Statement by Ms. Ita Mannathoko,
Executive Director for Uganda, and Ms. Gonaya Basutli,
Advisor to Executive Director
June 28, 2021

Introduction

1. Our authorities appreciate the constructive engagement during the recent negotiations for an arrangement under the Extended Credit Facility (ECF). We thank staff for an insightful and well-written report. The authorities broadly share staff's assessment and policy recommendations.

2. Notwithstanding the authorities' swift response to the COVID-19 crisis, supported by IMF and World Bank emergency financing, the pandemic has had a significant impact on Uganda, with deterioration in fiscal balances and intensified pressure on external buffers. An aggressive new wave is now underway, and the immediate priority is to limit the spread of the coronavirus disease. Access to vaccines needed for timely vaccination is therefore critical. The authorities envision that the ECF program will help efforts to overcome the pandemic and mitigate its impacts, while preserving macroeconomic stability, and positioning the economy for recovery.

3. Directors' support is sought for an arrangement amounting to SDR722 million under the Extended Credit Facility to navigate the highly uncertain outlook including risks associated with the emergence of new variants of the virus and rapid escalation in infections. The ECF arrangement is expected to play a catalytic role, unlocking additional donor support required to accelerate the vaccination campaign, and effectively tackle the resurgence of the pandemic. It will also buttress reforms geared at placing the country back on a path towards inclusive growth and sustainable development, as encapsulated in the National Development Plan (NDP) III, while backing measures to bolster good governance, transparency and accountability, further advancing the progress the authorities made in implementing governance reforms in line with the commitments made under the Rapid Credit Facility.

4. The authorities have a proven reform track record and have further demonstrated their commitment to reform through a range of prior actions and appropriate policies needed to reach the goals of the program.

Impact of the Pandemic, Recent Economic Developments and Outlook

5. An aggressive new wave of the pandemic is underway with daily infection rates having risen 17-fold to over 1700 in June, compared to less than 100 last month (Reuters' reporting on President Museveni's televised address). Deaths so far are 8 percent of those infected. The latest wave has necessitated renewed containment measures, with a lockdown and other restrictions set to last through end July 2021, with the potential to dampen the already limited recovery momentum, which falls short of what is required to reduce poverty and high unemployment.

6. In addition to the deterioration of fiscal balances, and intensified pressure on external buffers, the COVID-19 pandemic has halved growth, contributing to a decline in per capita GDP growth. In 2020, stringent lockdown measures coupled with the weak global economy, led to depressed economic growth. There was a sharp contraction in services and manufacturing output. Activity in other sectors such as tourism and transport also declined. Fortunately, economic activity improved in the last quarter of 2020 and for FY 2020/21, the Uganda Bureau of Statistics estimates real GDP to have grown by 3.3 percent owing mainly to strong household consumption. GDP is expected to grow by around 3-4 percent in 2021/22, improving in the medium term to around 6-7 percent as international demand and private investment recover.

7. Inflation picked up in 2020, reflecting pandemic-related developments. However, it has started trending downwards, with headline and core inflation falling to around 4 percent and 5 percent respectively, in April 2021, from peaks of 4.5 percent and 6.3 percent respectively, in October 2020. The decrease mainly reflects a reversal of the earlier rising trend in transportation costs and food prices. That said, newly rebased measures of inflation, which staff indicate will be used in the program, show lower inflation, with headline inflation at 1.9 percent and core inflation at 3.1 percent in May 2021, implying some room for policy maneuver. Core inflation is expected to remain within the 5 percent target for the duration of the program.

8. The current account deficit deteriorated from 5.9 percent of GDP in FY19/20 to an estimated 9.2 percent of GDP in FY20/21, reflecting a weaker trade balance and higher interest payments on public debt. International reserves have declined from 4.4 months import cover in FY19/20 to 4.0 months in FY20/21, below the EAC target of 4.5 months. After an initial decline, imports have begun to recover while remittances and tourism receipts remain subdued, implying an urgent need to increase reserve buffers. Going forward, the current account is likely to be shaped by further improvements in global demand and higher imports related to capital investment in oil projects.

The Authorities' Response to the Pandemic

9. When the pandemic struck, the authorities acted swiftly to contain the spread of COVID-19, instituting a four-month lockdown that successfully kept infection and mortality rates low. Emergency financing from the IMF and World Bank supported their multi-pronged response strategy. They deployed budgetary resources to the health sector for the purchase of medical equipment and vaccines, and to support households, firms, and employment. They also postponed tax payments, alongside other limited measures to contain scarring.

10. The Bank of Uganda maintained an accommodative monetary policy stance, with the Central Bank Rate reduced by a cumulative 200 basis points in April and June 2020. Other measures included dividend and bonus payment deferment by all Supervised Financial Institutions (SFIs) to ensure capital adequacy, liquidity support to institutions in need, and purchases of Treasury Bonds held by microfinance deposit taking and credit institutions to ease liquidity pressures. SFIs could also restructure loans as needed. Given the evolution of the pandemic, these measures have now been extended through September 2021.

11. At this juncture, the immediate priority is securing vaccines, and successful rapid rollout of vaccinations once vaccines are delivered. Last week, Uganda's health minister reported that

her country had received only 1.1 million vaccine doses for a population of 45 million (one dose for 2.4% of population or two doses for 1.2% of population), at the same time that the country was dealing with at least five COVID-19 variants with "very aggressive transmission".

12. Uganda's comprehensive national vaccine deployment plan aims to vaccinate 49.6 percent of the total population in a phased manner. The country has requested vaccines under various arrangements, including the COVAX facility. Budget support for vaccines of about US$139 million in FY2020/21 and US$122 million in FY 2021/22, has been allocated.

Macroeconomic Policies

13. The three-year ECF will backstop the authorities' goal to recover from COVID-19 in the near term while accelerating inclusive growth and sustainable development as articulated in the NDP III. The priorities of the NDP include maintaining public debt on a sustainable path while improving spending composition and providing space for much needed private investment. Structural reforms will include strengthening the governance framework and financial sector development and inclusion, consistent with the ECF program.

Fiscal Policy

14. Our authorities continue to seek an appropriate policy mix within government's financing constraints, to mitigate the impact of the COVID-19 crisis and support economic recovery. In the near-term, they are focused on crisis mitigation measures. The ECF program will also help close the financing gap and free up resources for priority social spending.

15. The authorities intend to contain widening fiscal deficits with pro-poor fiscal consolidation over the medium term, leading up to the time that new export projects under development come on stream and boost revenues. The domestic revenue mobilization strategy—which relies on both tax policy, and customs and revenue administration reforms, was recently adopted by the Ministry of Finance and the Commissioner of the Uganda Revenue Administration and is being implemented starting in FY21/22. It will add at least 0.5 percent of GDP in revenue a year in the medium term, with even higher revenue gains in the FY21/22 fiscal year. Planned reforms also include removal of some exemptions and increases in excise duties on fuel, measures to collect arrears, broadening the tax base and enhancing tax audits and investigations.

16. On spending, as space is created for much-needed investment, improvements in public investment management and composition and prioritization of spending are envisaged. In the medium-term, spending composition will shift to a higher share for education, health and social development, while rolling back security spending to normal levels. The authorities will target debt levels of 50 percent of GDP, as codified in the authorities' Charter of Fiscal Responsibility.

Monetary and Exchange Rate Policies

17. The authorities will maintain an accommodative monetary policy stance and focus on maintaining price stability in line with the 5 percent core inflation target. They recognize the importance of containing inflation and its associated impacts on the poor while curbing escalating costs for small businesses. The Bank of Uganda (BoU) will continue to monitor

price developments and respond appropriately, should core inflation breach the upper limit. The authorities also note that deficit financing has had a detrimental effect on the impact of monetary policy and expect the envisaged fiscal adjustment and reduced dependence on domestic financing to support policy effectiveness. The BoU will continue fine-tuning its liquidity forecasting and use liquidity management tools such as repos and FX swaps, while limiting its direct financing of fiscal operations in line with program requirements. Furthermore, following the July 2020 recapitalization of the central bank, the authorities intend to further recapitalize BOU and strengthen safeguards for institutional autonomy. Cabinet is expected to approve the amended central bank law in December 2021.

18. The authorities remain committed to the exchange rate flexibility required to adjust to external shocks. They will continue to limit foreign exchange interventions to smoothing out excess volatility.

<u>Financial Sector Policies</u>

19. The financial system remains liquid and well-capitalized, and stress tests show that banks remain resilient to capital risk. That said, the authorities remain vigilant and committed to ensuring financial sector stability. The 2020 Financial Institutions Regulations aimed at enhancing resilience, introduced capital buffers, while Domestic Systemically Important Banks were encouraged to hold additional capital. The authorities will ensure adherence to loan classification and provisioning rules as well as prudential and accounting requirements. They will also enhance bank oversight and follow through with the transition to Basel II and III, strengthen bank supervision, enhance the resolution framework, and modernize the financial market infrastructure, while guarding against cyber risks.

20. The authorities plan to strengthen the AML/CFT framework and are working together with the Financial Action Task Force towards full implementation of the grey list action plan. They are also working to ensure compliance following the adoption of the National AML/CFT Strategy.

Structural Reforms

21. The authorities' structural reform agenda is aimed at strengthening governance while fostering private sector activity and enhancing human capital development. Reforms include measures to improve transparency and accountability, and to reduce the cost of doing business and foster financial inclusion. On transparency, the authorities have published the independent audit report on expenditure arrears as well as the first annual tax expenditure statement for FY2019/20. They have also taken advantage of ongoing Fund technical assistance to create a system for tracking COVID-19 spending. They published a comprehensive COVID-19 spending report for FY2019/20, and a list of procurement contracts; and conducted and published an independent audit of COVID-19 spending. Furthermore, they have committed to improve the asset declaration regime during the program, and plan to leverage the enhanced regime to fight corruption vulnerabilities.

22. The authorities are committed to tackling corruption and are prioritizing the implementation and enforcement of the anti-corruption legal framework. Uganda recently joined the Extractive Industries Transparency Initiative (EITI), and, as part of their commitments to the EITI, the authorities stand ready to disclose contracts and licenses for oil and gas production

and beneficial owners of corporate entities that hold legal interests. More broadly, the authorities will establish legal and regulatory mechanisms for timely access to accurate and basic beneficial ownership information to strengthen governance.

23. In addition to ongoing work to reduce legal and administrative impediments to doing business, the authorities' pro-business reforms will support efforts to increase the value of manufactured exports in total exports, improve access to electricity for processing and manufacturing enterprises and improve ICT access, quality and coverage.

Conclusion

24. The Ugandan authorities remain committed to maintaining macroeconomic stability even as they work to exit from the COVID-19 crisis, and to support sustainable growth and an inclusive recovery. They envision a transition to higher middle-income status by 2040. The authorities look forward to the support of Executive Directors for this arrangement under the ECF.