/13 Finance Bill the following measures, which are expected to yield at least Ush 130 billion (0.3 percent of GDP):

Tax Policy measures—FY2012/13

Reinstate VAT on water;

Terminate VAT exemptions in the textile sector and for computers, software, printers;

Apply the standard VAT rate to hotels outside Kampala;

Increase the excise duty on locally-produced spirits from 45 to 60 percent;

Increase and shift the excise duty on cigarettes from specific to ad valorem;

Impose excise duty on imported fresh juices;

Terminate corporate income tax exemptions on agro-processing;

Impose an additional 10 percent marginal rate for the top bracket of PAYE;

Tighten the scope of corporate income tax exemptions for plant and machinery and civil works;

Increase the withholding tax rate on interest and dividends from 15 to 20 percent;

Enforce the existing capital gains tax on the sale of commercial buildings by individuals.

- Existing resources will be conserved through renewed emphasis on the efficiency of public spending by implementing performance-based, output-based budgeting. Efforts to synchronize quarterly spending with work plans will be strengthened; and quarterly cash releases will be phased so as to create a more even distribution of the fiscal deficit throughout the year. This is expected to lead to greater spending efficiency, as well as facilitate the more effective conduct of monetary policy.

- Moreover, government will begin to address outstanding weaknesses in tax administration. A Tax Procedure Code (TPC) is being prepared aimed at enhancing the efficiency of our revenue collection. Submission of the TPC to cabinet by the beginning of April 2012 has been set as a structural benchmark for the fifth review of the PSI-supported program. Although progress with the introduction of the National Identification Card system has been delayed, Government expects to accelerate progress over the coming months, such that 4 million ID cards will have been issued by December 31, 2012 (structural benchmark).

- Fiscal space will also be augmented by raising new sources of external financing for selected, well conceived investment projects. The existing US$800 million limit under the PSI-supported program is expected to be fully utilized. Government is therefore requesting a US$200 million increase in this limit to be effective from June 2012. Funds raised in this manner will be committed only on projects that have been appropriately vetted and judged to be both efficient and consistent with long-term debt sustainability, and which are "shovel ready" so as to avoid excess finance charges. Government will also investigate the feasibility and advisability of issuing long-term domestic currency denominated bonds to finance critical infrastructure projects, but will refrain from direct borrowing from the BOU for this purpose.

Monetary Policy

22. Government's overarching objective is to bring inflation down to the 5 percent target for core inflation over the medium term. The BoU will maintain its inflation targeting lite (ITL) framework, which has enhanced the transparency and effectiveness of monetary policy, and in this context will steer the CBR such that the pace of disinflation is expected to be consistent with reaching single digits late in 2012, and 5 percent in 2013. Looking ahead, if inflation is higher than forecast over the coming months, the BOU will raise the CBR, to ensure that real interest rates increase. The BOU is committed to act in a manner which will stabilise inflation, by raising the CBR by more than the change in the inflation forecast, i.e. by tightening further if the inflation outlook deteriorates.

23. If, however, price pressures continue to abate as expected, the BOU will gradually relax its policy stance in a manner and rate slow enough to keep expectations well grounded and to minimize both interest rate and exchange rate volatility. This is important not only to facilitate an orderly movement of short-term capital, but also to avoid exacerbating policy challenges stemming from global economic and financial volatility, which has led to uncertainty in regional foreign exchange markets. The flexible exchange rate regime will be maintained along with an open capital account, and the exchange rate will be allowed to fluctuate as needed to absorb external shocks—with intervention limited to smoothing short-term deviations from long-term trend.

24. BOU will continue with reforms to modernise and increase the effectiveness of its monetary policy framework. This will include settling on a definitive inflation target, enhancing the institutional and technical capacity for macroeconomic modelling and forecasting, and improving monetary policy communication in order to boost public confidence in the policy process to further anchor inflationary expectations. The BOU is also seeking to improve liquidity forecasting, develop procedures to ensure greater transparency and accountability, and enhance central bank independence. In this latter regard, and within the context of the Government's intended revision of its Debt Strategy, Government and BoU will review central bank capital arrangements and propose changes to legislation or policy as needed to ensure that the Bank is able to carry out its mandate. As a step toward full fledged inflation targeting, the BoU intends to begin publishing on its website its new monthly indicator of economic activity. It will also begin to distribute in draft form a quarterly inflation report (structural benchmark for December 2012). The BoU has requested the International Monetary Fund provide technical support to help carry out this program.

IV. Structural Issues and Reforms

A. Co-ordination and policy harmonization in the EAC

25. Policy coordination among the member countries is a prerequisite for deeper regional integration and a monetary union. Since the EAC countries are currently negotiating a monetary union protocol, which will pave way for monetary integration, it is important that they increase the level of macroeconomic policy harmonization.

B. Public Finance Management

26. Government has submitted to Parliament a new "Public Finance Bill" which seeks to consolidate all public finance management legislation. The proposed law consolidates the current PFAA 2003 and the Budget Act 2001 into one comprehensive law. In addition, the proposed new legislation contains provisions for the prudent management of oil revenues as well as for strengthening the management of public assets and liabilities. Moreover, it seeks to improve budget credibility by placing limit on reallocation within the budget, and by establishing a Contingencies Fund to finance supplementary spending. The proposed law is expected to be enacted by Parliament during FY 2012/13 for effect in FY 2013/14.

27. Although the new Public Finance Bill should clarify and limit the ability of government to carry forward expenditure appropriations from one fiscal year to the next, in the meantime, to limit the potential for abuse and diversion of funds, Government will take the following measures regarding unspent balances at the end of FY 2011/12: (i) publish the balances on all government accounts both in the BoU and in commercial banks as at June 30, 2012 and September 30, 2012; (ii) the Minister responsible for finance will present these accounts to parliament by July 31, 2012, and October 30, 2012, respectively; (iii) parliamentary approval, as well as supporting work and procurement plans, will be required in order to spend any balances held over from the previous year; and (iv) all unspent balances which have not been re-appropriated by parliament by end-September must be returned immediately to the Uganda Consolidated Fund.

28. Government understands that internal controls to prevent the accumulation of arrears need to be strengthened. In this context, Government will continue to report on a quarterly basis to Cabinet on all unpaid claims of spending units.

C. Improving the efficiency of cash management

29. To avoid unnecessary interest costs associated with Government borrowing from the domestic market, Government intends to implement measures aimed at improving the efficiency of cash management. One of the key reforms in this regard is the consolidation of the many fragmented Government accounts into a Single Treasury Account. This will help to bring about transparency in the interaction of fiscal and monetary policy, which may help in the appropriate pricing of Government securities.

D. **Oil Revenue Management**

30. The Government in February 2012 approved a policy on oil revenue management. The policy stipulates Government's continuation with prudent macroeconomic management to ensure a sustainable path for the non-oil budget deficit, aimed at minimizing the Dutch disease risks, boom and bust cycles, and excessive borrowing. Given that oil and gas revenues are subject to price volatility, we intend to use the non-oil, non-grant budget deficit (consistent with the broader macroeconomic management objectives) as a fiscal anchor to manage this volatility and to mitigate the risks to the economy from natural resource wealth. The anchor sets out the level of oil and gas revenues to be integrated into the budget on annual basis within the overall fiscal framework in a manner that limits the impact on other sectors of the economy.

31. The collection and administration of Government revenues from oil and gas activities will be the responsibility of URA. All oil revenues will be deposited in a special Petroleum Fund at Bank of Uganda with a twin objective of financing the budget and saving for future generations.

32. In order to promote social cohesion and stable investment and production environment, 7 percent of all royalty revenues shall be set aside for sharing between local governments located in the oil and gas producing areas. The mechanism of sharing these revenues amongst the local governments will take into account intra-regional fairness, level of production and sustainability principles.

33. Tax policy and revenue administration will continue to focus on improving non-oil tax revenues, given that oil is a finite and volatile source of revenue. Government borrowing will be conducted in accordance with revised National Debt Strategy. However, no debt will be securitized on the basis of future oil and gas revenues.

E. **Improving Public Investment Planning**

34. The Public Investment Plan (PIP) is to be re-focused on the National Development Plan, as it does not at present fully reflect the priorities of Government. Most of the projects in the PIP have not been subjected to a critical assessment to determine their benefits and costs. As a result the PIP is bloated with too many projects which are often not adequately funded, and which are not implemented efficiently due to capacity constraints and lack of preparedness. Some projects in the PIP lack feasibility studies, which significantly delays their implementation and often leads to a waste of public funds. A review of the PIP will be carried out and submitted to cabinet by September 2012 aimed at scaling back the number of projects and aligning the remainder with the availability of resources. Going forward, new projects will all be subject to critical cost-benefit analysis before their inclusion in the PIP, and the quality of these projects will generally be improved at the identification stage. This will facilitate credible alignment of the NDP priorities with the Medium Term Expenditure Framework (MTEF) and a proper costing of Government programs and projects, and hence promote improved value for money.

F. **Power Sector Reforms**

35. Government is committed to undertaking reforms that will create a more attractive business environment for private sector investment. These reforms include reducing system loses and improving financial management by rolling out prepaid meters. To this effect, Government will begin implementing its strategy for the power mix of the country. We plan to start production of heavy diesel oil which will be used to generate thermal power at a lower cost than the current private operators. The Bujagali Hydropower has come partially on stream and is expected to reach full capacity of 200 megawatts by later this year. However, in view of growing power demand as the economy expands, the additional power thus generated will only be adequate for the next two years, beyond which demand will again outstrip supply. Government is therefore exploring various financing options for new power plants, including possible issuance of Government infrastructure bonds when macroeconomic conditions improve.

V. PROGRAM MONITORING

36. Progress with implementation of the policies under this program will be monitored through quantitative assessment criteria (QACs), indicative targets (ITs), and structural benchmarks (SBs), as detailed in the attached Tables 1 and 2; and through semi-annual reviews. Modified QACs are proposed for end-June 2012 and new QACs are proposed for end-December 2012. The sixth review is expected to be completed by May 11, 2013. The attached Technical Memorandum of Understanding—which is an integral part of this Memorandum—contains definitions and adjusters. During the program period, we will refrain from imposing or intensifying exchange restrictions as well as restrictions on imports for balance of payments reasons, or from introducing multiple currency practices.

Table 1. Uganda: Proposed Quantitative Assessment Criteria and Indicative Targets for June 30, 2012 - March 31, 2013[1]
(Cumulative change from the beginning of the fiscal year, unless otherwise stated)

	June 30 2012		Sept. 30 2012 [2]	Dec. 31 2012	Mar. 31 2013 [2]
	3rd Review	Rev. Prog.			
			(Ush billions)		
Assessment criteria					
Ceiling on the increase in net domestic assets of the Bank of Uganda	892	892	120	265	182
Ceiling on the increase in net claims on the central government by the banking system	481	537	170	683	868
			(US$ millions)		
Ceiling on the stock of external payments arrears incurred by the public sector [3]	0	0	0	0	0
Ceiling on the contracting or guaranteeing of new nonconcessional external debt with maturities greater than one year by the public sector [3, 4]	800	1,000	1,000	1,000	1,000
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector [3 5]	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda (US$mn)	300	300	41	83	144
Share of oil revenue placed in the Petroleum Fund	100	100	100	100	100
			(Ush billions)		
Indicative targets					
Ceiling on the increase in base money liabilities of the Bank of Uganda	471	471	156	318	400
Stock of domestic budgetary arrears under the Commitment Control System (CCS) [6]	0	0	…	…	…
Minimum expenditures under the Poverty Action Fund	1,300	1,300	…	700	…
Ceiling on the issuance of guarantees by the Government/Bank of Uganda	0	0	0	0	0
Memo item					
Upper band	…	18.0	16.0	12.0	10.0
Twelve-month consumer price inflation (percent) [7]	…	15.0	13.0	9.0	7.0
Lower band	…	12.0	10.0	6.0	4.0

[1] Defined in the technical memorandum of understanding (TMU).
[2] Indicative Target
[3] Continuous assessment criterion.
[4] Cumulative change from May, 2010. To be used exclusively for infrastructure investment projects.
[5] Excluding normal import-related credits.
[6] Monitored annually.
[7] Annual end-of-period inflation.

Table 2. Uganda: Structural Benchmarks Under the PSI

Policy Measure	Macroeconomic Rationale	Date
Government to begin to gazette and publish on the internet the names of beneficiaries (whether individual or corporation) of all tax expenditures.	Enforce discipline in issuance of tax exemptions.	July 1, 2012, for quarter ending March 31, 2012; October 1, 2012, for quarter ending June 30, 2012; January 1, 2013, for quarter ending September 30, 2012; and April 1, 2013, for quarter ending December 31, 2012.
Begin submitting to Cabinet regular quarterly reports on unpaid bills of nine Ministries based on data in the Commitment Control System (CCS) for the previous quarter of the fiscal year (MEFP ¶8).	To facilitate control and elimination of expenditure arrears	As for measure immediately above.
Produce and disseminate within government a monthly index of economic activity relying on the various high-frequency indicators available (MEFP ¶24).	To facilitate the conduct of monetary policy.	As for measure immediately above.
BoU to include in Quarterly Report data on the net and gross positions of government in the BoU.	Enhance central bank independence and prepare Bank of Uganda to move toward inflation targeting.	As for measure immediately above.
Government to publish releases by MoFPED for power and water obligations of spending ministries, and actual payments by them, with sanctions to be applied to the named Accounting Officers of agencies that run arrears on these utilities. (MEFP ¶4).	Help control accumulation of arrears. Replaces benchmark on "straight-through payments"	As for measure immediately above.
As part of introduction of national identification system, 4 million additional citizens will have received IDs (MEFP ¶21).	To support efforts to strengthen revenue collection and combat money laundering and the financing of terrorism.	December 31, 2012.
Government to maintain transparency over the treatment of unspent budgetary funds at the end of the fiscal year by (i) publishing the balances as at June 30 and September 30 on all government accounts in the BoU and commercial banks, and (ii) in order to spend any balances held over from the previous year beyond end June, parliamentary approval as well as supporting work and procurement plans will be required (MEFP ¶27).	To enhance budgetary discipline and promote fiscal transparency.	(i) June 30, 2012 data to be published by July 31, 2012, and September 30 date to be published by October 30. (ii) Continuous
Submit to Cabinet a new tax procedure code (MEFP ¶21).	To improve domestic revenue mobilization.	April 1, 2013
Bank of Uganda to distribute in draft form a quarterly inflation report	To improve the monetary policy framework.	December 31, 2012

Attachment II. Uganda: Technical Memorandum of Understanding

I. INTRODUCTION

1. This memorandum defines the quarterly assessment criteria and indicative targets described in the memorandum of economic and financial policies (MEFP) for the financial program supported by the IMF Policy Support Instrument (PSI) over the period of June 30, 2012—March 31, 2013, and sets forth the reporting requirements under the instrument.

II. CEILING ON THE CUMULATIVE INCREASE IN NET DOMESTIC ASSETS (NDA) OF THE BANK OF UGANDA (BOU)

2. Net foreign assets (NFA) of the BOU are defined as the monthly average (based on daily data) of foreign assets minus foreign liabilities, and include all foreign claims and liabilities of the central bank, excluding oil revenues in the petroleum fund. The monthly average values of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the average cross exchange rates referred to in the table below for the various currencies and then converted into Uganda shillings using the program average U.S. dollar-Uganda shilling exchange rate for August 31, 2011.

Program Exchange Rates	
US dollar (US$)	1.0000
British pound/US$	1.6282
US$/Japanese yen	76.4600
SDR/US$	1.6094
US$/Kenyan shillings	93.8000
US$/Tanzania shillings	1,619.5000
Euro/US$	1.4398
US$/Ugandan shillings	2,821.1300

3. Net domestic assets (NDA) of the BoU are defined as the monthly average (based on daily data) of base money (defined below) less net foreign assets of the BoU (as defined in paragraph 2). Based on this definition, the NDA limit for June 2012 will be a ceiling on the cumulative change from the monthly average based on daily data for June 2011 to the same monthly average for June 2012. The NDA limits for September 2012, December 2012, and March 2013 will be ceilings on the cumulative change from the monthly average based on daily data for June 2012 to the same monthly averages for September 2012, December 2012, and March 2013, respectively. NDA limits for June 2012 and December 2012 will be quantitative assessment criteria under the PSI-supported program; limits for September 2012 and March 2013 will be indicative targets.

III. Base Money

4. Base money is defined as the sum of currency issued by the BoU and the commercial banks' deposits in the BoU. The commercial bank deposits include the statutory required reserves and excess reserves held at the BoU and are net of the deposits of closed banks at the BoU and Development Finance Funds (DFF) contributed by commercial banks held at the BoU. The base money limit for June 2012 will be a ceiling on the cumulative change from the monthly average based on daily data for June 2011 to the same monthly average for June 2012. The base money limits for September 2012, December 2012, and March 2013 will be ceilings on the cumulative change from the monthly average based on daily data for June 2012 to the same monthly averages for September 2012, December 2012, and March 2013, respectively. Base money limits for June 2012, September 2012, December 2012, and March 2013 will be indicative targets under the PSI-supported program.

IV. Ceiling on the Cumulative Increase in Net Claims on the Central Government by the banking system[1]

5. Net claims on the central government by the banking system is defined as the difference between the outstanding amount of bank credits to the central government and the central government's deposits with the banking system, excluding oil revenues in the petroleum fund and deposits in administered accounts and project accounts with the banking system, including the central bank. Credits comprise bank loans and advances to the government and holdings of government securities and promissory notes. Central government's deposits with the banking system include the full amount of resources freed by the IMF MDRI. NCG by the banking system will be calculated based on data from balance sheets of the monetary authority and commercial banks as per the monetary survey.

V. Floor on Net International Reserves of the Bank of Uganda

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

7. For program-monitoring purposes, reserve assets and short-term liabilities at the end of each test period will be calculated in U.S. dollars by converting the stock from their original currency denomination at program exchange rates (as specified in paragraph 2). The NIR limit for June 2012 will be a floor on the change of the NIR stock from June 2011 to June 2012. The NIR limits for September 2012, December 2012, and March 2013 will be

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

floors on the change of the NIR stock from June 2012 to September 2012, December 2012, and March 2013, respectively. NIR limits for June 2012 and December 2012 will be quantitative assessment criteria under the PSI-supported program; floors for September 2012 and March 2013 will be indicative targets.

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

8. The stock of domestic payment arrears/unpaid payment claims will be monitored on a quarterly basis. Domestic payments arrears/unpaid payment claims under the CCS are defined as the sum of all bills that have been received by a central government spending unit or line ministry delivered prior to the end of the quarter in question, and for which payment has not been made, under the recurrent expenditure budget (excluding court awards and pensions) or the development expenditure budget. For the purpose of program monitoring, the reports on domestic payment arrears/unpaid payment claims prepared by the Auditor General will be used to monitor this item following the end of the fiscal year. In the interim, the reports prepared by the Accountant General on unpaid claims will be monitored to gauge expenditure pressures.

VII. Expenditures under the Poverty Action Fund (PAF)

9. The indicative target on expenditures under the Poverty Action Fund is designed to ensure that resources freed by debt relief are used for additional PAF expenditures. Compliance with the indicative floor for PAF expenditures will be verified on the basis of releases (PAF resources made available to spending agencies).

VIII. Ceiling on Issuance of Guarantees by the Government or Bank of Uganda

10. The indicative target on issuance of guarantees by the Government or Bank of Uganda aims to prevent accumulation of contingent liabilities by the Government (including Government entities such as ministries, agencies and authorities). Included against the ceiling are any direct, contingent liabilities of Government (including entities that are part of government such as ministries, agencies and authorities) issued after June 30, 2011, and including any guarantees issued prior to July 1, 2011 but which are extended after June 30, 2011. This excludes guarantee programs which have explicit budget appropriations.

IX. Share of Oil Revenue Placed in Petroleum Fund

11. The purpose of this assessment criterion is to avoid a situation whereby petroleum revenues bypass the Ugandan budget framework. A petroleum fund will be created upon passage of the revised Public Finance Act; in the meantime, government has established a petroleum revenue account in the Bank of Uganda. This QAC will be deemed satisfied if 100 percent of petroleum revenues are transferred to this account upon collection by URA.

These resources may then be spent or saved as governed by the organic budget law in force at the time (PFAA 2003 until the new PFA is enacted).

X. Consumer Price Inflation

12. Inflation is measured by the headline twelve-month rate of annual end-of-period CPI inflation published by the Uganda Bureau of Statistics (UBOS). Quarterly bands denoting the target range are specified in Table 1.

XI. Adjusters

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

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

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

Schedule A: Budget Support (Including HIPC and MDRI)
(Ush billions)

	Jun-12	Sep-12	Dec-12	Mar-13
Cumulative change from July 1, 2011	1,017	…	…	…
Cumulative change from July 1, 2012	…	146	346	473

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

Schedule B: External Debt Service
(Ush billions)

	Jun-12	Sep-12	Dec-12	Mar-13
Cumulative change from July 1, 2011	108	…	…	…
Cumulative change from July 1, 2012	…	21	46	68

17. The ceiling on increases in NCG of the banking system will be adjusted downward (upward) by any excess (shortfall) in nonbank financing, relative to the programmed cumulative amounts in Schedule C. Non-bank financing will include any domestic debt—either in domestic currency or foreign currency— of the Government of Uganda that is held by creditors—whether resident or nonresident[3]—that is not included in the Ugandan banking system. It will include the change in government securities held by the nonbank sector as reported in the monetary survey, as calculated by data provided by the Central Depository System (CDS), plus any other claims on government, including entities of government (ministries, agencies, authorities, etc.), held outside the banking system, including those

Schedule C: Non-bank Financing
(Ush billions)

	Jun-12	Sep-12	Dec-12	Mar-13
Cumulative change from July 1, 2011	482	…	…	…
Cumulative change from July 1, 2012	…	86	105	256

[2] Debt service due is defined as pre-HIPC Initiative debt service due, excluding debt service subject to HIPC Initiative debt rescheduling.

[3] Non-residents holding government securities are excluded from the definition of external debt in paragraph 20.

which might be held by the National Social Security Fund (NSSF).

18. The floor on the cumulative increase in NIR of the BOU will be adjusted downward by the amount by which foreign exchange expenditures on the Karuma hydropower project exceeds the projected amounts as set out in Schedule D. The ceiling on NDA will be adjusted upward (downward) by the amount by which the domestic currency equivalent of Karuma spending (using the annual program exchange rate) exceeds (falls short of) the projected amounts as set out in Schedule D. The ceiling on NCG will be adjusted upward (downward) by the amount by which the domestic currency equivalent of Karuma spending (using the market exchange rate) exceeds (falls short of) the projected amounts as set out in Schedule D.

Schedule D: Expenditures for Karuma Hydropower Project
(US$ millions)

	Jun-12	Sep-12	Dec-12	Mar-13
Cumulative change from July 1, 2011	157	…	…	…
Cumulative change from July 1, 2012	…	0	365	365

19. The floor on the cumulative increase in NIR of the BOU will be adjusted downward by the amount by which inflows into the Petroleum Fund falls short of the projected amounts as set out in Schedule E. The ceiling on NDA will be adjusted upward (downward) by the amount by which the domestic currency equivalent of Karuma spending (using the annual program exchange rate) falls short of (exceeds) the projected amounts as set out in Schedule E. The ceiling on NCG will be adjusted upward (downward) by the amount by which the domestic currency equivalent of Karuma spending (using the market exchange rate) falls short of (exceeds) the projected amounts as set out in Schedule E.

Schedule E: Inflows into Petroleum Fund
(US$ millions)

	Jun-12	Sep-12	Dec-12	Mar-13
Cumulative change from July 1, 2011	…	…	…	…
Cumulative change from July 1, 2012	…	308	308	308

20. The ceiling on NDA of the BoU for every test date will be adjusted upward by the daily average amount of commercial bank automatic access to the BoU discount window and re-discounting of government securities by commercial banks.

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

XII. Ceiling on the Contracting or Guaranteeing of New Nonconcessional External Debt by the Public Sector, and Ceiling on the Stock of External Payments Arrears Incurred by the Public Sector[4]

22. The assessment criterion on short-term debt refers to contracting or guaranteeing external debt with original maturity of one year or less by the public sector. Excluded from this assessment criterion are normal import-related credits and non-resident holdings of government securities and government promissory notes. The definition of "debt" is set out in paragraph 23.

23. The program includes a ceiling on new nonconcessional borrowing with maturities greater than one year contracted or guaranteed by the public sector.[5] Nonconcessional borrowing is defined as loans with a grant element of less than 35 percent, calculated using average commercial interest rates references (CIRRs) published by the Organization for Economic Cooperation and Development (OECD). In assessing the level of concessionality, the 10-year average CIRRs should be used to discount loans with maturities of at least 15 years, while the 6-month average CIRRs should be used for loans with shorter maturities. To both the 10-year and 6-month averages, the following margins for differing payment periods should be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–25 years; and 1.25 percent for 30 years or more. The ceiling on nonconcessional external borrowing or guarantees is to be observed on a continuous basis. The coverage of borrowing includes financial leases and other instruments giving rise to external liabilities, not only current as defined below, but also contingent, on nonconcessional terms. External debt for the purpose of this assessment criterion means borrowing giving rise to liabilities to non-residents. Excluded from the limits are changes in indebtedness resulting from non-resident holdings of government securities and government promissory notes, refinancing credits and rescheduling operations, and credits extended by the IMF. For the purposes of the program, arrangements to pay over time obligations arising from judicial awards to external creditors that have not participated in the HIPC Initiative do not constitute nonconcessional external borrowing. Excluded from these limits are also

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

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

nonconcessional borrowing within the limits specified in Table 1 of the MEFP. The ceiling also excludes nonconcessional borrowing by one state-owned bank, Housing Finance Bank, which poses limited fiscal risk and is in a position to borrow without a government guarantee.

24. The definition of debt, for the purposes of the limit, is set out in point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No 14416-(09/91, effective December 1, 2009). It not only applies to the debt as defined in Point 9 of the Executive Board decision, but also to commitments contracted or guaranteed for which value has not been received. The definition of debt set forth in No. 9 of the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements reads as follows:

> (a) For the purpose of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

25. The ceiling on the accumulation of new external payments arrears is zero. This limit, which is to be observed on a continuous basis, applies to the change in the stock of overdue payments on debt contracted or guaranteed by the public sector from their level at end-June 2006. External debt payment arrears consist of external debt service obligations (reported by the Statistics Department of the BOU, the Macro Department of the Ministry of Finance) that have not been paid at the time they are due as specified in the contractual agreements but shall exclude arrears on obligations subject to rescheduling.

XIII. Monitoring and Reporting Requirements

26. The Government of Uganda will submit information to IMF staff with the frequency and submission time lag as indicated in Table 1. The quality and timeliness of the data submission will be tracked and reported by IMF staff. The information should be mailed electronically to AFRUGA@IMF.ORG.

Attachment II. Table 1. Summary of Reporting Requirements

Reporting institution	**Report/Table**	**Submission Frequency**	**Submission lag**
I. Bank of Uganda	Issuance of government securities, repurchase operations and reverse repurchase operations	Weekly	5 working days
	Operations in the foreign exchange	Weekly	5 working days
	Interest rates (7 day interbank, commercial bank prime lending rate, government securities)	Weekly	5 working days
	Private sector credit growth by shilling and forex, and excess reserves of commercial banks	Weekly	5 working days
	Disaggregated consumer price index.	Monthly	2 weeks
	Balance sheet of the BOU, consolidated accounts of the commercial banks, and monetary survey.	Monthly	4 weeks
	Daily balances of net foreign assets, net domestic assets, and base money of the BoU (as defined in paragraphs 2, 3, and 4)	Monthly	4 weeks
	Monthly foreign exchange cash flow table of BOU.	quarterly	4 weeks
	Statement of (i) cash balances held in project accounts at commercial banks; (ii) total value (measured at issue price) of outstanding government securities from the Central Depository System (CDS); and (iii) the stock of government securities (measured at issue price) held by commercial banks from the CDS.	Quarterly	6 weeks
	Summary of (i) monthly commodity and direction of trade statistics; (ii) disbursements, principal and interest, flows of debt rescheduling and debt cancellation, arrears, and committed undisbursed balances—by creditor category; and (iii) composition of nominal HIPC Initiative assistance.	Quarterly	6 weeks
	Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	Quarterly	6 weeks
	Standard off-site bank supervision indicators for deposit money banks.	Quarterly	4 weeks
	Summary table of preliminary program performance comparing actual outcome with adjusted program targets for (i) base money; (ii) net claims on central government by the banking system; ((iv) new nonconcessional external borrowing; and (v) net international reserves	Quarterly	6 weeks

Attachment II. Table 1. Summary of Reporting Requirements (concluded)			
Reporting institution	**Report/Table**	**Frequency**	**Submission lag**
II. Ministry of Finance	Summary of central government accounts. Revenues shall be recorded on a cash basis. Expenditures shall be recorded when checks are issued, except for domestic and external debt-service payments, cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due).	Monthly	4 weeks
	Summary of outstanding stock of unpaid payment claims	Quarterly	6 weeks
	Summary of contingent liabilities of the central government and the Bank of Uganda. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, government guarantees, claims against the government in court cases that are pending, or court awards that the government has appealed.	Quarterly	6 weeks
	Detailed monthly central government account of disbursed budget support and project grants and loans (less change in the stock of project accounts held at the BoU and commercial banks), HIPC support, and external debt service due and paid.	Quarterly	4 weeks
	Detailed central government account of disbursed donor project support grants and loans.	Monthly	6 weeks
	Statement on new external loans contracted or guaranteed by the central government and the Bank of Uganda during the period according to loan agreements.	Quarterly	6 weeks
	Updated national accounts statistics (real and nominal) according to UBOS and medium-term projections.	Quarterly	12 weeks