International Monetary Fund

Uganda and the IMF

Press Release:
IMF Executive Board Completes Third PSI Review for Uganda
December 10, 2014

Country's Policy Intentions Documents

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

November 19, 2014

The following item is a Letter of Intent of the government of Uganda, which describes the policies that Uganda intends to implement in the context of its request for a policy support instrument from the IMF. The document, which is the property of Uganda, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

Kampala, Uganda,
November 19, 2014

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

Dear Madame Lagarde:

On behalf of the Government of Uganda, we would like to provide you with an update on the progress we have achieved under our economic program supported by the IMF's Policy Support Instrument (PSI). Although economic growth was slightly lower than projected, there are indicators that growth is rebounding, despite the adverse impact of the ongoing regional conflict on agricultural production, trade, and remittances. In the context of our inflation targeting framework, we have successfully kept inflation under control. On account of a benign current account outlook and strong capital inflows, we have maintained our international reserves at comfortable levels.

Performance under the PSI-supported program remains satisfactory. In particular, we observed all June 2014 quantitative assessment criteria and indicative targets, with the exception of the indicative target on tax revenue, which was unfortunately missed. The implementation of the revenue enhancing package, together with new corrective measures to compensate for the lower yield of a significant measure, is now our key priority. Implementation of the package is expected to proceed smoothly and we are committed to its strict enforcement.

These and other details of our economic program are set out in the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU), which extend our commitments to end-December 2015. In the context of the successful performance of the inflation targeting policy, we have reached understandings with Fund staff to request the removal of the indicative target on base money. An updated TMU includes this change and other information updates.

A program of infrastructure investment in electricity and road projects to address the infrastructure gap is at the center of our growth and development strategy. To maintain macroeconomic stability, we will ensure that this program is consistent with debt sustainability and the absorption and implementation capacities of the economy. Execution of other important infrastructure projects is also under consideration, and we will continue to inform IMF staff on their progress to discuss them further in upcoming reviews.

We are also advancing integration efforts with other East African countries, with the ultimate objective of creating a monetary union to boost trade and improve competiveness. Significant progress has been made on enhancing public financial management and we will continue to take steps to advance further. To assist us in carrying out this ambitious reform agenda, the government of Uganda wishes to continue to benefit from technical assistance from the IMF in areas included in the program.

In light of this satisfactory performance and our continued commitment to and ownership of the program, we request completion of the third review under our PSI-supported program. We also request modification of the December 2014 quantitative assessment criterion and indicative targets in line with recent developments.

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

Sincerely yours

/s/
Maria Kiwanuka
Minister of Finance, Planning
and Economic Development

/s/
Prof. E. Tumusiime Mutebile
Governor
Bank of Uganda

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

A. Introduction

1. This Memorandum of Economic and Financial Policies complements the previously agreed policies under the June and December 2013 and June 2014 Memoranda of Economic and Financial Policies. It presents an update on the economic performance in the second half of FY2013/14, and provides details of the policies the Government intends to implement over the period ahead to preserve fiscal sustainability and achieve Uganda's macroeconomic objectives. The memorandum proposes extension of quantitative and indicative targets, structural benchmarks, and other reform commitments to end-December 2015.

B. Recent Economic and Policy Developments

2. Growth in FY2013/14 is now estimated at 5.2 percent, somewhat lower than anticipated under the program, mainly reflecting the combination of the adverse impact of regional developments on the external sector, the slower-than-expected growth in key trading partners, and lower public sector investment. In the context of the inflation targeting framework, the Bank of Uganda's (BoU) cautious monetary policy stance kept inflation under control and well within the PSI consultation clause.

3. The current account deficit improved, with higher service receipts and lower-than-expected imports on account of delays in the implementation of the Karuma and Isimba hydroelectric projects. Together with resilient FDI inflows, reserve coverage increased to over 4½ months of imports.

4. Fiscal performance was less expansionary than expected. Notwithstanding our commitment to raise revenue in the last quarter of the fiscal year, the compliance efforts did not yield the expected revenue. There was an underperformance of Shs 83 billion for the year as a whole compared to the projections of the last PSI review. Weak VAT collections and lower corporate income tax returns by key taxpayers, including banks and telecommunication companies—partly attributed to lower economic activity—explained the shortfall. Improvements in tax compliance and enforcement also fell short of expectations. However, weaker-than-expected implementation of externally-financed projects related to project management difficulties reduced expenditures by about 1 percent of GDP, more than compensating for the revenue shortfall. The overall deficit was 4.1 percent of GDP, against an expectation of 5 percent of GDP at the time of the last PSI review.

5. Core inflation reached 2.4 percent and headline inflation 1.8 percent by end-October 2014. The monetary policy stance remained cautious despite low inflation as the inflation forecast pointed to an increase in prices on account of anticipated higher food prices, exchange rate pass through and a rebound in private sector demand. The banking sector remains well capitalized, liquid, and able to absorb eventual losses. However, the BoU had to revoke the license of one

small bank that had incurred persistent losses. Non-performing loans remain high reflecting the protracted impact of the lagged effect of the economic slowdown in FY2011/12.

C. Performance under the PSI

6. As of end-June 2014, we successfully observed the quantitative assessment criteria (QAC) on net domestic financing and net international reserves, and core inflation was well within the consultation clause. We also observed the indicative targets on base money, change in the stock of domestic arrears, and social spending. However, we missed the indicative target on tax revenue as, regrettably, the envisaged efficiency measures in the last months of the fiscal year did not produce the expected yields. Corrective action has been taken in the form of the newly approved revenue package, together with additional efficiency gains and tax policy measures.

7. Progress is being made on structural reforms. Parliament approved a strong package of revenue measures. The exemption on interest earned on agriculture-related loans was approved in its original form, but the expected yield of the discontinuation of exemptions on supply of goods and services related to hydro-power, roads and bridges was modified preventing this measure from yielding additional revenue this year. Government continued with the BoU recapitalization, recently providing Shs 250 billion of marketable securities (October 2014 benchmark). The Ministry of Finance published a report on the stock of domestic arrears of all government entities contained in the central government votes on October 24, 2014 (September structural benchmark).

D. Macroeconomic Outlook

8. Growth is expected to accelerate to 6.1 percent in FY2014/15—as foreseen in the last PSI review—supported by the scaling up of public investment in infrastructure; a recovery in private sector activity fueled by higher credit growth; increased foreign direct investment; and a rebound in agricultural production. Core inflation is expected to remain within the PSI consultation clause, despite likely upward pressure resulting from tax increases, exchange rate depreciation and potential second round effects of a rebound in food crop prices. The implementation of the two hydropower projects will result in an important fiscal expansion, but since the projects are mostly externally financed and with high import content, we do not expect crowding out effects on the private sector. The projects will also influence the balance of payments dynamics, with associated imports widening the current account deficit. We project to keep reserves at a comfortable level of 4.1 months of imports after the use of government deposits from the energy and petroleum funds to finance Uganda's share of the hydropower projects. The main risks to the outlook emanate from further spillovers from external developments and delays in implementation of the envisaged projects.

E. Economic Policies

Fiscal Policy

9. On the revenue side, we aim at increasing tax revenue by 0.5 percent of GDP, supported by the implementation of the approved revenue package and efficiency gains. On the expenditure side, we foresee a significant increase of infrastructure investment with the start of the construction of the two large hydropower plants (HPP), Karuma and Isimba. While the envisaged deficit is expected to be large, at 6.8 percent of GDP, it would reach only 3.1 percent of GDP if the projects (which have a high import content and bring their own financing) and the central bank recapitalization (which does not have an impact on aggregate demand) are excluded. The necessary domestic financing is expected to be compatible with the envisaged increase in bank credit to the private sector.

Tax revenue

10. Parliament approved the elimination of many VAT exemptions, several goods lost their zero-rate status, government procurement is now tax inclusive, and corporate income taxes are charged on initial allowances on eligible property, interest earned by banks on loans to the agricultural sector, and educational institutions. Despite general opposition, excise duties were also increased on fuels, sugar and money transfers. These measures are in force since July 1.

11. Parliament did not approve the elimination of the exemptions on agricultural inputs, due to its social sensitivity, but the expected yield of this measure was not anticipated to be large. In addition, the yield of removing the VAT exemption on goods and services provided to civil works, agriculture, education and health sectors will be lower than initially expected due to an overestimation during the budgetary process. In addition, cabinet decided to renew the tax exemption granted to the textile sector, albeit with stricter conditions and a requirement that government pay the tax on behalf of the exempt companies. To compensate for the lower yield of these measures, we will take compensatory action, including introducing an export levy on unprocessed tobacco leaf, withholding tax on re-insurance; requiring Members of Parliament to pay tax on their additional emoluments; generating additional efficiency gains from improving customs valuation controls; and increasing the tax compliance of government suppliers.

12. Successful implementation of the revenue package is a key priority for us. While tax collection during the first three months of the fiscal year fell slightly short of expectations, it turned above expectations in October. These developments are explained by the fact that in some cases, new revenues materialized with a delay, partly because the protracted parliamentary discussions and strong lobbying from stakeholders affected compliance. A slowdown of imports due to construction at the port of Mombasa contributed to reducing the income from international trade taxes. Nonetheless, we are confident that the improvement experienced in October will be maintained for the rest of the year and fully compensate for the initial delays.

13. Improvements in tax efficiency are being increasingly implemented. The action plan developed on the basis of the recommendations coming out of the VAT gap analysis includes enhanced collaboration with public agencies and the private sector to strengthen income tax management. While this effort for now covers only Kampala, due to limited funding, we have registered 8,525 taxpayers and collected Shs 1.2 billion. We are planning to step up resources to be able to register, assess, and collect revenues in collaboration with local governments in at least three municipalities by December 2014 (structural benchmark). We are strengthening compliance in international taxation and we envisage additional training for tax auditors and an IMF technical assistance mission to take place before the end of the year. In line with our commitment in the previous MEFP, we expect to conduct 6 document reviews and conclude 2 international tax audits by December 2014 and another 6 document reviews and 2 international tax audits by June 2015. Furthermore, we have established a public sector office within URA to monitor government taxes. We also plan to devote efforts to sensitize the population, strengthening the civil culture of tax compliance.

Expenditure

14. Statutory expenditure was increased during the budgetary approval process, including increased wages for Parliamentarians and an increase in resources devoted to their security. Additional funding was also provided to align the funding for the education system to the school year. In line with the new PFM bill before Parliament, we introduced a contingency provision in the budget to allow us to respond to unexpected expenditure, fixed costs overruns, and revenue shortfalls that could not be accommodated through reallocations or spending cuts. Unfortunately we had used a large part of such contingency provision to cover the new unexpected expenditures, thus reducing our buffer for the rest of the year. Nonetheless, we are committed to adhering to the approved budget and preserving the quality of expenditure in this pre-electoral year. In particular, we will take into account the savings realized until now in wages when making quarterly cash allocations as a way to ensure expenditure discipline.

15. Construction of the two large HPPs has started. On Isimba, following the conclusion of negotiations with China's Eximbank and the relocation of the population residing on the site, we envisage parliamentary approval of the loan soon and start of construction in January 2015. On Karuma, negotiations between the Government and China Eximbank are expected to be finalized before the end of 2014. The 15 percent Government contribution to both projects (Shs. 880 billion) was released to the contractors during quarter 1 of 2014/15 to ensure the continuation of works while the loan agreements are being finalized.

Financing and Arrears

16. As anticipated, we plan to finance our overall deficit by using China's Eximbank loans for the HPPs, a reduction of government savings in the oil and energy funds to provide for the domestic contribution to the projects, and domestic debt issuance up to Shs. 1.4 trillion, as we will maintain a contingency reserve of Shs. 100 billion in our fiscal accounts.

17. We have made significant progress in the reduction of domestic arrears, although we acknowledge further improvements in coordination with all government entities responsible are required. Arrears have declined by about Shs. 544 billion, and we will continue publishing reports on the stock of arrears and unpaid bills. For the first quarter of the year, the report will be published on time.

18. To strengthen institutional arrangements to improve cash management and eliminate arrears, we have established a new Directorate dedicated to cash and debt management. A new department has also been created to focus on implementation capacity and public investment management.

Monetary and Financial Policies

19. Our inflation targeting framework is working well, and our commitment to achieve the 5 percent medium-term inflation target is now well entrenched. The BoU will continue to carefully assess developments and adapt the stance to the changing circumstances with the aim of maintaining inflation within its target.

20. The monetary transmission mechanism is gradually improving as interbank market interest rates are very responsive to BoU's monetary policy moves. Interest rates on government securities have also followed the policy rate but lending rates have responded more slowly. As a result, credit to the private sector is gradually rebounding.

21. The BoU has continued with its regular announced interventions in the foreign exchange market with the objective of maintaining reserves at an adequate level, and preventing excessive exchange rate volatility. Recent interventions were aimed at replenishing reserves used to pay for the government's share of the Karuma and Isimba projects. On days of excessive volatility, BoU suspended purchases for reserve build up. The interventions have been fully sterilized. We remain committed to updating markets on our policies in this area through our existing and new communication channels.

22. On the financial sector side, we continue to monitor nonperforming loans. Lending rates remain relatively sticky downwards, in part reflecting high overhead costs and provisioning for nonperforming loans. According to the September 2014 credit survey, credit standards to enterprises are expected to stay broadly unchanged, with a bias toward easing for both enterprises and households. On supervision, the BoU had to revoke the license of a bank that incurred persistent losses and missed reporting requirements, displaying the high quality of supervision and our strong commitment to maintain financial stability.

F. Structural Reforms

23. Uganda's investment needs remain considerable. In the context of stepped up efforts towards regional integration, the coming on stream of oil and the efforts to improve the business environment, we plan to boost infrastructure investments. To that end we are exploring options

to plan the construction and financing of works to prepare for oil production (including road, water, and electricity access), the standard gauge railway, and the refinery. In doing that, we will take into account our updated debt sustainability analysis to be sure that the risk of debt distress remains low; assess the absorptive and implementation capacity of the economy; and ensure commercial viability of all projects. While future oil revenues will be an important source of repayment of the needed financing, we do not intend to use them as collateral for external borrowing. We will continuously update IMF staff of all future developments and details of the infrastructure investment plans. Upon availability of relevant feasibility studies and concrete financing plans, we intend to discuss the inclusion of these medium-term projects under the PSI program in the context of upcoming reviews. Previous to embarking in these projects we intend to develop and publish a set of public investment management guidelines to significantly improve screening, selecting and financing assessment of investment projects (new structural benchmark).

24. Progress on PFM continued since the completion of the last PSI review. We carried on with our efforts to clean up the payroll, which allowed us to save about Shs. 100 billion in the first quarter of the FY. We received an IMF technical assistance mission to continue discussions on the implementation of the second phase of the Treasury Single Account (TSA), which concluded that excellent progress has been made but additional effort is still required to get to a well structured and fully functional TSA. To this end, we now intend to strengthen the TSA design by converting to a TSA head and TSA sub-account structure, and to complete a pilot exercise aimed at including donor-funded projects in the TSA (structural benchmarks for May and July 2015).

25. The Public Finance Management Bill remains at the plenary of Parliament for consideration and approval, and it is expected to be the first item of discussions following the recent parliamentary recess. We have started to work on the regulations to operationalize the act on a range of issues with IMF technical assistance. This will allow us to meet the May 2015 deadline for completion of the regulations and the charter of fiscal responsibility (structural benchmarks). In particular, we intend to use the new budgetary calendar for the FY2015/16 budget. On identity cards, we are progressing towards our goal of issuing 3 million by July 2015 (structural benchmark).

26. We are working on enhancing coordination within the Ministry of Finance, Planning and Economic Development to improve estimates of revenue yields and ensure consistency across all entities producing arrears figures and interest projections.

27. Work is ongoing to prepare an updated National Development Plan (NDP II). Discussions with relevant stakeholders are ongoing, as the process has to be open, participatory and transparent. Our initial plan was to adopt the NDP II by end-June 2015, when the first NDP was set to expire. However, to incorporate the impact of expected rebased GDP figures, the new Public Finance Management Bill, the results of the population census, and the forthcoming Charter of Fiscal Responsibility, we have decided to extend the current NDP for another year. We have produced a note on progress up to date that explains these developments and our intention to use the extended plan as our Assessment Progress Report of the Poverty Reduction

Strategy. According to this progress report, recent developments have been positive in terms of poverty reduction and our decision to maintain macroeconomic stability, scale-up infrastructure and make growth inclusive will help further.

28. To support the legal framework of our inflation targeting regime, we remain committed to continue working on the amendments to the BoU Act, with the aim of finalizing and submitting to Parliament by April 2015 (structural benchmark). To enhance financial sector stability, a new Financial Institutions Act will be presented to Parliament in 2015/16.

29. Progress towards regional integration in the last few months include the approval of the Monetary Union Protocol by cabinet that is expected to be ratified by the parliament by the end of 2014.

G. Risks to the Program

30. The key risks to the program come from external uncertainties, including those arising from developments in neighboring countries and policies in advanced economies that could affect trade, FDI, and portfolio inflows, as well as domestic developments in a pre-electoral context.

H. Program Monitoring

31. Progress in the implementation of the policies under this program will be monitored through quantitative assessment criteria (QAC), indicative targets (ITs), and structural benchmarks (SBs) detailed in the attached Tables 1 and 2 and through semi-annual reviews. The net domestic financing quantitative assessment criterion is proposed to be modified for end–December 2014, and new quantitative assessment criteria are proposed to be established for end-June 2015, to be monitored respectively at the fourth and fifth PSI reviews. Indicative targets are proposed for March, September and December 2015. The fourth review is expected to be completed by end-June 2015 and the fifth review by end-December 2015. The attached Technical Memorandum of Understanding—which is an integral part of this memorandum—contains the needed definitions.

Table 1. Uganda: Quantitative Assessment Criteria and Indicative Targets for June 2014–December 2015[1]

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

	June 30, 2014[2]				September 30, 2014 [3] (Preliminary)				December 31, 2014 [3]		March 31, 2015 [3]		June 30, 2015 [3]		Sept 30, 2015 [4]	December 31, 2015 [4]
	Program	Adjusted Target	Outturn	Result	Program	Adjusted Target	Outturn	Result	Program	Revised Program	Program	Revised Program	Program	Revised Program	Program	Program
							(Billions of Ugandan shillings)									
Assessment criteria																
Ceiling on the increase in net domestic financing of the central government	1,647	1,557 [5]	1,341	Met	1,539	1,326 [5]	1,371	Not met	2,196	2,461	2,542	2,896	2,600	2,832	353	937
							(Millions of US dollars)									
Ceiling on the stock of external payments arrears incurred by the public sector	0	0	0	Met	0		0	Met	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 [6,7]	2,200	2,200	81	Met	2,200	2,200	81	Met	2,200	2,200	2,200	2,200	2,200	2,200	2,200	2,200
Ceiling on new external debt with maturity up to one year contracted or guaranteed by the public sector [6, 8]	0	0	0	Met	0		0	Met	0	0	0	0	0	0	0	0
Minimum increase in net international reserves of the Bank of Uganda (US$mn)	178	164 [5,9]	379 [10]	Met	-250	-254 [5,9]	-288	Not met	-275	-275	-175	-245	-109	-236	63	125
Share of oil revenue placed in the Petroleum Fund [11]	100		100	Met	100		100	Met	100	100	100	100	100	100	100	100
							(Billions of Ugandan shillings)									
Indicative targets																
Ceiling on the increase in base money liabilities of the Bank of Uganda	570		547	Met	236		109	Met	n.a	n.a.	n.a.		n.a.	n.a.	n.a.	n.a.
Floor on tax revenue[12]	7,914		7,831	Not Met	2,078		2,035	Not Met	4,422	4,362	6,736	6,576	9,372	9,132	2,345	5028
Expenditures on poverty alleviating sectors	2,731		2,841	Met	701		782	Met	1,403	1,277	2,104	2,141	2,806	2,994	884	1,443
Ceiling on the issuance of guarantees by the Government/Bank of Uganda	0		0	Met	0		0	Met	0		0		0		0	0
Net change in the stock of domestic arrears[13]	-50		-544	Met	-20		-26	Met	-40	-70	-60	-80	-80	-80	-20	-40
Ceiling on withdrawals from energy and petroleum funds	120	26	26	Met	1,102	652	652	Met	1,102	1,230	1,102	1,230	1,102	1,230	1,230	1,230
							(Annual percentage change)									
Inflation consultation clause																
Outer band (upper limit)	9.3				9.0				8.7		8.3	8.3	8.0	8.0	8.0	8.0
Inner band (upper limit)	8.3				8.0				7.7		7.3	7.3	7.0	7.0	7.0	7.0
Core inflation target [14]	6.3		5.2	Met	6.0		4.2	Met	5.7		5.3	5.3	5.0	5.0	5.0	5.0
Inner band (lower limit)	4.3				4.0				3.7		3.3	3.3	3.0	3.0	3.0	3.0
Outer band (lower limit)	3.3				3.0				2.7		2.3	2.3	2.0	2.0	2.0	2.0

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

[2] Proposed targets are measured as the change from June 2013, except as marked.

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

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

[5] The adjusted target is calculated applying the budget support excluding HIPC assistance of Ush 86 billion in June and Ush 7 billion in September 2014 in line with the text of the TMU for the Second Review. The numbers published in Schedule A to the TMU for the Second Review incorrectly included HIPC assistance.

[6] Continuous assessment criterion.

[7] Cumulative change from June 28, 2013. To be used exclusively for infrastructure investment projects. A loan from the Islamic Development Bank was contracted in December 2013 to finance a development project. Another loan mentioned at the time of the Second Review was revealed to be concessional.

[8] Excluding normal import-related credits.

[9] The adjusted target is calculated including the Ush and the USD denominated deposits of the GoU in the Energy Fund, in line with Schedule D of the TMU, Second Review.

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

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

[12] The floors on tax revenue for the "Program" column for December 2014 to June 2015 have been corrected, as inadvertently the numbers presented at the time of the second PSI review (December Shs. 4,625 billion; March Shs. 7,038 billion; June Shs. 9,777 billion) refer to Total revenue rather than Tax revenue.

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

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

Table 2. Structural Benchmarks

Policy Measure	Macroeconomic Rationale	Date	Status
Ministry of Finance to submit to Parliament amendments to the Bank of Uganda Act including a provision for capital adequacy of BoU as an adequate percent of monetary liabilities, as well as other provisions to support implementation of inflation targeting in line with international best practices.	To enable monetary policy independence and credibility of the central bank.	April 2015	
Government to continue with annual recapitalizations of the Bank of Uganda with marketable securities to bring capital to the statutory level until amendments to the Bank of Uganda Act come into force, on the basis of the BoU's commitment to implement its business plan to contain operational and administrative costs.	To enhance central bank efficiency. To enhance central bank discipline and monetary policy independence.	October 2014 October 2015	Met
Ministry of Finance to publish quarterly reports signed by the PS/ST on the stock of unpaid bills of all government entities contained in the central government votes.	To facilitate control and reduction of unpaid bills.	November 15, 2014 for the quarter ending September 30, 2014. February 15, 2015 for the quarter ending December 31, 2014. May 15, 2015 for the quarter ending March 31, 2015.	
Ministry of Finance to publish a report signed by the PS/ST on the stock of domestic arrears of all government entities contained in the central government votes.	To facilitate control and reduction of expenditure arrears.	September 30, 2014 for the quarter ending June 30, 2014.	Met with delay (Report published on October 24, 2014)
Government to have issued a minimum of 3 million ID cards under the new national identification system.	To support efforts to strengthen revenue collection, promote the unique identification of financial sector clients, and combat money laundering and the financing of terrorism.	July 2015	

Table 2. Structural Benchmarks (Concluded)

Policy Measure	Macroeconomic Rationale	Date	Status
Government to eliminate exemptions on supply of specialized vehicles, plant and machinery, feasibility studies, engineering designs, consultancy services and civil works related to hydro-electric power, roads and bridges.	To increase revenue and tax administration efficiency.	July 2014	Met
Government to eliminate exemption from tax of interest earned on loans granted for the purpose of agriculture including farming, forestry, fish farming, bee keeping, animal husbandry or similar operations.	To increase revenue and tax administration efficiency.	July 2014	Met
URA to register, assess, and collect revenue using the trading license regime in at least three municipalities.	To enhance revenue collections.	December 2014	
Ministry of Finance to complete the second phase of the TSA implementation and strengthen its design by converting to a TSA head and TSA sub-account structure. This would eliminate movements of cash by giving votes appropriate level of spending authority within cash limits consistent with the macro-framework.	Complete the process of improving cash management and controls.	May 2015	
Ministry of Finance to finalize regulations for implementation of the PFM bill.	Ensure efficient PFM implementation and oil revenue management by providing guidelines, clarifying and making specific those aspects that are general in the law.	May 2015	
Ministry of Finance to finalize the charter of fiscal responsibility.	To improve fiscal and macroeconomic management.	May 2015	
Development and publication of the Public Investment Management Guidelines and Procedures.	To strengthen the capacity of MDAs in the preparation of feasibility studies, project preparation, analysis and appraisal, and financing assessments.	June 2015	
Ministry of Finance to begin the third phase of TSA implementation by conducting a pilot exercise aimed at including donor-supported projects in the TSA.	Provide a key milestone for full TSA implementation.	July 2015	

Attachment II. Technical Memorandum of Understanding

A. Introduction

1. This memorandum defines the quarterly quantitative assessment criteria (QAC) and indicative targets (ITs) described in the Memorandum of Economic and Financial Policies (MEFP) for the economic program supported by the IMF Policy Support Instrument (PSI) over the period of December 31, 2014—December 31, 2015, and sets forth the reporting requirements under the instrument. The stock of all foreign assets and liabilities will be converted into U.S. dollars at each test date using the cross exchange rates referred to in the table below for the various currencies and then converted into Uganda shillings using the program U.S. dollar-Uganda shilling exchange rate for end-March 2014, unless otherwise indicated in the text.

Program Exchange Rates (end-March 2014)	
US Dollar (US$)	1.0
British Pound/US$	0.6
Japanese Yen/US$	102.9
SDR/US$	0.6
Kenyan Shilling/US$	86.3
Tanzanian Shilling/US$	1630.7
Euro/US$	0.7
Ugandan Shillings/US$	2549.5

B. Consultation Mechanism on Inflation (QAC)

2. The quarterly consultation bands for the twelve-month average rate of consumer price inflation (as measured by the core consumer price index (CCPI) published by the Uganda Bureau of Statistics (UBOS)) are specified in Text Table 1. Projected CCPI inflation for end-December 2014 and end-June 2015 will be subject to the consultation mechanism, while those for end-March, end-September and end-December 2015 are indicative targets.

Text Table 1. Inflation Targets					
	Dec. 2014	Mar. 2015	Jun. 2015	Sep. 2015	Dec. 2015
Outer band (upper limit)	8.7	8.3	8.0	8.0	8.0
Inner band (upper limit)	7.7	7.3	7.0	7.0	7.0
Core inflation target	5.7	5.3	5.0	5.0	5.0
Inner band (lower limit)	3.7	3.3	3.0	3.0	3.0
Outer band (lower limit)	2.7	2.3	2.0	2.0	2.0

3. Should the observed average CCPI inflation for the test date linked to a PSI program review (i.e., end-December 2014 for the fourth review and end-June 2015 for the fifth review) fall outside the outer band as specified in the above table, the authorities will complete a consultation with the Executive Board of the Fund on their proposed policy response before requesting completion of the review under the program. The authorities will not be able to request completing a review under the PSI-supported program if the average CCPI inflation has moved outside of the outer band as of the test date linked to such review, until the consultation with the Executive Board has taken place. In line with the accountability principles, the BoU will report to the public the reasons for any breach of the outer bands, and its policy response. In addition, the BoU will conduct discussions with the Fund staff when the observed average CCPI inflation falls outside the inner band as specified for the end of each quarter in Text Table 1.

C. Ceiling on the Cumulative Increase in Net Domestic Financing of the Central Government[9] (QAC)

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

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

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

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

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

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

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

6. For program-monitoring purposes, reserve assets and short-term liabilities at the end of each test period will be calculated in U.S. dollars by converting the stock from their original currency denomination at program exchange rates (as specified in paragraph 1). The NIR limits are the cumulative changes of the NIR stock from July 1 of respective fiscal year to the specified dates. The NIR floor for December 2014 and June 2015 will be quantitative assessment criteria under the PSI-supported program; the floor for March, September and December 2015 will be indicative targets.

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

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

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

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

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

9. The purpose of this quantitative assessment criterion is to avoid a situation whereby petroleum revenues bypass the Ugandan budget framework. A petroleum fund will be created upon passage of the revised PFM bill; in the meantime, government has established a petroleum revenue account in the BoU. This QAC will be deemed satisfied if 100 percent of petroleum revenues are transferred to this account upon collection by URA. These resources may then be spent or saved as governed by the organic budget law in force at the time (PFAA 2003 until the new PFM Bill is enacted).

H. Tax Revenue (IT)

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

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

11. A ceiling applies to net accumulation of domestic arrears of the central government as an indicative target.[10] The ceiling for each test date is measured cumulatively from July 1 of respective fiscal year.

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

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

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

14. The indicative target on the ceiling on withdrawals from the GoU deposits from the Petroleum Fund and the Energy Fund aims at channeling these resources to key infrastructure projects while ensuring coordination on accompanying impact on liquidity. A ceiling applies on withdrawals from the GoU deposits from the Petroleum Fund and the Energy Fund measured cumulatively from the beginning of the fiscal year. Withdrawals will be restricted to meet the following uses (i) spending on Karuma and Isimba hydro-power projects and the associated industrial substations, specifically related to the loan agreement between the GoU and China Eximbank (the GoU's share adds up to US$424 million covering 15 percent of total costs of projects, loan insurance, and management fees); (ii) spending on land acquisition for Karuma and Isimba HPPs (Ush120 billion), and (iii) a maximum of the domestic currency equivalent of US$64 million, as stated in paragraph 19 below.

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

K. Adjusters

Adjustor related to budget support

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

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

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

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cumulative from July 1 of respective fiscal year	50	62	62	28	83

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

Adjustors related to the financing of the Hydropower Plants

Background and Energy and Petroleum Fund stocks

17. The GoU is expected to cofinance the Karuma and Isimba hydropower projects and the associated industrial substations, in accordance to loan agreements about to be concluded with China's Eximbank. The GoU's share is expected to cover (i) 15 percent of the total project costs, loan insurance, and management fees (US$424 million); and (ii) land acquisition for Karuma and Isimba HPPs at a total cost of Ush 120 billion. These funds are expected to come from withdrawals of deposits in the energy and petroleum funds.

18. By the end of the first quarter 2014, the GoU had already spent US$338 million, coming from the Energy Fund and temporarily the Uganda Consolidated Fund —as bridge financing while the budget was approved and thus the Petroleum Fund could be used—with the stocks as of October 16, 2014 described below. The foreign currency-denominated deposits of the Petroleum Fund do not constitute part of the BoU's international reserves and as such are recorded under other foreign assets of the BoU. Any further foreign currency denominated inflows to the Fund will continue to be recorded outside of the reserves and under other foreign assets of the BoU.

Stock of the Oil and Energy Fund at October 16, 2014
(Ush billions and USD millions)

	Ush	USD	
Energy Fund	92	0	(BoU reserves)
Petroleum Fund	1612	0	(BoU other assets)

Adjustor on Expenditures on HPP

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

Schedule B: Expenditures on hydropower projects
(Ush billions)

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cumulative from July 1 of respective fiscal year					
Land acquisition for Karuma and Isimba HPPs	100	100	100	0	0
Government share associated with the China Eximbank loan	1,130	1,130	1,130	0	0

Adjustor on Inflows into the Petroleum Fund

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

Schedule C: Inflows into Petroleum Fund
(Ush billions)

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cumulative from November 1, 2013	0	0	0	0	0

Adjustor on Foreign Currency Spending for HPPs

21. The floor on the change in NIR will be adjusted upward (downward) by the amount by which the GoU's spending in foreign currency to cofinance the hydropower projects, in line with point (i) above in paragraph 17 (converted at the market exchange rate) falls short of (exceeds) the projected amounts set out in Schedule D. Any downward adjustment will be capped at US$64 million. The GoU will first withdraw the foreign currency denominated portion of its deposits, including any new foreign currency inflows to the energy and petroleum funds.

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

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cumulative from October 1, 2014	86	86	86	0	0

Adjustor related to the Bank of Uganda recapitalization

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

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

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cumulative from July 1 of respective fiscal year	250	250	250	0	200

L. Ceiling on the Contracting or Guaranteeing of New Non-concessional External Debt by the Public Sector, and Ceiling on the Stock of External Payments Arrears Incurred by the Public Sector[11]

23. 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.

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

24. The program includes a ceiling on new non-concessional borrowing with maturities greater than one year contracted or guaranteed by the public sector, measured cumulatively from June 28, 2013.[12] Non-concessional borrowing is defined as loans with a grant element of less than 35 percent. The discount rate used for this purpose is 5 percent. The ceiling on non-concessional external borrowing or guarantees is to be observed on a continuous basis. 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 non-concessional 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 non-concessional external borrowing. Excluded from these limits are also non-concessional borrowing within the limits specified in Table 1 of the MEFP. The ceiling also excludes non-concessional 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.

25. 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

[4] 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.

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 are 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.

26. 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 2014. External debt payment arrears consist of external debt service obligations (reported by the Statistics Department of the BoU, the Macro Department of the Ministry of Finance) that have not been paid at the time they are due as specified in the contractual agreements but shall exclude arrears on obligations subject to rescheduling.

M. Monitoring and Reporting Requirements

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

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

Attachment II. Table 1. Summary of Reporting Requirements			
Reporting institution	**Report/Table**	**Submission Frequency**	**Submission Lag**
	Summary table of preliminary program performance comparing actual outcome with adjusted program targets for (i) net claims on central government by the banking system; (ii) new non-concessional external borrowing; and (iii) net international reserves.	Quarterly	6 weeks
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[13], cash transfers to districts, and externally funded development expenditures. Expenditures on domestic interest will be recorded on an accrual basis and external debt service will be recorded on a commitment basis (i.e., when payment is due).	Monthly	4 weeks
	Summary of the stock of unpaid bills by government entities contained in the central government votes as reported by the Accountant General and signed by the PS/ST.	Quarterly	6 weeks
	Summary of the stock of arrears by government entities contained in the central government votes as reported by the Accountant General and signed by the PS/ST.	Annual	3 months
	Summary of contingent liabilities of the central government and the BoU. For the purpose of the program, contingent liabilities include all borrowings by statutory bodies, government guarantees, claims against the government in court cases that are pending, or court awards that the government has appealed.	Quarterly	6 weeks
	Detailed monthly central government account of disbursed budget support and project grants and loans (less change in the stock of project accounts held at the BoU and commercial banks), HIPC support, and external debt service due and paid.	Quarterly	4 weeks
	Detailed central government account of disbursed donor project support grants and loans.	Monthly	6 weeks

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

Attachment II. Table 1. Summary of Reporting Requirements			
Reporting institution	**Report/Table**	**Submission Frequency**	**Submission Lag**
	Statement on new external loans contracted or guaranteed by the central government and the BoU 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