"A continued focus on price stability as the primary objective of monetary policy has allowed inflation to ease after temporary supply shocks last year. This focus will remain essential as increased volatility in foreign exchange flows poses challenges to the conduct of monetary policy.

"The government's restraint on less-essential current expenditure and continued efforts in tax revenue collection will be vital to raise public saving, provide room for poverty-reducing spending, and avoid domestic arrears. Expenditures associated with the Commonwealth Heads of Government Meeting in Kampala, floods, and peace in the North have already led to some expenditure overruns this fiscal year, and left limited space to accommodate additional budgetary pressures.

"A strong focus on public investment is needed to eliminate infrastructure bottlenecks and increase productivity. Implementation delays in donor-financed projects have led the government to explore alternative approaches to infrastructure investment and financing. Projects should be evaluated carefully in terms of their cost effectiveness and impact on debt sustainability, especially to the extent that financing may be non-concessional.

"Transparency and an appropriate balance between spending and saving will be key elements to maximize Uganda's benefits from future oil production. The government's comprehensive approach to the management of oil resources and the plans to introduce a national energy policy are encouraging steps toward these objectives," Mr. Kato said.

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Statement by Peter Gakunu, Executive Director for Uganda and Godwill Efiong Ukpong, Senior Advisor to the Executive Director
December 19, 2007

1. The Ugandan authorities express appreciation to the Executive Board, Management and staff for valuable engagement and support for their macroeconomic and structural reform program under the PSI. They welcome the concise, informative and balanced set of staff reports on economic developments, challenges and outlook in Uganda. They are in broad agreement with the thrust of the analyses, conclusions, and recommendations.

Recent Macroeconomic Developments and Performance

2. Competent macroeconomic management and appropriate response to emerging economic problems, including acute electricity supply bottlenecks, have facilitated the achievement of better-than-expected economic performance. Some key indicators of strong economic performance include: robust real GDP growth of 6.2 percent in 2006/07, compared to 5.1 percent in 2005/06; and successful containment of underlying inflation expected to fall below the targeted ceiling of 5 percent in 2007/08. Progress in addressing electricity shortages and the associated boosting of economic activity, and favorable international commodity prices, contributed to observed GDP growth. The recent inflationary pressure arose mainly from the one-time shock of increases in electricity tariffs and temporary sugar and diesel fuel shortages.

3. The authorities' prudent public finance management, aimed at minimizing costs, enhancing savings, and debt sustainability, has largely underpinned past and current economic achievements. The Bank of Uganda (BOU) complemented the prudent fiscal stance by skillfully managing the surge in foreign exchange inflows since late 2006 by taking suitable monetary policy measures to arrest the resultant appreciation of the shilling.

4. Notwithstanding the attainment of some important policy objectives, the Ugandan authorities are aware that a number of challenges to further economic progress require continuous implementation of strong policies and reforms. Mobilizing long-term savings for investment and financing of infrastructure critical for sustainable economic growth and poverty reduction; improving the business environment to enhance the role of private sector in the economy; facilitating financial deepening; and strengthening human capacity for better service delivery are some of the major challenges going forward. Other challenges include meeting the expected high cost of September 2007 floods in eastern and northern parts of the country, and articulating suitable monetary policy measures to deal with continuous foreign exchange inflows. In this regard, the authorities have taken necessary actions to address the

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challenges, including alleviation of electricity shortage through addition of new generating capacity and providing for additional investment in infrastructure in the 2007/08 budget. Other actions taken in this respect include a near doubling of funds for clearing domestic arrears in 2008 in order to sustain the country's low debt profile, and continuation with the implementation of sound economic reform policies.

Performance Under the PSI

5. The authorities' unwavering commitment to sustaining macroeconomic stability and advancing structural reforms is demonstrated by the observance of all end-June 2007 assessment criteria, except the ceiling on base money where there was a temporary deviation from the target. However, this was subsequently met at end-September 2007. The expansion of the monetary base was associated with policy measures adopted by the BOU to stem appreciation of the shilling following strong foreign exchange inflows and rising sterilization costs. The Ugandan Revenue Authority (URA) has made commendable progress under the PSI; its revenue collection exceeded initial program projections by 0.3 percent of GDP, and contributed significantly to meeting the end-June 2007 assessment criterion on credit to government. Effective policy implementation by the BOU has facilitated soundness of the banking system and stability of the exchange rate. The Bank has introduced Net Domestic Assets (NDA of the BOU) as the near-term operating target to accord it greater flexibility in dealing with temporary currency flows or unanticipated shifts in money demand, while preparing for eventual adoption of inflation targeting by enhancing data collection, analysis and outreach. The authorities' implementation of structural measures as envisaged, has been instrumental to the achievement of policy objectives under the program.

Macroeconomic Policies for 2007/08 and the MTEF

6. In addition to the traditional areas of policy objectives, namely maintenance of macroeconomic stability, stimulation of sustainable growth, and reduction of poverty, the authorities have increased budget allocations for investments in infrastructure, energy, education, rural development, and arrears repayment. Investments in these sectors, along with the reported positive macroeconomic outlook, are expected to boost GDP growth in the near to medium-term and facilitate increased role of the private sector in the economy. Real GDP growth is projected at 7 percent over the next few years, while inflation is projected at below 5 percent by end-2007/08. Imports for Bujagali dam construction are however, expected to widen the current account deficit, but without undermining external sustainability. The authorities see the risk of increased oil prices as manageable, especially as commercial oil production is due to commence in 2009, with derivable oil revenue to be incorporated into the MTEF. The planned national energy policy aims at transparency, fiscal sustainability, and appropriate balance between current spending and savings for the future. These developments should help mitigate the risk going forward.

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7. The authorities are aware of and take seriously other downside risks to the favorable economic prospects, including electricity and infrastructure bottlenecks, especially delays in the construction of the Bujagali dam, and the likelihood of an overshoot in CHOGM-related expenditure jeopardizing priority spending. The government made substantial budget allocations for financing the supply of essential growth-enhancing infrastructure, while most CHOGM-related expenditures were for revamping infrastructure such as roads and the airport expected to support productive economic activities and wealth creation overtime. The temporary extension of a limited government loan to the Bujagali project is aimed at minimizing delays and associated costs of its construction, while the commencement of domestic oil production in 2009 is expected to enhance government revenue profile and assist in meeting outstanding financial obligations. The authorities consider that the risks can be effectively managed.

Fiscal Policy and Public Sector Reforms

8. In line with the MTEF, the Ugandan authorities are committed to prudent public expenditure management. Accordingly, the 2007-08 budget is anchored on a strategy of targeted increases in domestic revenue collection and sustained expenditure control, with improvement in domestic revenue targeted at 0.7 percentage point to 14.1 percent of GDP. The budget also provides for reduction in the deficit, excluding grants. The authorities consider these targets feasible, given the better-than-expected tax revenue performance in the last quarter of 2006/07 and the first quarter of 2007/08; tight control over non-priority spending; and ongoing efforts to improve tax administration. The government's announced tax holidays for exporters, involving revenue loss of 0.1 percent of GDP and inline with East African Community practice, is seen as manageable and exceptional. In order to address spending pressures, largely associated with the recent hosting of CHOGM and emergency spending on floods and peace in the north without incurring new arrears, the government is focusing on reallocation within the budget envelope. In line with Fund advice, steps taken to address domestic arrears include introduction of integrated personnel and payroll system, and verification of gratuity and pension arrears for FY 2006/07.

9. The authorities' new Debt Management Strategy will, among other things, support the selection and financing of turnkey projects being considered to speed up investment in productivity-enhancing infrastructure deemed viable by the Bank-Fund DSA. Projects will be evaluated on a case-by-case basis for cost effectiveness and impact on debt sustainability. The strategy provides for borrowing for priority sectors on concessional terms. The Debt Management Strategy will guide domestic and external borrowing and repayment of arrears.

Monetary and Financial Sector Policies

10. The monetary authority is committed to implementing policies that would bring underlying inflation to under 5 percent by end 2007/08. The BOU is making use of a mix of

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