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Address: 37 Kampala Road
Postal: P.O. Box 7120, Kampala
Tel: +256 414 258 441-6
Fax: +256 414 233 818
Email: info@bou.or.ug
Web: www.bou.or.ug

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Foreword

This report combines the Bank's *Annual Supervision Report* and *Financial Stability Report*, which were previously issued separately. It provides an account of the main supervisory activities related to the financial sector which were undertaken by the BOU in 2010, analyses the performance and condition of Uganda's financial system and evaluates threats to its systemic stability. The *Financial Stability Report* will be issued bi-annually, once in conjunction with the Annual Supervision Report and a second time as a separate publication.

During 2010, Uganda's financial sector registered strong growth, reflecting the rebound in economic growth which took place on the second half of 2010 together with heightened competition in the banking sector. The performance of the banking industry improved, as manifested in higher asset quality and profitability. The ratio of non-performing loans to total gross loans decreased from 4.2 percent of total gross loans in December 2009 to 2.1 percent in December 2010. Commercial banks remained well capitalised. Aggregated across the banking system, the core capital to risk weighted assets ratio was 17.4 percent as at December 2010, far above the regulatory minimum level of 8 percent. Profitability also improved, including among the new banks whose operating costs reduced significantly. Earnings grew by 13.8 percent for the year to December 2010.

In a bid to strengthen the soundness of financial institutions, Bank of Uganda initiated a number of regulatory reforms during 2010. A draft implementing regulation in respect of a capital charge for market risk was submitted to the Ministry of Finance Planning & Economic Development for gazetting. The Bank of Uganda has also prepared amendments to the Financial Institutions Act to allow banks to engage in bancassurance and to provide Islamic financial products. In addition the minimum capital adequacy requirement for commercial banks was raised to Ugx.25 billion, although existing banks have until March 2013 to meet the higher requirement in full. A review of the MDI Act 2003 was started, aimed at strengthening regulation of Tier 3 institutions and encouraging new microfinance institutions to come under the regulatory umbrella.

On the international scene, in November 2010, the G20 meeting in South Korea approved the proposals by the Basle Committee on Banking Supervision (BCBS) to strengthen bank regulations, in particular by raising the quality and quantity of capital which banks must hold.

There are no major threats to the systemic stability of the Ugandan banking system in the short term. Nevertheless, the financial system continues to evolve rapidly and hence Bank of Uganda will continue to monitor potential systemic vulnerabilities closely and tackle any threats to stability which might emerge in the future.

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Emmanuel Tumusiime-Mutebile

GOVERNOR

PART I: SUPERVISION OF FINANCIAL INSTITUTIONS

1. Overview

During 2010, the financial system in Uganda showed significant growth compared to the previous period in 2009, profitability rose and capital remained above statutory limits, bolstered by strong supervision. While the global financial and economic crisis was the key challenge during 2009, new challenges emerged during the year ended 2010 and presented a new dimension to the supervision and regulation of the financial sector during the year.

Challenges and emerging issues during 2010

Among the issues that arose during 2010 was the increased significance of operational risk. It is an increasingly becoming an important area which supervisors should monitor. One of the reasons for this rise in operational risk includes banking institutions' reliance on information and communication technology (ICT) platforms for the delivery of financial services. The heightened pace of ICT usage in the financial sector poses a challenge to supervisors to understand the risks involved and ensure appropriate monitoring of ICT-related vulnerabilities in the sector.

Although only two banks were licensed in 2010, the build up of new banks in the previous years and rapid innovations in banking services and products has increased supervisory demands. Against this backdrop, the limited pool of skilled bank examiners poses challenges to the supervision of commercial banks. Accordingly, continuous capacity building is required to ensure effective regulation of new and often complex financial products.

The large presence of regional banks in Uganda has highlighted the need for cross-border cooperation with regional supervisors in the exchange of information on financial activities and performance of parent banks. One of the lessons of the recent global crisis was that supervision of banks needs to be consolidated. This is critical in enhancing oversight and strengthening the safety and soundness of banking systems in the region. Bank of Uganda continued to pursue consolidated supervision and information sharing under the formal memorandum of understanding signed by the BOU and other East African Community (EAC) central banks to facilitate cross border information sharing.

In a bid to strengthen the soundness of the financial sector, Bank of Uganda implemented a number of regulatory reforms. First was the increase in banks' statutory minimum capital requirements to Ushs.10 billion by 1st March 2011 and Ushs.25 billion by March 2013. In addition, applicants for a banking licence will have to meet the new requirement for capital of Ushs.25 billion. All the existing banks were able to meet the new capital requirement of Ushs.10 billion by 1st March 2011.

Secondly, Bank of Uganda embarked on the process of amending some sections of the Financial Institutions Act (FIA), 2004 and implementing regulations to strengthen the soundness and competitiveness of the banking sector. These amendments are discussed further in Section 5 of this report.

Thirdly, Bank of Uganda (BOU) is studying the recent proposals made by the G20 and Basel Committee on Banking Supervision on the post crisis regulatory framework with a view to implementing them in future.

On the financial inclusion front, the BOU continued to closely monitor recent and proposed innovations to support financial inclusion, including the roll out of the mobile phone money transfer service and the approval of agent banking services. Efforts by financial institutions to explore other avenues of boosting income streams such as providing bancassurance services will require amendment of the Financial Institutions Act 2004 and effective collaboration and implementation of memoranda of understanding (MOU) between financial sector regulators, that is, the Bank of Uganda, the Uganda Insurance Commission and Capital Markets Authority to ensure that emerging risks emanating from financial sector activities are identified and mitigated.

2. On-Site Inspection

Commercial banks

During 2010, BOU conducted risk-based on-site examinations of twenty one banks and follow-up

examinations for seven banks. The main objective of the on-site examinations was to assess the robustness of the banks' risk management systems in view of the challenges posed by the increased risks in the global economy, as well as dynamism in Uganda's banking sector. In addition, the examinations were intended to establish the banks' financial condition and resilience to both internal and external shocks and, to ascertain their compliance with applicable laws, regulations, prudential guidelines as well as supervisory recommendations.

On-site examination findings revealed that nine banks were exposed to high composite risk[1], eleven to moderate composite risk and one to low composite risk. According to the CAMELS[2] rating system, the financial condition of five banks was satisfactory, ten fair, two marginal while four banks were rated unsatisfactory. The direction of risk in the banking sector was deemed to be increasing mainly due to the numerous innovations of new products coupled with new service channels such as internet and mobile telephone banking.

Credit institutions

BOU continued to conduct on-site surveillance over credit institutions to ensure the safety of depositors' funds and overall soundness of the financial sector. In this regard, BOU carried out a full scope on-site examination of one large credit institution to determine the financial condition and adequacy of its risk management framework. Two follow-up examinations of the remaining two credit institutions were also conducted to assess the adequacy of the corrective measures they were taking to address supervisory recommendations. The examination findings indicated that the credit institutions were in satisfactory financial health and were addressing supervisory concerns within the specified time frames.

Microfinance deposit-taking institutions

On-site inspection was carried out on two of the three microfinance deposit-taking institutions (MDIs). The inspections established that the two institutions had implemented recommendations of previous on-site examinations. The main issues noted during inspection were; the need for strengthening board composition (by bringing in finance and accounting professionals), improving suspicious activity reporting, filling of risk management positions and, ensuring that information technology (IT) systems controls are well documented and implemented.

Foreign exchange bureaus

On-site inspections for 143 out of 307 licensed foreign exchange bureaus and money remitters were conducted during 2010. The objective was to assess the level of compliance with the provisions of the Foreign Exchange Act (FEA) 2004 and the Foreign Exchange Bureau and Money Remittance Regulations (FER) of 2006, as well as the guidelines and circulars issued by the BOU. The major supervisory concern related to the lapse in "Know your customer" (KYC) rules and procedures. In contravention of regulations, a number of operators do not comprehensively capture the identities of customers dealing in large transactions and, source and purpose of funds on the official receipt books. Bank of Uganda is exploring appropriate sanctions for such cases.

National Social Security Fund (NSSF)

In line with the mandate given to BOU as the interim regulator on behalf of the Minister of Finance, Planning and Economic Development (MFPED), BOU conducted a full scope onsite examination of the National Social Security Fund (NSSF) during December 2010. The examination focused on assessing NSSF's overall financial condition, soundness of its risk management framework, policies and procedures, and strategic direction. A report of the examination was prepared and will be submitted to the Minister of Finance.

[1] Composite risk is an overall measure of risks within financial institutions. There are several risks including strategic risk, operational risk, credit risk, market risk, liquidity risk and compliance risk. These are aggregated together to come up with an overall measure referred to as Composite risk.

[2] The CAMELS rating system is a classification method that is used by the Central Bank to assess the relative soundness of a banking institution. CAMELS is an acronym for Capital adequacy, Asset quality, Management, Earnings, Liquidity and, Sensitivity to market risk.

3. Off-Site Analysis

As part of the continuous assessment of the financial sector, BOU continued to conduct off-site surveillance of Supervised Financial Institutions (SFIs) through the collection and analysis of financial data obtained from adhoc and periodical statistical and statutory returns. Off-site analysis continued to play a critical role in the continuous implementation of the risk-based supervision methodology. It provides BoU with high frequency data for further analysis and helps for planning on site visits.

Commercial banks

During the year ended 31st December 2010, BOU continued to monitor the performance of all banks through off-site surveillance using data from periodic returns submitted by the commercial banks. The quarterly off-site analysis reports for the year 2010 were prepared and dispatched to the respective banks. In addition and in line with Bank of Uganda's mandate, audited annual accounts of all banks for the financial year ended 31st December 2009 were reviewed and thereafter, all the banks published their respective annual accounts in the print media by the statutory deadline date of 30th April 2010.

Stress testing

Using the returns submitted by banks, stress tests were conducted to estimate the effect of specific shocks on bank's soundness. Specifically, the tests were aimed at determining the losses which banks would incur, and the consequent impact of these losses on their capital. The shocks included in the stress tests were:

a) Decline in net interest margin,
b) Decrease in interest income on government securities,
c) Depreciation of the Uganda shilling against the US dollar,
d) Increase in non-performing loans and,
e) 100 percent loan loss of each bank's largest borrowers.

The stress tests were conducted at the end of each quarter in 2010. The results of the tests conducted on the banks' financial positions as of December 2010 are shown in Table 1. As can be seen in the table, an adverse shock to net interest income, income received from government securities, an increase in non-performing loans (NPLs) and a depreciation of the Ugandan shilling all have roughly similar impact on the capital position of the banking system. For each of these shocks, the capital adequacy of only 2 individual banks is pushed below the statutory minimum, with the overall capital shortfall being in the range of Ushs.154 million to Ushs.807 million. The resultant shortfall is considered minor given that Uganda's banking system has an aggregate total capital of Ushs.1,473 billion recorded as at the end of December 2010.

Table 1: Stress test shock for quarter ended December 31, 2010

Stress Test Variable	Number of Banks [a)]	Aggregate additional capital (Ushs. billion) [b)]
Decline in net interest margin		
Decrease in net interest income by 20%	2	0.32
Decrease in net interest income by 50%	2	0.81
Decrease in interest income on government securities		
Decrease in income from government securities by 20%	1	0.53
Decrease in income from government securities by 50%	1	0.56
Depreciation of Shilling against US dollar		
Depreciation of Ushs. against US Dollar by 20%	2	0.15
Depreciation of Ushs. against US Dollar by 30%	2	0.24
Increase in non-performing loans		
Increase in NPLs by 30%	2	0.41
Increase in NPLs by 50%	2	0.69
Loan loss of each bank's largest borrowers		
Default by single largest borrower	5	20.0
Default by 3 largest borrowers	15	293.3

Source: Bank of Uganda

Notes:

a) *The number of banks which fail the stress test in each category*

b) *This is the amount of additional capital that would be required to bring the affected institutions' capital back to the minimum statutory levels.*

However, analysis of default by the banks' largest borrowers reveals an inherent credit risk. If each banks' single largest borrower were to default, with a loan loss of 100 percent, 5 banks would be become under-capitalised with an aggregate capital shortfall of Ushs.20 billion. If the three largest borrowers of each bank were to default with 100 percent loan loss, 15 banks would be under-capitalised with an aggregate capital shortfall of Ushs.293 billion.

The stress testing results indicate that if the 3 largest borrowers in banks were to default this would severely affect capital adequacy in the majority of banks. However, default involving the largest borrowers is likely to happen only in extreme situations such as a macro economic shock associated with a recession. For all other risks, the results show that the Ugandan banks are resilient and have adequate capital to mitigate their impact.

BOX 1: Stress Testing

Introduction

Stress testing is synonymous with sensitivity analysis and in essence, attempts to assess the capacity of financial institutions to withstand shocks which may arise from changes in the market environment and potentially affect their balance sheets. With the advent of globalisation, countries have become more inter-dependent and shocks affecting particular market segments transmit easily to other market participants, particularly financial institutions. Therefore, assessing potentials of financial institutions to withstand such shocks is useful in providing early warning information, which could be used to devise policy measures to reduce the impact of these scenarios.

The various techniques used to measure the impact of stress conditions are of varying degrees of sophistication and, corresponding results depend on the assumptions made. The extent and direction of key parameters like interest and foreign exchange rates incorporated in the analysis has been predicted using econometric models or real historical data with similar conditions. The stress testing exercise places emphasis on the impact of the shocks on income and ultimately on the equity/capital of financial institutions. Estimated capital requirements to bring the institution's capital to equilibrium (regulatory limits) are worked out. The relevance of including these estimates is supported by the fact that stress tests attempt to estimate the magnitude of the potential specific corrections for which the banking system is at risk. Key shocks applied include interest rate, foreign exchange rate and credit default resulting to deterioration in asset quality, which could as well be a residual of interest rate and foreign exchange rate risks. The Bank is taking steps to enhance capacity in macro-modelling and stress testing, working with Technical Assistance from the International Monetary Fund.

Interpreting stress test results

Stress tests measure financial institutions' exposures and resilience to shocks. At the **Institution level**, the stress test measures a particular entity's exposure to a potential shock. At the **Sector level**, the net exposure of the entire financial sector may be determined. Significant exposures in a big financial institution could raise concern even when the overall net exposure of the financial sector is small. It is important to note that a stress test considers only a part of a financial institution's income generating operations. The financial institution may however, have significant positions in assets whose values may be affected by the shocks used but were not included in the specific sample stress scenarios.

Credit institutions and microfinance deposit-taking institutions

BOU conducted off-site surveillance of the three credit institutions through the collection and analysis of financial data obtained from adhoc and periodical statistical and statutory returns. According to off-site reports, the three credit institutions scored satisfactory composite ratings under the CAMELS assessment methodology. In addition, continuous off-site surveillance of microfinance deposit-taking institutions (MDIs) was undertaken. All the credit institutions and MDIs were in compliance with statutory liquidity, capital and other requirements.

Revision of reporting returns

Bank of Uganda launched the revised version of the balance sheet (BS100/MDI 100) return to accommodate emerging data requirements for monetary policy formulation. Additionally, Bank of Uganda conducted quarterly visits to commercial banks, credit institutions and MDIs to validate the data submitted for accuracy and consistency and provide information to staff of financial institutions on how to compile the different statutory and statistical returns.

The automation of statutory returns for foreign exchange bureaus and money remitters was also successfully launched in April 2010. All foreign exchange bureaus and money remitters now submit returns. The manual component in the processing of data from operators, which is not only prone to human error but also time consuming has as a result been minimised.

Banking Supervision Application

Efforts continued to prepare for the launching of the Banking Supervision (BSA) system. The software is designed as a platform for data submission by SFIs and for off-site analysis of these institutions. A test run of the system commenced during 2010 with three SFIs; one commercial bank, one credit institution and one MDI. Regarding capacity building, all officers responsible for off-site analysis were trained on the upgraded version 2.1 of the Banking Supervision Application (BSA) software in preparation for its roll out in 2011.

4. Licensing and Approvals

New institutions and branches

During 2010, Bank of Uganda licensed two new commercial banks, namely ABC Capital Bank Limited (which converted from a credit institution) and Imperial Bank Uganda Limited, bringing the total number of commercial banks to 23. Over the same period, the industry experienced a rapid expansion in service outlets, closing the year with 393 bank branches and 598 ATMs, compared to 363 branches and 480 ATMs as at 31st December 2009 as indicated in Table 2 below.

Table 2: Number of licensed branches / outlets

	2008	2009	2010
Banks	301	363	393
Bank ATMs		480	598
Foreign exchange bureaus	114	135	158
Money remitters	80	91	149
MDIs	96	76	83
Credit institutions	27	45	42

Source: Bank of Uganda

At end December 2010, the total number of branches for licensed foreign exchange bureaus and money remitters were 307, compared to 226 as at end of December 2009. The total number of MDI branches increased to 82 up from 76 as at end of December 2009. Six new MDI branches were opened by FINCA and Pride Microfinance Ltd during the year 2010.

New products

In a bid to encourage an environment conducive for access to financial services, a number of banks were approved to launch alternative delivery channels, which included, point of sale products, agency operations and mobile and internet banking services. The services allow customers to use their computers and cell phones to carry out limited transactions such as intra and interbank funds transfers to nominated accounts, balance enquiries, inquiries on foreign exchange rates, mini-statement and cheque book requests. Additionally, money transfer services and cross-border teller services were also approved for a number of banks.

BOX 2: Strategy for Regulating Microfinance Institutions

Introduction

During 2010, Bank of Uganda initiated a review the Microfinance Deposit-taking Institutions (MDI) Act (2003) aimed at enhancing the way microfinance institutions (MFIs) are regulated in Uganda. Microfinance institutions play an important role in enhancing financial sector deepening in Uganda by increasing outreach to support poverty reduction. The initial thrust for the regulation of the microfinance industry focused mainly on integrating its upper segment into the supervised financial system. This resulted into the Microfinance Deposit-taking Institutions (MDI) Act of 2003. This regulation allowed 4 of the bigger MFIs to mobilise deposits from the public, under a framework where they are the third tier of financial institutions licensed and supervised by BOU. In spite of this achievement, it has become clear over time that there is need to revisit the way MFIs are regulated and ensure that there is sufficient oversight of their performance and safety of the savings deposited by their members.

The main objective of the current review is to provide regulation for the larger MFIs which take members deposits and might want to come under the regulatory orbit. In addition, there are further reasons for the review. First, Bank of Uganda is concerned that since the initial four institutions were licensed, no new MFIs have been licensed under MDI Act, while one of the formerly licensed institutions has since upgraded to a Tier 1 institution. Secondly, the rapid developments that have taken place in Uganda's financial sector since enactment of the MDI Act in 2003 call for a review. Thirdly, there are several MFIs and SACCOs that are indirectly engaged in deposit-taking who need to be brought under regulation to ensure safety of the members' deposits. There have been persistent and increasing complaints from the public on fraudulent and illegal deposit-taking and hence, the need to clarify who can take deposits. Clearly, the challenge in having many MFIs under inadequate supervision is the lack of oversight for savings used as collateral, which some MFIs may be attracted to intermediate. Such savings are in essence voluntary and should be treated like deposits. A revision of the regulatory framework for the microfinance industry will help to protect the members' savings and ensure that weak MFIs do not undermine the stability of the financial system.

Emerging issues

The Bank has taken a proactive approach to learn more about the unregulated microfinance institutions (MFIs). Following a period of consultation in 2010, Bank of Uganda initiated a process to revise the MDI Act 2003.

First, meetings were held with the 14 largest unregulated microfinance institutions (commonly referred to as Tier 4) and 8 SACCOs (basing on the size of their operations and business). The underlying purpose was to establish the scope of their operations, the reasons for the unwillingness of some institutions to upgrade to MDI status or any other BOU license, as well as to identify institutions that could be taking deposits illegally or intermediating compulsory savings. Through these discussions a number of issues emerged. It was established that some microfinance institutions (MFIs) are interested in becoming microfinance deposit-taking institutions (MDIs) but are unable to apply due to some limiting provisions in the MDI Act 2003 (only companies can be licensed). Others are more comfortable operating in the loosely regulated environment offered by other legal frameworks under which MFIs can operate (The Cooperative Societies Act 1992 and the Money Lenders Act 1952). A number of institutions also had very serious weaknesses in the areas of management, internal controls and information technology (IT). There was also a lack of oversight in cases where member's savings were being intermediated by some MFIs.

Secondly, a call for comments (on the MDI Act 2003) was sent to all major stakeholders in the microfinance industry and, a wide range of comments were received. The main issues raised include; the cost of branches and possible less costly options (agencies); maximum shareholding levels allowed; licensing of non-company MFIs and the use of the term 'bank' by MDIs.

There were also issues raised that related to the limitations in the current definition of the term 'deposit' to ensure compulsory savings are not intermediated and in case of large SACCOs where 'member savings' turn into de facto 'public deposit'. A review of these issues was undertaken and the study was complimented with study visits to Germany and Canada which have well developed cooperative banking systems.

Policy proposals and activities by Bank of Uganda

Following consolidation of the comments from stakeholders and BOU internal review, a number of amendments to the MDI Act 2003 have been proposed, intended to enhance licensing and operative provisions, to facilitate the removal of legal barriers to the efficient and cost-effective operations of the MDIs and the graduation of Tier 4 institutions to Tier 3, and to enhance consumer protection.

First, Bank of Uganda will address issues relating to the way limitations in the current definition of the term 'deposit' allow MFIs to intermediate compulsory savings and in the case of large SACCOs 'member savings' turn into *de facto* 'public deposit'. This is an area where prudential regulation should be applied. In addition, regulations are also being proposed to create a single Deposit Protection Fund for MDIs and other MFIs which are not regulated by Bank of Uganda.

Secondly, to address some of the issues raised by stakeholders and enhance competitiveness of the MDIs, the proposed amendments will allow MDIs to use the word 'bank' provided it is preceded by the qualifying word 'microfinance' e.g. XYZ Microfinance Bank. Thirdly, the MDI Act review will take into account the infrastructural requirements for setting up an MDI Agency or mini branches in rural areas and allow Islamic Banking /Finance option for MDIs. The revised regulation will set forth and define activities and a framework for branchless and agency banking services as delivery channels for offering financial services in a cost effective manner and as a means of promoting financial inclusion. However, the issue of whether non-company type MFIs like SACCOs and other types of *mutuals* should transform into companies limited by shares or not prior to licensing as MDIs is still under discussion. Fourth, the proposals will seek to develop a consumer protection program and a mechanism to address complaints of illegal deposit-taking by MFIs in a timely manner. This initiative will include a component to strengthen members' awareness and ability to oversee MFIs where they save.

The way forward

In late 2010, Bank of Uganda constituted a dedicated team to finalise the review of the Microfinance Deposit-taking Institutions (MDI) Act 2003 and Implementing Regulation 2004. The team, which has already visited Germany to learn from their well established MFI sector, is expected to finalise the review exercise by mid 2011.

5. New Developments and Reforms to Strengthen Supervision

5.1. Amendment of Regulations

Minimum capital requirements

The *Financial Institutions Instrument No. 43 (Revision of Minimum Capital Requirements for Banks)* of 2010, was gazetted on 3rd November 2010. The instrument raised minimum paid-up capital requirements from Ushs.4 billion to Ushs.25 billion. The revised capital requirements are aimed at providing banks with sufficient capital to support growth, cushion risk and, harmonise minimum capital requirements for banks within the EAC countries. Transitional provisions of the instrument allow existing banks up to 1st March 2011 to build up the paid-up capital to Ushs.10 billion and up to 1st March 2013 to reach Ushs.25 billion.

Deposit Protection Fund, Islamic banking, Bancassurance

Amendments to the Financial Institutions' Act 2004 regarding the Deposit Protection Fund, Islamic Banking and Bancassurance were submitted to the Minister of Finance, Planning and Economic Development (MFPED) for onward submission to Parliament for legislation. The amendments are intended to allow supervised financial institutions (SFIs) to offer Islamic banking and insurance products within their product range, to foster financial sector development and inclusion. Reform of the Deposit Protection Fund is intended to merge the separate funds under the FIA 2004 and MDI 2003, for increased efficiency. The merged fund will have the mandate to collect premiums, invest collected funds and, where necessary, act as an agent of the Bank of Uganda in the receivership or liquidation of failed institutions.

Capital charge for market risk

In order to fully comply with the provisions of Basel I, proposed amendments to the Capital Adequacy Requirements Regulations (2005) were made to incorporate a capital charge for market risk. The amendment takes cognisance of the existence of market risk in all SFIs, especially through interest rate risk and foreign exchange risk. Incorporation of a capital charge for market risk will therefore provide adequate capital as a cushion for risks which exist in SFIs' securities portfolios and foreign exchange activities. The amendment awaits gazetting by the MFPED.

5.2. The Microfinance Deposit-Taking Institutions' Deposit Protection Fund

The MDI Deposit Protection Fund (MDI-DPF) became operational during the course of the year. All the MDIs contributed their first premiums to the MDI-DPF at the beginning of 2010. The MDI-DPF amount currently holds a balance of Ushs.67.3 million. A further €2 million is expected from the German Kreditanstalt fur Wiederaufbau (KfW) to boost the Fund. The amount from KfW will be split between MDI–DPF Seed Capital (€1.8 million) and the MDI-DPF Public Awareness Campaign (€0.2 million). The Campaign will focus on making the public aware of the existence of the Fund and its benefits, which include guaranteed recovery of deposits in the event of MDI liquidation.

5.3. The Money Remittance Security Deposit

Investment of the Money Remittance Security Deposit was commenced in October 2010 by African Alliance Limited, a fund manager recruited by Bank of Uganda. The market value of the Money Remittance Fund as at 31st December 2010 amounted to Ushs.1.9 billion and comprised of treasury bills (Ushs.1.5 billion), treasury bonds (Ushs.307.1 million) and cash (Ushs.86 million). The Money Remittance Security Deposit held at BOU serves as security for the due performance of operators' obligations to those persons who deposit or who will deposit moneys with it for remittance purposes.

5.4. Progress on the Establishment of the Credit Reference Bureau

The first phase of the Credit Reference Bureau (CRB) Project ended 30th September 2010 and the second phase, where participating institutions (commercial banks, credit institutions and microfinance deposit taking institutions) are charged fees for every credit enquiry made, commenced effective 1st October 2010. With effect from March 2010, participating institutions (PIs) were mandated to make credit enquiries on all new credit applications processed. The usage of the CRB services in the credit

appraisal process subsequently gained momentum among all the participating institutions. The number of credit enquiries made on new credit applications processed increased to over 53,000 on a monthly basis. Participating institutions started to appreciate the CRB System as information derived from the credit reports was continuously used in the credit appraisal process.

The number of Participating Institution branches on the CRB and Financial card systems grew to over 500 and the number of financial cards issued to customers increased to over 478,000 against an estimated 530,000 borrowers in the entire financial sector. Bank of Uganda continued to monitor and enforce improvements in the quality of data submitted to the CRB in order to ensure the achievement of value for money. Participating Institutions also stepped up data clean-up efforts by intensifying the Know-Your-Customer procedures. However, data integrity issues in terms of risk classification continued to remain a challenge.

5.5. Mobile Money Transfer Services

Bank of Uganda continued to oversee the operations of the licensed mobile money transfer services in Uganda i.e. MTN Uganda, Uganda Telecom (UTL) and Airtel, mainly through off-site analysis and regulation. During 2010, the number of registered customers increased from 552,047 to 1,683,713. The amount transferred by customers rose from Ushs.132.5 billion in 2009 to Ushs.962.7 billion during 2010. As the market grows, Bank of Uganda will continue to strengthen its oversight of these services, with particular attention paid to those banking institututions through which the funds are transferred, to protect customers' funds and reduce the risk of disruption to other financial services. In this regard, participating firms are already required to have a robust risk management framework.

6. Strengthening Capacity for Supervision

The BOU continued to explore and undertake capacity building initiatives aimed at strengthening supervisory skills and practices in order to move with emerging supervisory challenges and developments in the global, regional and local financial sectors. During the year the following initiatives were undertaken;

a) The Supervision Function continued to conduct weekly in-house training sessions covering various topical supervisory issues but largely focusing on banking risks and risk based supervision concepts and principles
b) The IMF's East Africa Technical Assistance Centre (EastAfritac) conducted training sessions on consolidated supervision and anti-money laundering and combating the financing of terrorism for all members of staff;
c) The Macroeconomic and Financial Management Institute (MEFMI) facilitated workshops for some members of staff on consolidated supervision and risk based supervision;
d) SIDA sponsored training for two members of staff in risk management in finance and banking in Sweden and South Africa;
e) Some members of staff received training in Islamic Banking and Finance, IT audit, microfinance, basic implementation of Basel II and the assessment and capitalization of distressed credit portfolios.

Further, some members of staff participated in regional training programmes as resource persons and/or consultants. BOU continued to be committed to working with various development partners on a number of training initiatives to ensure the achievement of the Supervision Function's training capacity building goals and objectives.

7. Regional Cooperation

During the year ended 2010, the Monetary Affairs Committee (MAC) of the East African Community (EAC) identified the following priority actions and/or strategic objectives related to banking supervision and financial stability aimed at achieving the establishment of East African Monetary Union (EAMU);

(i) Harmonisation of supervisory, legal and regulatory frameworks.
(ii) Promotion of financial stability in the EAC.

The BOU has so far implemented the following activities aimed at achieving the above objectives:

- Completion of matrices on supervisory and prudential practices as well as legal and regulatory

frameworks for commercial banks, credit institutions, micro deposit-taking institutions, foreign exchange bureaux and the credit reference bureau. These will be consolidated by Central Bank of Kenya and discussed at a regional level in 2011;

- Completion of a self-assessment of Uganda's compliance with Basel Core Principles for Effective Banking Supervision;
- Completion of a matrix aimed at reviewing and harmonising the existing financial stability assessment frameworks at the regional level and promoting financial stability in EAC central banks.

8. Activities Planned for 2011

Agent banking

The Bank of Uganda, in line with its strategic objective of promoting financial inclusion and a stable financial sector, plans to expedite approval of agent banking during the year 2011. This regulation will allow financial institutions to provide branchless banking services whereby they can provide services through outlets and agents which carry out various commercial activities. It involves a partnership between banks and non-banking sector agents for purposes of delivering financial services to the unbanked population with greater convenience, at a modest cost.

Banking Supervision Application

Upon completion of the BSA pilot test phase, the Bank of Uganda is planning to roll out the system to all supervised financial institutions before the end of 2011.

Automation of foreign exchange bureaus' receipts

The Uganda Foreign Exchange Bureau and Money Remittance Association (UFBMRA) requested BOU to consider allowing foreign exchange bureaus to issue their own electronic sales and purchases receipts. Discussions are underway with the Association over the matter. This move is intended to improve the capture of sources of and purpose for funds. The automation of receipts issued to customers for transactions by the operators can ease the capture of information that is required for the analysis of balance of payments. The proposal is being reviewed but in the meantime, operators will continue to submit copies of electronic sales and purchases receipts.

Finalise review of the MDI Act 2003

The review of the proposed MDI Act amendments is in progress and information gathering and analysis on the above tasks is under way. Review of comments (on the MDI Act 2003) received from all major stakeholders in the microfinance industry has been finalised. A special team which was constituted to finalise review of the Microfinance Deposit-taking Institutions (MDI) Act 2003 and implementing regulations, will incorporate the comments in its final report. The team will also develop a consumer protection program and a mechanism to address depositor complaints in a timely manner. It is expected that the exercise will be finalised and the draft amendments forwarded to the Minister of Finance, Planning and Economic Development.

Post-crisis regulatory in the EAC

Since the onset of the financial crisis, efforts have been ongoing internationally to improve bank resilience and regulation. During November 2010, the G20 meeting in Seoul South Korea approved proposals by the Basel Committee on Banking Supervision (BCBS) to strengthen the regulation of banks, improve quality of capital and reduce procyclicality. Bank of Uganda is working with the EAC central banks to study these reforms and implement them. A workshop is planned in Kampala in early 2011 to discuss these reforms. In addition, the Bank is working with Technical Assistance from the IMF to develop capacity and appropriate tools for macroprudential policy.

Consolidated supervision and supervisory colleges

Given the lessons from the recent global crisis, supervisory colleges are an important component of effective supervisory oversight of international banking groups. Bank of Uganda will move to implement consolidated supervision for regional banks during 2011 and increase participation in supervisory colleges for international banks. Emphasis will be put on cross-border cooperation and information-sharing between Bank of Uganda and host supervisors of regional and international banks. The enabling regulation was passed during 2010 and staff capacity has been enhanced to prepare for this activity.

PART II: ASSESSMENT OF FINANCIAL STABILITY

9. Banking Sector Performance

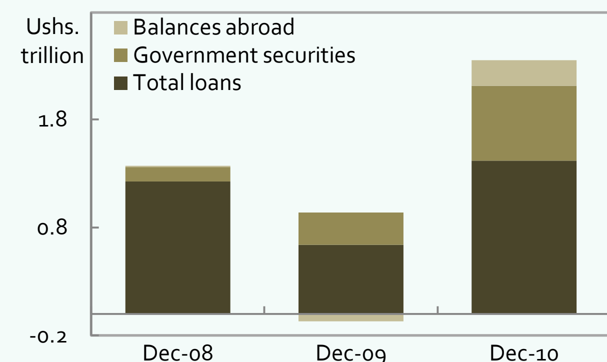
Since the publication of the last Financial Stability Report, *Uganda's banking sector has gone through a period of significant growth in the year to December 2010. A key aspect was the improvement in the banks' asset quality which was as a result of lower non-performing loans compared to the year ending December 2009. Banks' performance in the year 2010 was also characterised by strong credit growth to the private sector and, a sharp rise in foreign currency loans during the last half of 2010. Bank profitability improved, particularly for the new banks whose operating costs were significantly reduced. Although banks remained adequately capitalised, there are concerns over the increased rate of credit growth impacting on the capital adequacy ratio and banks' increased use of swaps for funding.*

Table 3: Annual developments in banks' assets and deposits

	Dec-08	Dec-09	Dec-10
Assets			
Volumes (Ushs. trillion)	7.58	8.73	11.30
Annual growth (%)	35.22	15.13	29.40
Deposits			
Volumes (Ushs. trillion)	4.77	5.63	8.02
Annual growth (%)	28.94	18.10	42.50
Loans			
Volumes (Ushs. trillion)	3.40	4.04	5.46
Annual growth (%)	60.63	18.80	35.11

Source: Bank of Uganda

Chart 1: Annual changes in banks' major assets



Source: Bank of Uganda

Table 4: Foreign currency denominated assets and liabilities (percentage ratios)

	Dec-08	Dec-09	Dec-10
Forex assets to total assets	26.78	22.61	24.68
Forex liabilities to total liabilities	31.29	25.58	29.25
Forex loans to total loans	25.71	21.07	27.06
Forex deposits to total deposits	27.99	26.13	28.20

Source: Bank of Uganda

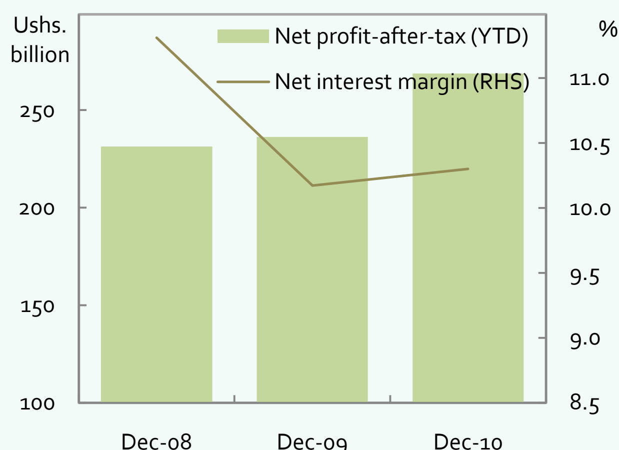
9.1. Changes in Banks' Key Assets and Liabilities

The banking sector's total assets increased strongly during 2010, indicating a recovery from the slowdown in 2009 following the global financial crisis. Banks' total assets grew by 29.4 percent in 2010, mainly driven by increased lending activity. There was also an increase in the value of government securities held by banks as these amounts grew by Ushs.694.2 billion in 2010 compared to Ushs.299.7 billion in the previous year. The increase in government securities was in response to the pick-up in interest rates during 2010, which in turn followed increased government borrowing. Banks' balances held with financial institutions abroad increased by Ushs.234.6 billion during the period under review.

Deposits provide the cheapest source of funding for commercial banks, playing a vital role in their profitability. The year-on-year growth rate for total deposits held by commercial banks significantly increased during 2010 to 42.5 percent at end December 2010, up from 18.1 percent for end December 2009 as shown in Table 3. While deposit growth provided banks with sufficient funding for loan growth, other sources of funding became increasingly important and were also utilised, as discussed later.

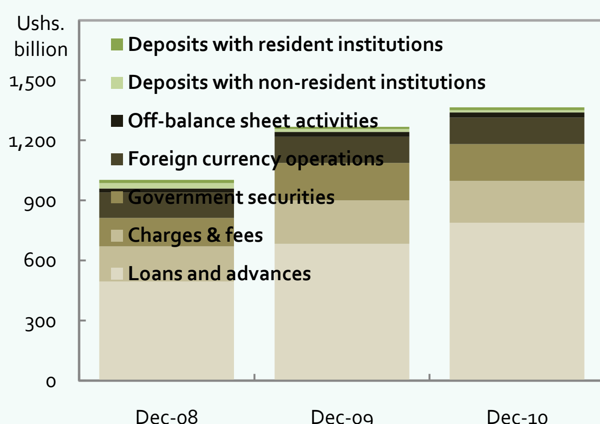
There was a slight change in the structure of the industry's balance sheet with regards to foreign currency denominated components. Table 4 shows that, overall, there was an increase in the share of foreign currency denominated assets and liabilities. The most notable change was that of foreign currency loans whose share of total loans increased from 21.1 percent to 27.1 percent.

Chart 2: Banks' net profit-after-tax and interest margin



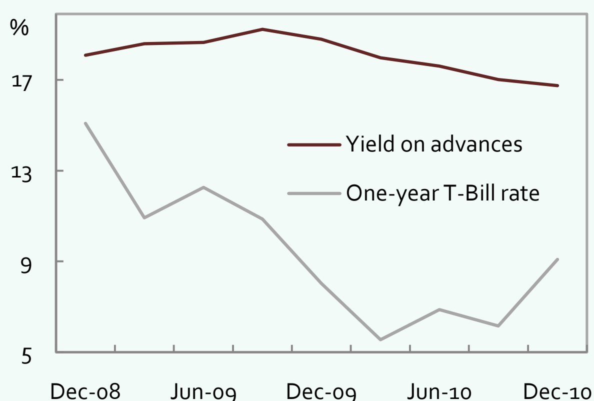
Source: Bank of Uganda

Chart 3: Components of banks' income from financial activities (year-to-date)



Source: Bank of Uganda

Chart 4: Banks' yield on advances and one-year T-Bill rates



Source: Bank of Uganda

9.2. Earnings and Profitability

As at the end of December 2010, banks' earnings had reached Ushs.268.7 billion compared to Ushs.236.1 billion in December 2009. The rise in banks' earnings was due to improved performance during 2010 especially in the quarter ending December 2010.

The key driver of banks' revenue, like in the previous two years, was income from bank lending. As a share of total income, income from loans and advances rose from 51.4 percent to 53.6 percent between December 2009 and December 2010. Another significant contribution to total income was charges and fees on loans and deposits which amounted to 14.3 percent, down from 16.3 percent in December 2009.

Earnings on government securities remained broadly unchanged, reducing by only 1.9 percent in the year to December 2010. However, this small change resulted in a reduction in the share of these earnings to total income, from 14.1 percent to 12.5 percent. The changes in government securities income were a reflection of the drop in interest rates on government securities that occurred between September 2009 and March 2010.

Net interest income increased by Ushs.102.7 billion between December 2009 and December 2010 while the net interest margin rose from 10.2 percent to 10.3 percent. During the same period, banks' yield on advances decreased to 16.7 percent from 18.8 percent. The cost of deposits continued to decline during 2010, dropping from 3.9 percent to 2.4 percent.

In the period between December 2009 and December 2010, banks operating costs amounted to Ushs.484.2 billion, an increase of Ushs.52.4 billion on the amount recorded in the year ending December 2009. However, the industry-wide cost-to-income ratio reduced from 82.2 percent to 70.7 percent, implying that the growth of total income outstripped that of costs. In addition, return on average assets (ROA) and return on average equity (ROE) figures recovered significantly compared to 2009 (*see Table 5*).

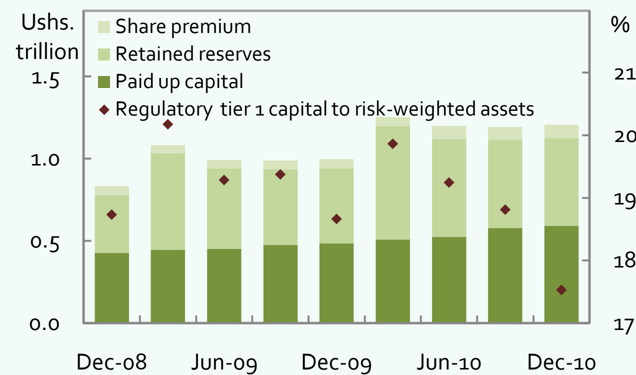
A number of new banking institutions continued to register losses in 2010. However, the volume of losses incurred by these banks reduced and consequently, all the major indicators of profitability for new banks improved markedly; ROA and ROE improved to -9 percent and -63.4 percent at the end of

Table 5: Profitability indicators for banking sector and new banks (percentage ratios)

	Dec-09	Dec-10
New banks		
ROA	-24.95	-9.03
ROE	-108.73	-63.35
Cost to income	352.05	157.3
Industry		
ROA	2.00	2.98
ROE	12.69	21.29
Cost to income	82.23	70.72

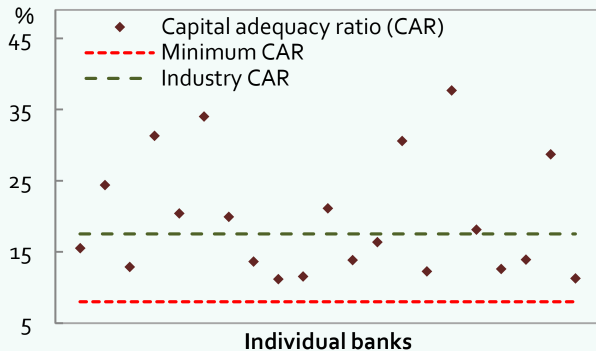
Source: Bank of Uganda

Chart 5: Developments in banks' tier 1 capital



Source: Bank of Uganda

Chart 6: Distribution of individual banks' capital adequacy ratios as at end December 2010



Source: Bank of Uganda

Note: The horizontal axis represents individual banks.

December 2010 from -24.9 percent and -108.7 percent respectively at December 2009 while, the cost-to-income ratio improved to 157.3 percent. The improved performance of new banks signals that not only have these banks increased the efficiency of their operations by curbing costs, but also that business conditions within the banking industry may have become more favourable for new entrants.

9.3. Adequacy of Banks' Capital

At an aggregate level, the capital adequacy ratio (*regulatory tier 1 capital to risk-weighted assets*) for banks was 17.5 percent at the end of December 2010, far above the regulatory minimum of 8 percent. This figure averaged 18.9 percent during 2010 compared to 19.4 percent in 2009. Banks' capital adequacy is strongly influenced by the volume of risk-weighted assets they hold, which are comprised primarily of loans. For the period to December 2010, risk-weighted assets grew by 30.8 percent compared to 17.4 percent in 2009, thus indicating that the change in capital adequacy was not due to banks making losses but rather, it was a result of increased growth in risk-weighted assets. Nevertheless, all banks were able to meet the minimum capital adequacy ratio requirement. Overall, the quality of tier 1 capital in Uganda is very high and is constituted mostly of paid-up capital and retained earnings.

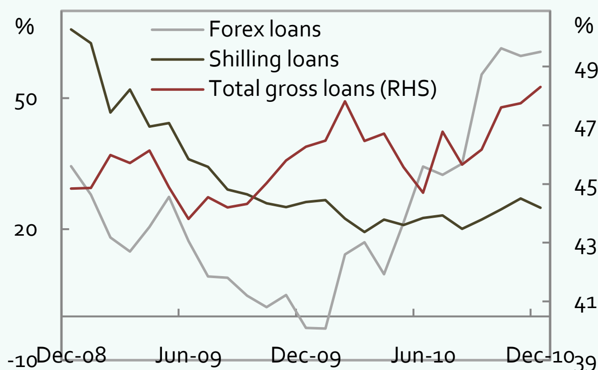
The recent global financial crisis generated a call for reforms to the regulatory framework to strengthen banking systems and improve their resilience to shocks. In a bid to further improve the quality of the capital base, the Bank of Uganda has revised the capital requirements by raising the statutory minimum from Ushs.4 billion to Ushs.25 billion by 2013. These reforms will ensure that banks hold substantial levels of capital that can absorb losses and enable them to remain resilient to shocks.

9.4. Performance of Credit

Lending activity

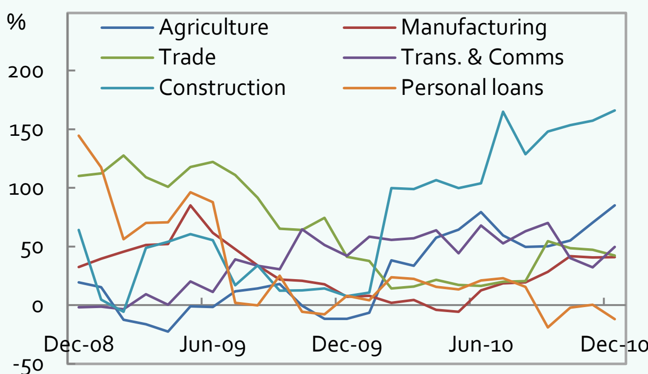
Banks' lending continued to grow, especially during the last half of 2010. Total gross loans grew by 35.1 percent in the year to December 2010 compared to 18.8 percent in the same period to December 2009. A significant development in banks' lending was the accelerated growth in foreign currency loans. While the foreign currency denominated loans amounted to only 27.1 percent of total loans in December 2010, foreign currency loans recorded an annual growth rate of 60.6 percent, while that for shilling loans was 24.9 percent. The available

Chart 7: Annual percentage growth of loans



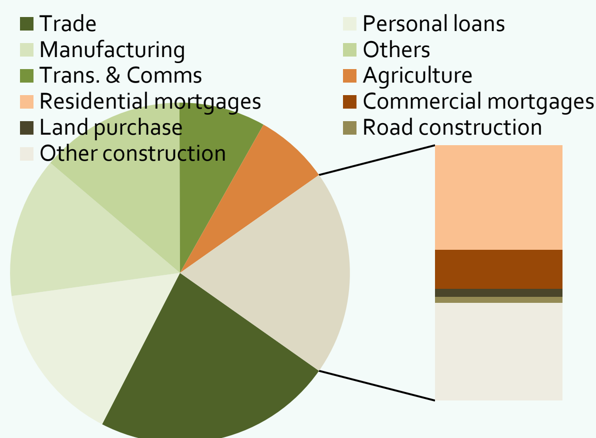
Source: Bank of Uganda

Chart 8: Annual percentage growth of loans for selected business sectors



Source: Bank of Uganda

Chart 9: Sectoral distribution of loans as at end December 2010



Source: Bank of Uganda

data reveals that foreign currency liabilities rose to Ushs.2.8 trillion as at the end of December 2010, enabling banks to fund the Ushs.1.5 trillion worth of credit that was extended in foreign currency. All banks continued to meet limits on foreign currency exposure during the year.

In terms of sectoral lending, banks displayed a shift in lending strategies as they reduced credit to households and increased lending to businesses, particularly the trade and commerce sector. Between December 2009 and December 2010, loans to households reduced from 23.4 percent to 15.3 percent of total loans while those to the trade and commerce sector grew from 21.6 percent to 22.8 percent of total loans. The sector that experienced the most significant rate of growth in loans was building and construction, with an increase of 166 percent during 2010, up from 7.7 percent during the same period in 2009.

Levels of overall credit to the private sector recovered during 2010 compared to 2009, implying increased demand for loans by the private sector. This is in line with the results of the Bank lending survey for June 2010[3] in which most banks indicated strong demand for loans, and stronger willingness by banks to lend. The banks' lending activities will continue to be closely monitored in order to avoid a decline in lending standards that could facilitate a build up of systemic risks.

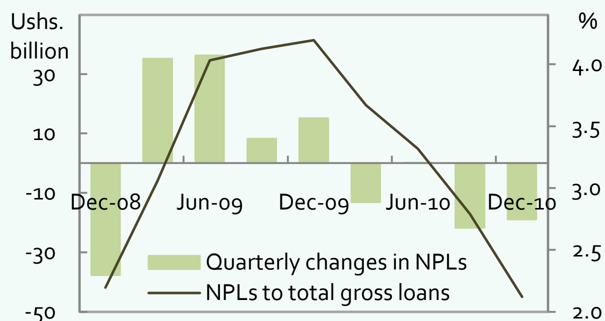
Non-performing loans

Developments in banks' non-performing loans (NPLs) pointed towards an improvement in the overall asset quality in 2010. The ratio of NPLs to total gross loans reduced from 4.2 percent to 2.1 percent between 2009 and 2010. The agricultural sector maintained the highest share of total non-performing loans for two consecutive years, that is, 28.8 percent and 22.1 percent for 2009 and 2010 respectively. Despite having the second largest share of NPLs during 2010, the building and construction sector lowered its ratio of NPLs to total loans to the sector from 2.9 percent to 1.5 percent, thus possibly fuelling banks' lending to the sector. All sectors except the agricultural sector had NPLs to total loans ratios below the industry average of 2.1 percent in 2010 (See Table 6).

The decline in NPLs during the year resulted in banks holding lower loan-loss provisions which dropped from Ushs.96.9 billion to Ushs.75.2 billion between December 2009 and

[3] Bank of Uganda (2010), Bank Lending Survey June 2010.

Chart 10: Changes in banks' non-performing loans



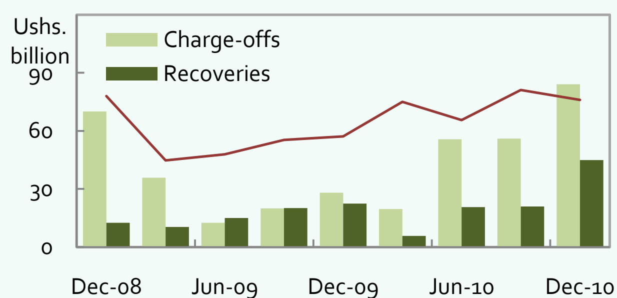
Source: Bank of Uganda

Table 6: Developments in non-performing loans by sector

	Dec-08	Dec-09	Dec-10
NPLs by sector (*percentage share*)			
Agriculture	9.82	28.84	22.08
Manufacturing	4.57	5.33	1.24
Trade	13.03	17.61	13.80
Transport & communications	1.45	4.09	2.18
Building & construction	25.86	6.85	14.01
Personal & household loans	-	-	11.76
NPLs to loans by sector (%)			
Agriculture	3.12	23.45	6.63
Manufacturing	0.71	1.75	0.20
Trade	1.58	3.42	1.28
Transport & communications	0.52	2.31	0.56
Building & construction	5.21	2.90	1.52
Personal & household loans	-	-	1.63
INDUSTRY FIGURE	**2.20**	**4.20**	**2.12**

Source: Bank of Uganda

Chart 11: Banks' loan losses and recoveries



Source: Bank of Uganda

December 2010. However, the amount of charge-offs[4] recorded between 2009 and 2010 was far greater than the recoveries made on non-performing loans during the same period and thus, may have been responsible for the drop in NPLs. For the quarter ending December 2010, charge-offs were Ushs.84 billion while recoveries were Ushs.44.9 billion. These figures are not entirely unexpected following what was a rather difficult 15-month period of recovery for the banking industry.

Nevertheless, the NPL coverage ratio (*calculated as the ratio of loan loss reserves to total NPLs*) for the duration of 2010 was significantly high and had reached 76 percent by the end of 2010 up from 57.2 percent in 2009. In the case of individual banking institutions, a high NPL coverage ratio reduces recorded income through higher provisioning expense. From a financial stability point of view, it signals a prudent approach to guarding against credit risk, especially that arising from highly risky and unpredictable components of the industry's loan portfolio.

9.5. Funding and Liquidity

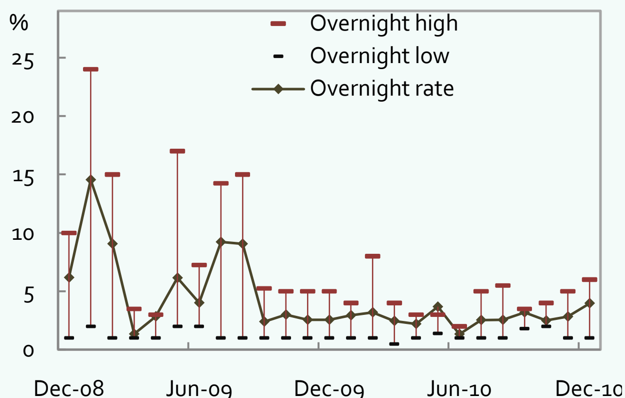
Interbank activity

Activity in Uganda's interbank market increased during 2010, although interest rates rose slightly compared to the high rates that were registered in the previous two years. Between December 2009 and December 2010, average monthly amounts traded during 2010 were Ushs.722.3 billion, compared to Ushs.467.8 billion in 2009.

Interbank rates followed a minor downward trend during the first half of 2010, with the weighted average overnight and 7-day rates reduced by 1.2 percent and 0.8 percent respectively. However, the second half of 2010 saw a reversal in these trends; the weighted average 7-day rate grew from 3.2 percent to 6.3 percent while the overnight rate rose from 2.5 percent to 4 percent as a number of big banks entered the market for liquidity to cover short term positions. The Central Bank responded to the increased tightness of liquidity by issuing reverse repos amounting to Ushs.434 billion during 2010.

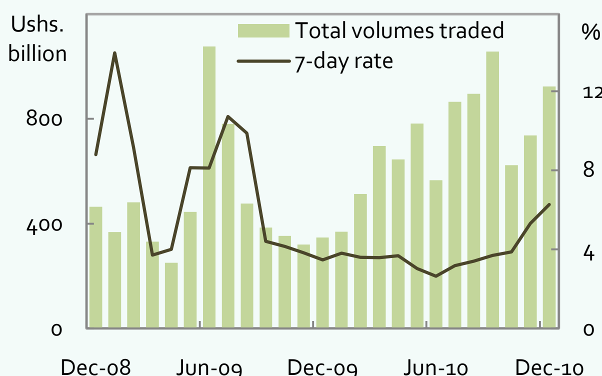
[4] A charge-off is a reduction to the provisions for bad debt account of a bank for an impaired loan that is deemed uncollectable by a bank. The impaired loan is also removed from the balance sheet.

Chart 12: Weighted average overnight interbank rate



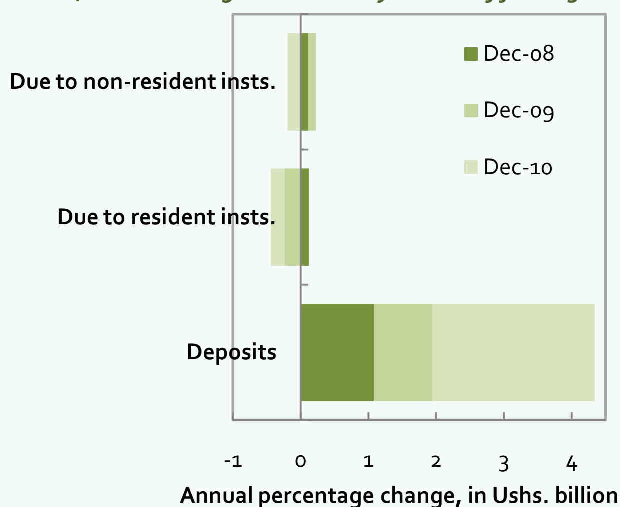
Source: Bank of Uganda

Chart 13: Monthly interbank activity and weighted average 7-day rate



Source: Bank of Uganda

Chart 14: Annual changes in banks' key sources of funding



Source: Bank of Uganda

Other sources of funding

Banks in Uganda are primarily funded by customer deposits. In spite of the strong growth in deposits during 2010, asset growth at most banks was higher, creating a funding gap. During 2010, a number of banks with access to international counterparties increased their funding from foreign banks through their liabilities to non-resident financial institutions.

The issue of banks' funding and liquidity is discussed further in Section 10 and 11 below.

9.6. Sensitivity to Market Risk

The proportion of the banks' balance sheet that is denominated in foreign currency remained fairly constant during 2010. The share of foreign currency assets to total assets increased from 22.6 percent to 24.7 percent between 2009 and 2010, despite the sharp growth in foreign currency loans. Foreign currency loans constituted 53 percent of total foreign currency assets in 2010, Nevertheless, banks still maintained low exposure to foreign exchange risk with the ratio of foreign currency exposure to regulatory tier 1 (core) capital being at -1.56 percent at the end of December 2010. This is shows prudent market risk management by banks, given the recent rapid depreciation of the Shilling against the US Dollar.

*Table 7: Banks' foreign currency exposure (percent)**

	Forex exposure to core capital	Forex assets to forex liabilities	Forex loans to forex deposits	Forex assets to total assets
Jun-08	-7.93	97.20	56.82	26.95
Sep-08	-10.74	91.79	65.02	24.47
Dec-08	-1.42	103.72	65.51	26.78
Mar-09	-1.49	102.04	57.96	25.28
Jun-09	-2.93	111.32	57.29	24.95
Sep-09	-0.93	110.13	53.26	22.35
Dec-09	-0.70	108.84	57.85	22.61
Mar-10	-2.95	101.29	59.84	25.64
Jun-10	-3.48	98.42	52.11	25.28
Sep-10	-11.14	96.26	54.40	24.61
Dec-10	-1.56	97.95	65.25	24.68

Source: Bank of Uganda

10. Macroprudential Assessment

This section of the report provides Bank of Uganda's view of systemic risk in the banking sector. The main issues discussed are the overall rapid growth in credit and change in trends in commercial banks funding.

Table 8: Annual growth of bank lending

	Dec-08	Dec-09	Dec-10
A - Annual change (Ushs. bn)			
Total loans	1,225.8	639.1	1,417.9
o/w Foreign currency loans	223.8	(23.0)	625.5
o/w Shilling loans	1,002.0	662.1	792.4
B- Percentage Change			
Total loans	60.6	18.8	35.1
o/w Foreign currency loans	34.4	(2.6)	60.6
o/w Shilling loans	65.8	26.2	24.9
C – Ratios			
Foreign currency loans to total loans	25.7	21.1	27.1
Shilling loans to total loans	74.3	78.9	72.9

Source: Bank of Uganda

10.1. Overview

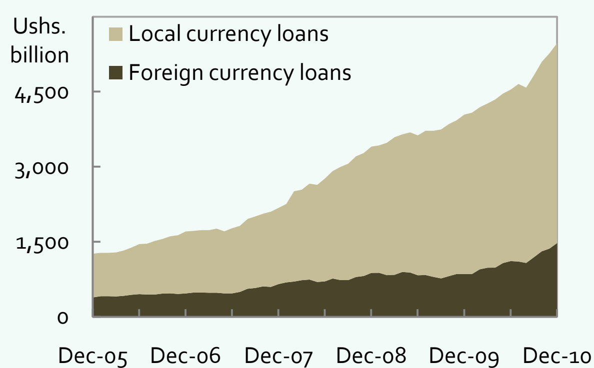
Over the year to December 31 2010, systemic risks for the banking sector were relatively moderate. The main systemic concerns relate to the rapid growth of credit and its likelihood to facilitate the build up of credit risk and, the increasing use by some banks of swaps with foreign counterparties for funding.

10.2. Credit Growth

Potential systemic effects of rapid credit growth

Accelerated credit growth is of concern because it can result in a build up of macroeconomic risks, as well as risks to the stability of the financial system. From a macroprudential perspective, rapid credit growth is associated with three main risks. First, it could lead to deterioration in loan quality, which in turn could lead to fragility in the banking system. Rapid growth of credit is sometimes accompanied by a decline in credit standards and excessive risk taking by lenders. It is therefore a forerunner of bank losses. Secondly, fast credit growth has implications for bank liquidity. Banks normally fund loan growth from deposits. However, deposit growth which depends on increased incomes of households and corporations, tends to be steadier compared to the upswings and downswings in credit. In some cases, credit growth is largely funded by short-term capital inflows. Therefore, in lending booms, banks often have to find other ways of funding credit growth, which are usually less stable sources, and may lead to liquidity problems and a build up of risks. Thirdly, the bulk of the credit booms have also tended to coincide with the emergence of asset price bubbles fuelled by rising investment and consumption booms, often followed by a sharp drop in these asset prices and the weakening of bank balance sheets.

Chart 15: Volume of shilling and foreign currency loans

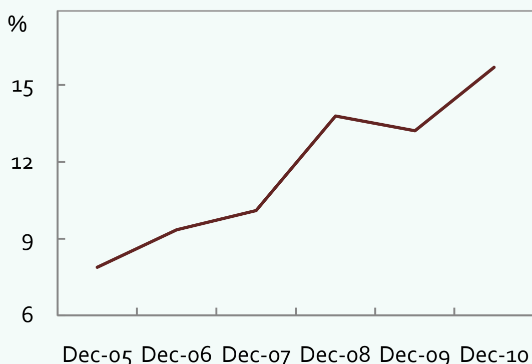


Source: Bank of Uganda

Was loan growth rapid during 2010?

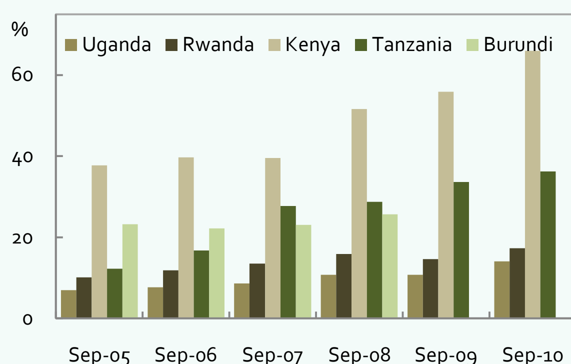
Commercial banks' total outstanding credit increased by 35.1

Chart 16: Lending to the private sector as a percentage of GDP



Source: Bank of Uganda

Chart 17: Ratio of private sector credit to GDP for EAC countries



Source: EAC Central Banks

Chart 18: Ratio of no- performing loans to total loans for East African countries

	Dec-09	Sep-10	Dec-10
Kenya	7.9	7.0	6.2
Rwanda	-	12.4	11.3
Tanzania	6.6	7.0	6.7
Uganda	4.2	2.8	2.1

Source: EAC Central Banks

percent during the year to December 2010, about double the growth to December 2009. Lending by banks especially picked up in the second half of 2010. This growth was mainly on account of foreign currency denominated loans which increased by 60.6 percent. As a result, the ratio of foreign currency loans to total loans has increased from 21.1 percent to 27.1 percent in the year to December 2010, while that of shilling loans reduced from 78.9 percent to 72.9 percent during the same period.

The recent growth in credit partly signals a recovery to the growth rates observed before the financial crisis and should be assessed with this in mind. For example, while total lending by banks had grown by 60.6 percent in the year to December 2008, it slowed down to 18.8 percent in the year to December 2009, while foreign currency lending slowed down from 34.4 percent to -2.6 percent over the same period as most banks tightened lending standards. Both indicators recovered during 2010, as economic performance improved following the measures taken to stimulate aggregate demand in the economy. Nevertheless, it would be prudent to conclude from the evidence, that overall loan growth since May 2010, especially foreign currency lending, has been relatively rapid.

Comparison of credit growth in the EAC Region

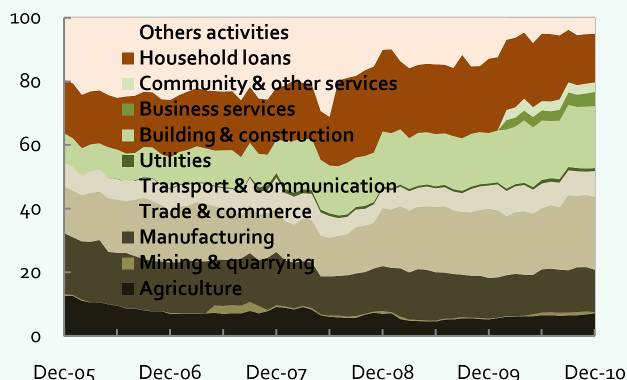
One indicator of rapid credit growth recommended by the BCBS is the ratio of private sector credit to Gross Domestic Product (GDP. For Uganda, this ratio was 15.7 percent as at end December 2010, up from 7.9 percent in December 2005. Within the East African region, the ratio of private sector credit to GDP for Kenya as at end September 2010 was 66 percent, Rwanda at 17.3 percent, while Tanzania was at 36.2 percent. From the above perspective, the recent growth in credit, although fairly rapid, may reflect convergence with the levels of the other EAC states.

Non-performing loans in the EAC Region

Banks' asset quality is a key indicator of the quality of banks' credit and overall risk of default (credit risk). Overall, bank asset quality in Uganda has improved in the period after the global crisis and continues to be good. The level of banks' NPLs has since declined to 2.1 percent as at December 2010[5]. Compared with other countries within the East African

[5] However, it is widely acknowledged that NPLs on average lag credit extension by six months to one year.

Chart 19: Sectoral distribution of loans (percentage share)



Source: Bank of Uganda

Table 9: Volumes of loans to the building and construction sector during 2010 (Ushs. billion)

	Mar-10	Dec-10
Residential mortgages	313.7	435.1
Commercial mortgages	174.2	165.0
Land purchase	27.5	32.6
Property developers	141.3	271.9
Others	114.3	160.4
Total	**771.0**	**1,065.0**

Source: Bank of Uganda

Table 10: Foreign currency loans to total loans by sector (percentage share)

	Dec-08	Dec-09	Dec-10
Agriculture	12.0	9.5	12.3
Mining & Quarrying	2.3	0.2	0.5
Manufacturing	26.9	16.5	20.8
Trade	14.0	24.5	26.5
Trans. & Comms	5.3	7.1	10.3
Construction	14.3	15.2	16.6
Personal loans	16.2	14.2	1.5

Source: Bank of Uganda

region, asset quality for Ugandan banks remains strong. Rwanda registered the highest ratio at 11.3 percent for end December 2010, while Kenya's ratio was 6.2 percent and Tanzania, 6.7 percent.

Changes in sectoral bank lending

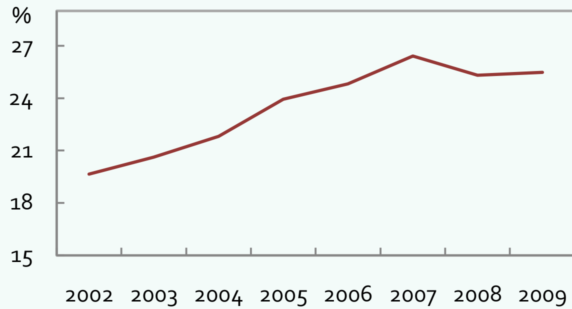
The structure of banks' lending portfolio by sector changed over the year to 2010. While personal and household loans used to constitute the largest share up to 2009 by end December 2010, the sector with the largest share of bank lending was trade and commerce with 22.8 percent, followed by the building and construction sector with 19.5 percent. Notably, banks' lending to the building and construction sector picked up strongly during 2010, driven by mortgage lending and loans to property developers as shown in Table 9. During the year, mortgage lending rose by 23 percent to Ushs.600.1 billion, suggesting banks' increased exposure to the sector, of which the largest share was to residential mortgages. The largest increase in loans to the Building and Construction sector was to property developers at Ushs.133.1 billion. At the moment, it is not clear whether the property values underlying these loans are stable due to the lack of reliable data. Cognisant of the systemic risks linked to property booms and to address this, Bank of Uganda is working with the Uganda Bureau of Statistics to set up a real estate price index to monitor real estate prices.

Foreign currency lending

The rise in foreign currency credit was largely due to three factors. First, there was very strong demand for these loans from the corporate sector. There was also strong demand among other firms mainly dealing with tradable goods as these companies positioned themselves to take advantage of deepening regional trade as well as the formation of the EAC common market. The drive to improve productivity and competitiveness domestically has been noticeable in the telecommunications and manufacturing sectors. Investment as a percentage of GDP has gradually increased from 19.6 percent in 2002 to 25.5 percent in 2009.

Secondly, overall, foreign currency credit had contracted by 2.6 percent in the year to December 2009 as banks exercised caution due to the uncertain liquidity conditions during the financial crisis. The trend reversed in 2010. Thirdly, the year to December 2010 also witnessed a strong increase in foreign currency deposits of 69.5 percent, which provided banks with

Chart 20: Ratio of investment to GDP



Source: Bank of Uganda

Table 11: Banks' funding of assets and liabilities

	Dec-09	Dec-10	Annual changes
Key sources of funding (Ushs. billion)	**6,512.6**	**8,510.6**	**1,998.0**
Deposits	5,630.5	8,023.5	2,393.0
o/w Foreign currency deposits	*1,471.1*	*2,262.9*	*791.8*
o/w Shilling deposits	*4,159.4*	*5,760.5*	*1,601.1*
Amounts due to resident institutions	370.0	167.5	-202.5
Amounts due to non-resident institutions	512.1	319.6	-192.5
Key assets (Ushs. billion)	**7,305.4**	**9,778.4**	**2,473.0**
Loans and advances	4,038.9	5,456.7	1,417.8
o/w Foreign currency loans	*851.1*	*1,476.5*	*625.4*
o/w Shilling loans	*3,074.1*	*3,980.2*	*906.1*
Government securities	1,832.3	2,526.5	694.2
Amounts due from non-resident institutions	807.4	1,042.0	234.6
Amounts due from resident institutions	225.5	273.2	47.7
Cash assets	401.4	480.0	78.6
Funding deficit (Ushs. billion)			**-475.1**

Source: Bank of Uganda

more funds to support the rising demand for foreign currency loans.

Risks associated with foreign currency lending

Where there is significant foreign currency lending, banks may be exposed to the *foreign exchange risk* arising from a sudden shift in the foreign exchange rate. This could affect the value of outstanding loans if there was a sudden depreciation in the exchange rate which would increase the value of loans and hamper the recovery of future debt payments. Foreign exchange risk could be amplified if there is a *mismatch* between foreign currency assets and liabilities. During the period under review, banks met the foreign currency exposure limits set by Bank of Uganda. Nevertheless, this in itself may not be sufficient to address foreign exchange risk, since the loan-to-income ratio can change if there is an exchange rate shock, affecting borrower's ability to make loan repayments.

In addition, risks are likely to arise depending on the *type of loans*, especially if lending is to non-tradable sectors. The share of foreign currency loans to the manufacturing sector at end December 2010 was 13.4 percent, although the sector with the largest share of foreign currency loans was trade and commerce (26.5 percent). Because most loans to the trade and commerce sector fund imports, risks arising from unhedged exchange rate movements are high. For example, during a sharp depreciation, importers are likely to suffer either lower profit margins or reduced demand for goods if they raise prices, thereby affecting their ability to service bank loans.

The share of foreign currency loans to the building and construction sector rose to 16.6 percent in the year to December 2010, signalling banks' rising exposure to this sector.

10.3. Commercial Banks' Funding

Risks from rapid credit growth could arise from the way lending is *funded*. For example, the effects of the recent financial crisis in many countries in Eastern Europe were amplified because a large percentage of bank asset growth, particularly mortgage lending was funded by short-term capital flows.

Banks in Uganda traditionally fund their growth through deposit mobilisation. The recent growth in credit has mainly been funded by deposit growth, which rose by 42.5 percent over the same period. Overall however, the data available indicates that on average, banks' assets are rising relatively faster than deposit growth. For instance, for the year to December 2010, changes in the major assets exceeded the change in deposits by over Ushs.475 billion. This funding gap between liabilities and assets is particularly pronounced for shilling as compared to foreign currency assets and liabilities.

Evidence indicates that commercial banks are funding this gap using balances that they hold with banking institutions abroad. Through the use of swaps with these institutions, banks have swapped dollars for shillings. For example, at end December 2010, banks owed Ushs.169.8 billion to foreign banks in swap transactions, for which they had provided US$75.6 million. This is analysed further in the next section of the report.

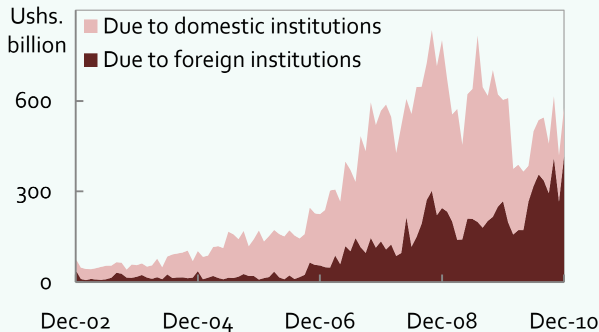
Conclusion

From the perspective of systemic stability, the risks from this growth are still quite moderate. The ratio of private sector credit to GDP for Uganda is only beginning to reach comparable levels to other counterparts in the region. In spite of the above, Bank of Uganda will continue to be vigilant to ensure that loan quality does not deteriorate. This is because of two particular areas of concern. The first relates to lending in foreign currency which continues to increase fairly rapidly. This may be putting pressure on the exchange rate. The second area of concern is the increased lending to the building and construction sector, which has potential to create a bubble if it is not properly monitored. In addition, the increased use of swaps for funding banks has the potential to create destabilising effects in the event of a reversal of the inflow of short-term deposits underlying these transactions.

11. Special Topics: Analysis of Banks' Liabilities Foreign Financial Institutions

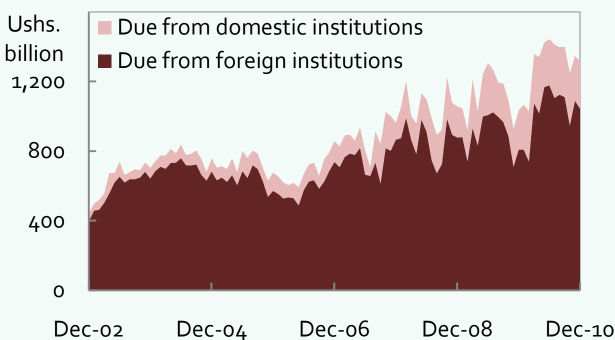
Banks in Uganda are primarily funded by customer deposits. Other major sources of funding are liabilities to resident financial institutions, and liabilities to non-resident financial institutions. Since 2006, banks have significantly increased their reliance on liabilities to non-resident financial institutions to fund their asset growth. This section provides an analysis of the trend of commercial banks' liabilities to non-resident financial institutions both on and off-balance sheet and, the potential risks to Uganda's financial system.

Chart 21: Liabilities to financial institutions



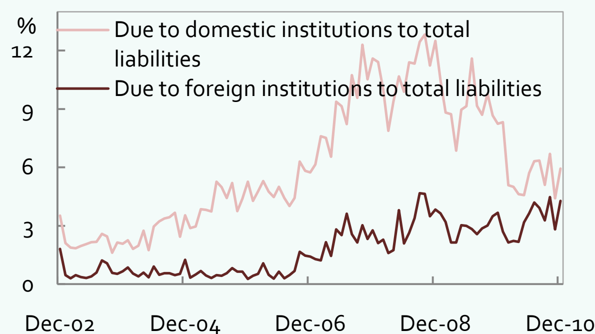
Source: Bank of Uganda

Chart 22: Claims on financial institutions



Source: Bank of Uganda

Chart 23: Ratio of liabilities due to financial institutions to total liabilities



Source: Bank of Uganda

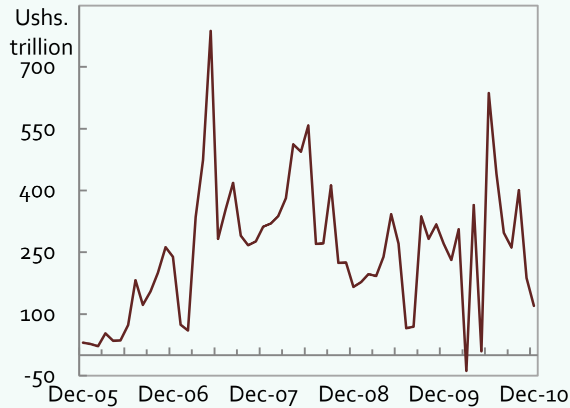
11.1. Evolution of Commercial Banks' Assets and Liabilities with Foreign Institutions

Conceptually, resident banks' balance sheet liabilities to non-resident financial institutions are composed of deposits and borrowings. At end December 2010, commercial banks' liabilities to non-resident financial institutions were Ushs.338.5 billion, an increase of Ushs.283.1 billion from December 2006 as shown in chart 21. The maturity structure of these liabilities is mainly short-term, that is, callable deposits. The liabilities to non-resident financial institutions were nearly double the liabilities due to resident banks which were only Ushs.119.5 billion as at the end of December 2010.

As a percentage of total liabilities, liabilities due to resident and non-resident financial institutions averaged 2.6 percent and 3.3 percent in the year to December 2010 respectively. This is compared to averages of 6.3 percent and 3 percent respectively during the previous year (see chart 23). This partly reflects that on average, there is a reduction in reliance on domestic financial institutions' funding compared to funding from non-resident financial institutions.

The liabilities of the banking system to foreign institutions have significantly risen starting from 2006 and through the financial crisis, partly reflecting a number of developments. First, as local interbank rates became attractive relative to returns in overseas markets, foreign institutions brought in more funds into the domestic financial system. Secondly, the rise in foreign liabilities has happened at a point of sustained high growth in private sector credit. As loans were growing more than deposits, local banks may have started looking at accessing foreign markets for funding and to unlock more liquidity.

Chart 24: Trend of total derivatives (including swaps and forwards) at commercial banks



Source: Bank of Uganda

Table 12: Maturity structure of outstanding swaps as at end of Friday 31/12/2010

	Daily Total Outstanding		
Total funds due to customers (in millions)	**UGX**	**KES**	**USD**
	169,793.3	**140.0**	**18.3**
1 day	3,999.5	-	6.7
2 days	35,502.9	-	-
3-7 days	31,963.5	140.0	10.6
8-14 days	22,310.0	-	1.0
15-30 days	16,967.4	-	-
31-60 days	59,050.0	-	-
61-90 days	-	-	-
>90 days	-	-	-
Total funds due from customers (in millions)	**UGX**	**KES**	**USD**
	45,050.0	**-**	**75.6**
1 day	17,230.0	-	1.7
2 days	-	-	15.5
3-7 days	25,510.0	-	15.6
8-14 days	2,310.0	-	9.7
15-30 days	-	-	7.4
31-60 days	-	-	25.6
61-90 days	-	-	-
>90 days	-	-	-

Source: Bank of Uganda

Commercial banks' exposure through off balance sheet liabilities (especially swaps)

Off-balance sheet exposure to non-resident financial institutions has increased since 2008 mainly through derivative activities. The outstanding derivatives were Ushs.236.9 billion at the end of December 2010. Of the outstanding derivatives at the end of December 2010, Ushs.194.6 billion were currency swaps. The counterparties to the currency swaps are mainly non-resident financial institutions.

Currency swaps are contracts involving the exchange of principal and interest payments in one currency for principal and interest payments in another currency. The currency swaps have mainly been used by banks as an alternative means of funding. However, in some cases, swaps are used by bank clients to hedge against foreign exchange risk. Currency swaps have mainly been used by commercial banks in Uganda to obtain shillings. Table 12 shows that of the Ushs.194.6 billion outstanding currency swaps at the end of December 2010, shillings obtained using swaps were Shs 169.8 billion (87 percent of funds due to customers arising from currency swaps).

Resident banks have increasingly used swaps to obtain shillings for three main reasons. Firstly, commercial banks use currency swaps as a source of shilling funding when the limits in the domestic unsecured interbank market have been exhausted. When short in Uganda shillings, resident banks can swap their foreign currency for shillings. Second, banks tend to use more currency swaps to obtain shillings when the cost of a using a currency swap is lower compared to borrowing shillings in the unsecured interbank market. Since borrowing using a currency swap involves another currency acting as collateral, it tends to be cheaper than unsecured borrowing. Thirdly, the callable deposits of the non-resident financial institutions are mainly in shillings. Through the use of swaps, banks are able to lock in callable non-resident deposits for longer periods of time by use of currency swaps. These callable non-resident deposits may otherwise be transferred to other domestic banks or out of the country thereby, increasing liquidity pressures on the paying bank.

11.2. Risks to the Financial System

Banks' funding from non-resident financial institutions exposes domestic banks mainly to liquidity and foreign exchange risk. To the broader economy, increased funding or inflows from abroad may result in appreciation of the domestic currency which fuels asset price bubbles and inflation, resulting in an increase in domestic interest rates which further encourages more inflows into the economy and further exacerbating the problem of capital inflows.

A "sudden stop" or reversal of these capital inflows may result in rapid depreciation of the domestic currency, and funding difficulty for the banks relying on foreign liabilities to fund their assets. Losses from depreciation of the domestic currency may result in solvency problems to banks with short foreign currency positions. Therefore, the proportion of foreign liabilities of banks serves as a useful indicator of the degree of vulnerability of the banking system to a downturn in case of reversal of capital flows.

At the current level, funding from non-resident financial institutions carries relatively moderate risk to the banking system. For the Ugandan market, it is feasible to suggest that there is liquidity risk and minimal market risk associated with funding from non-resident financial institutions.

Liquidity risk

The liabilities to non-resident financial institutions are mainly short-term (callable deposits). This implies they can be withdrawn any time from the banking system. Table 12 also shows that of the Ushs.194.2 billion outstanding swaps on 31 December 2010, Ushs.81.2 billion matures within 7 days time. There could be liquidity pressures in the event that banks are unable to rollover the maturing swap transactions, and do not hold sufficient funds to meet their obligations at the time of maturity of the swaps. In addition to the off-balance sheet exposure arising from swaps, banks have short-term balance sheet exposure to non-resident financial institutions. The balance sheet exposure to non-resident financial institutions at the end of December 2010 of Ushs.338.5 billion is 3.3 percent of total liabilities. Exposure to liquidity risk will increase if the proportion of these deposits to total liabilities increases.

Market risk

Banks may incur losses when they have short/long foreign currency positions and there is a depreciation/appreciation of the shilling. To reduce the risk arising from changes in foreign currency, Ugandan banks are expected to maintain a foreign currency exposure of less than +/-25 percent on a daily basis. This exposure includes both balance sheet and off-balance exposures. Off-balance sheet exposure includes currency swaps and foreign currency forward contracts. At the end of December 2010, banks had a foreign exchange exposure of only -0.2 percent.

Banks in Uganda mainly borrow shillings other than foreign currency using swaps further reducing potential foreign currency risk arising from paying maturing currency swaps. Table 12 shows that only Kshs.140.0 million (Ushs.4 billion) and US$18.3 million (Ushs 42.1 billion) as compared to Ushs.169.3 billion has been borrowed by use of swaps.

Conclusion

As of now, liabilities to non-resident financial institutions, although rising, are not significant relative total liabilities averaging 3.3 percent in the year to December 2010. Evidence shows that resident banks are increasingly using swaps for funding and to a less extent as an investment strategy in the foreign exchange market. Swaps with non-resident institutions provide an opportunity for banks to obtain more funding. The rising use of swaps adds to the existing funding sources including the unsecured interbank market and the horizontal and vertical REPO market. The liabilities (deposits) due to non-resident banks, is partly driving the increased use of SWAPs. This may indicate that Uganda is increasingly becoming a frontier market and investors are not only looking to place funds in Treasury securities but also in banks. This trend is likely to continue as long as the return is high. However this funding has potential systemic destabilising effects arising from liquidity risk i.e. sudden stop, and exchange rate risk. Bank of Uganda will continue to monitor the trend of these non-resident liabilities on a regular basis.

APPENDIX

Table A: Selected financial soundness indicators for Uganda's banking system (*percent*)

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Capital adequacy									
Regulatory capital to risk-weighted assets	20.74	22.04	21.13	21.82	20.95	22.68	21.67	21.22	20.16
Regulatory tier 1 capital to risk-weighted assets	18.73	20.18	19.29	19.38	18.67	19.87	19.25	18.81	17.53
Total capital to total assets	13.07	13.84	13.42	13.63	13.41	14.97	13.43	14.14	13.86
Asset quality									
NPLs to total gross loans	2.2	3.06	4.03	4.13	4.2	3.67	3.44	2.79	2.12
NPLs to total deposits	1.59	2.18	2.79	2.9	3.01	2.49	2.13	1.78	1.44
Sectoral distribution of loans									
Agriculture	6.93	5.38	4.5	5.49	5.17	6.06	6.45	6.73	7.07
Mining and quarrying	0.83	0.39	0.3	0.4	0.24	0.15	0.83	0.97	0.34
Manufacturing	14.2	15.07	15.17	13.33	12.81	13.26	13.63	13.90	13.36
Trade	18.2	19.88	20.62	19.76	21.66	19.37	19.17	22.73	22.81
Transport and communication	6.21	6.16	5.81	5.88	7.42	8.14	7.79	7.28	8.22
Utilities	0.74	0.68	0.63	0.76	0.65	0.68	1.16	0.95	0.91
Building and construction	10.94	10.81	11.45	10.13	9.91	18.1	18.62	19.48	19.52
Personal loans	25.73	21.26	21.93	26.22	23.41	21.9	21.19	15.55	15.26
Others	16.21	20.37	19.6	18.03	18.72	12.35	15.32	12.40	12.51
Large exposures to total capital	106.93	92.5	99.16	93.25	111.22	128.74	117.71	116.07	124.41
Earnings & profitability									
Return on assets	4.04	4.25	3.17	2.36	2.02	2.36	2.96	2.37	2.98
Return on equity	27.72	27.34	20.34	15.23	12.69	14.77	20.23	16.86	21.29
Net interest margin	11.31	11.27	10.67	10.09	10.17	10.02	9.84	9.98	10.30
Cost of deposits	2.49	3.28	3.32	4.02	3.87	3.46	3.08	2.60	2.39
Cost to income	65.79	64.68	74.34	79.76	82.23	78.98	76.16	77.68	70.72
Overhead to income	49.5	47.25	51.93	53.16	56.51	50.59	54.57	54.62	52.62
Liquidity									
Liquid assets to total deposits	48.09	42.27	42.17	43.63	44.67	45.47	41.55	40.54	39.78
Total loans to total deposits	72.51	71.32	69.14	70.39	71.73	67.76	61.8	63.79	68.01
Market Sensitivity									
Foreign currency exposure to regulatory tier 1 capital	-1.42	-1.49	-2.93	-0.93	-0.7	-2.95	-3.48	-11.82	-1.56
Foreign currency loans to foreign currency deposits	65.51	57.53	57.29	53.26	57.85	59.24	52.11	54.40	65.25
Foreign currency assets to foreign currency liabilities	102.72	98.41	109.77	108.72	106.96	101.12	98.42	96.26	97.95

Source: Bank of Uganda

Table B: Commercial banks' aggregated balance sheet

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
ASSETS (Ushs. Billion)									
Cash & cash assets	337.38	323.77	356.88	330.38	401.5	395.1	453.32	439.55	479.99
Balances with BOU	462.67	604.22	487.91	533.98	623.56	587.64	917.14	747.70	793.12
Due from financial institutions	1,026.82	1,165.91	1,280.61	1,170.74	1,016.60	1,336.34	1,414.37	1,373.23	1,289.02
Government securities	1,532.44	1,457.98	1,704.50	1,816.90	1,832.27	2,031.85	2,196.24	2,422.02	2,526.46
Total gross loans & advances	3,404.78	3,593.35	3,624.63	3,741.70	4,038.87	4,260.87	4,538.97	4,824.95	5,456.73
LESS: Provisions	-90	-82.86	-105.09	-121.7	-135.24	-117.31	-102.47	-109.24	-87.97
Net loans & advances	3,314.78	3,510.49	3,519.55	3,620.00	3,903.63	4,143.56	4,436.50	4,715.72	5,368.76
Net fixed assets	376.06	401	446.67	448.14	472.92	334.68	342.80	375.90	401.67
Other assets	414.62	377.66	372.03	400.15	344.22	313.49	394.75	376.40	437.34
TOTAL ASSETS	**7,464.77**	**7,841.04**	**8,168.15**	**8,320.29**	**8,594.70**	**9,170.59**	**10,155.12**	**10,450.50**	**11,296.37**
LIABILITIES (Ushs. Billion)									
Deposits	4,695.57	5,038.65	5,242.46	5,315.94	5,630.54	6,287.95	7,344.75	7,563.26	8,023.50
Due to financial institutions	680.8	576.39	639.3	616.5	602.86	388.42	381.73	142.89	136.63
Administered funds	323.71	306.37	321.93	297.1	279.23	475.29	230.6	292.99	310.61
Other liabilities	618.26	657.24	722.33	765.89	701.06	609.96	775.18	973.71	1,259.88
TOTAL LIABILITIES	**6,318.34**	**6,578.65**	**6,926.03**	**6,995.43**	**7,213.70**	**7,761.62**	**8,732.25**	**8,972.84**	**9,730.63**
CAPITAL (Ushs. Billion)									
Paid-up capital	426.53	446.65	452.34	475.46	485.77	508	523.77	578.17	591.91
Share premium	53.6	52.31	52.57	55.11	55.11	55.11	78.93	80.34	80.34
Retained reserves	352.52	584.04	488.45	457.99	456.67	689.44	596.54	535.37	534.06
Other reserves/subordinated debt	83.38	97.11	103.45	140.37	147.34	104.94	102.12	96.77	89.66
Profit – Loss (current year)	230.39	82.27	145.3	195.93	236.11	51.48	121.51	187.02	269.78
TOTAL SHAREHOLDERS' FUNDS	**1,146.43**	**1,262.38**	**1,242.12**	**1,324.86**	**1,381.00**	**1,408.97**	**1,422.87**	**1,477.66**	**1,565.74**
OFF BALANCE SHEET ITEMS (Ushs. Billion)									
Letters of Credit	212.82	241.83	241.04	196.38	201.92	230.97	293.26	299.74	335.76
Guarantees & performance bonds	380.45	377.48	412.38	457.75	520.55	519.36	678.76	668.32	606.57
Unused loans/overdrafts commitment	234.65	207.34	260.92	271.03	318.14	480.71	519.76	499.46	676.71
Other off balance sheet items	79.37	86.72	149.82	172.16	147.2	-30.71	636.67	261.30	120.31
TOTAL OFF BALANCE SHEET ITEMS	**907.28**	**913.36**	**1,064.16**	**1,097.31**	**1,187.81**	**1,200.33**	**2,128.45**	**1,728.82**	**1,739.35**

Source: Bank of Uganda

Table C: Commercial banks' aggregated income statement (*quarter by quarter*)

	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
INCOME (Ushs. Billion)									
Interest income									
Advances	146.07	162.62	168.15	176.98	182.65	186.38	193.56	199.08	215.15
Government securities	37.03	39.31	38.31	40.82	47.95	47.02	43.62	44.45	48.60
Deposits abroad	5.36	3.92	2.22	3.65	2.56	2.41	2.72	2.99	2.67
Other	17.13	15.68	17.26	18.35	6.79	9.18	11.86	10.90	12.27
Charges, fees & commissions	46.54	50.85	50.95	57.17	59.04	57.61	47.03	51.19	59.69
Foreign exchange income	52.47	33.55	37.94	32.01	26.78	30.33	37.87	38.67	26.85
Other income	70.44	75.22	72.97	73.8	70.59	72.7	84.53	82.89	94.39
TOTAL INCOME	**315.52**	**322.24**	**330.01**	**339.96**	**339.06**	**347.02**	**362.99**	**371.83**	**396.09**
EXPENSES (Ushs. Billion)									
Interest expense on deposits	-27.22	-39.86	-42.61	-53.08	-52.97	-51.51	-52.47	-48.51	-46.54
Other interest expenses	-24.52	-13.46	-13.1	-20.4	-15.9	-13.45	-12.96	-14.05	-16.87
Provisions for bad debts	0.32	-2.86	-18.21	-16.93	-18.33	-33.56	-12.88	-23.19	-8.25
Salaries, wages, staff costs	-62.87	-64.14	-70.17	-72.51	-78.03	-75.13	-81.47	-82.80	-92.75
Premises, depreciation, transport	-31.89	-33.93	-36.68	-39.23	-34.43	-38.73	-41.79	-45.17	-28.58
Other expenses	-61.41	-54.19	-64.54	-69	-79.15	-61.57	-74.37	-51.94	-78.86
TOTAL EXPENSES	**-207.59**	**-208.44**	**-245.31**	**-271.14**	**-278.81**	**-273.95**	**-275.93**	**-265.67**	**-271.84**
ADD: Extraordinary credits/charges	-	-	-	-	-	-0.13	-0.26	0.02	0.00
Net profit before tax	107.94	113.8	84.7	68.82	60.25	72.94	86.8	83.00	115.99
ADD: Corporation tax	-35.57	-31.49	-21.03	-19.94	-17.33	-21.43	-15.21	-21.85	-35.01
NET PROFIT AFTER TAX	**72.36**	**82.31**	**63.67**	**48.88**	**42.92**	**51.51**	**71.59**	**61.15**	**80.98**

Source: Bank of Uganda

Table D: Selected financial indicators for credit institutions

	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Capital Adequacy					
Core capital (Ushs. billion)	27.5	22.0	21.8	22.7	26.2
Total capital (Ushs. billion)	28.3	22.7	22.4	23.3	31.6
Risk-weighted assets (Ushs. billion)	87.1	91.3	95.0	101.2	114.6
Core capital to risk-weighted assets (% ratio)	31.6	24.1	22.9	22.4	22.9
Total capital to risk-weighted assets (% ratio)	32.5	24.8	23.5	23.0	27.5
Non-performing loans' provisions to core capital (% ratio)	4.8	6.6	7.5	6.6	4.8
Asset Quality					
Total loans (Ushs. billion)	63.5	63.5	65.9	71.7	79.7
Loan loss provisions (Ushs. billion)	1.3	1.5	1.6	1.5	1.3
Non-performing loans (Ushs. billion)	2.1	2.0	2.9	3.4	3.3
Non-performing loans to total loans (% ratio)	3.3	3.1	4.4	4.7	4.1
Profitability					
Year-to-date profit/loss (Ushs. million)	977.3	73.0	157.6	-159.3	273.3
Quarterly net profits (Ushs. million)	545.9	73.0	84.5	-316.9	432.6
Quarterly return on assets (% ratio)	0.4	0.1	0.0	-0.2	0.2
Year-to-date return on assets (% ratio)	0.8	0.1	0.1	-0.1	0.1
Liquidity					
Total public deposits (Ushs. billion)	74.4	80.0	88.0	90.0	107.7
Liquid assets (Ushs. billion)	38.9	37.6	44.5	39.2	54.3
Liquid assets to deposits (% ratio)	52.3	46.9	50.5	43.5	50.4
Loans to deposits* (% ratio)	65.9	62.5	59.2	63.3	56.1

*Calculation of the lending ratio excludes Opportunity Uganda Ltd where loans amounting to Shs.20.9 billion are funded from equity and borrowed funds.

Source: Bank of Uganda

Table E: Selected financial indicators for microfinance deposit-taking institutions

	Dec-09	Mar-10	Jun-10	Dec-10
Capital Adequacy				
Core capital (Ushs. billion)	26.1	29.2	29.1	29.8
Total capital (Ushs. billion)	35.3	44.7	44.6	45.9
Risk-weighted assets (Ushs. billion)	118.6	116.6	120.6	143.6
Core capital to risk-weighted assets (% ratio)	22.0	25.0	24.1	20.8
Total capital to risk-weighted assets (% ratio)	29.8	38.3	37.0	32.0
Asset Quality				
Total loans (Ushs. billion)	97.3	92.9	99.3	120.3
Non-performing loans (Ushs. billion)	2.3	2.7	2.8	2.4
Total provisions (Ushs. billion)	2.5	2.7	3.0	2.8
Portfolio at risk (% ratio)	2.4	3.0	2.8	2.0
Profitability				
Year-to-date profit/loss (Ushs. billion)	4.6	1.7	2.9	4.3
Year-to-date return on assets (% ratio)	3.4	4.9	4.0	2.6
Year-to-date return on equity (% ratio)	10.2	14.5	12.1	8.6
Liquidity				
Total deposits (Ushs. billion)	36.6	36.8	45.9	62.9
Liquid assets (Ushs. billion)	22.8	28.9	23.3	31.0
Liquid assets to deposits (% ratio)	62.4	78.4	50.9	49.3
Loans to deposits (% ratio)	77.4	74.2	78.7	75.1

Source: Bank of Uganda

ABBREVIATIONS

BCBS	Basel Committee on Banking Supervision
BOU	Bank of Uganda
EAC	East African Community
EEM	Emerging markets
EU	European Union
EUR	The Euro currency
FIA	Financial Institutions Act
FSR	Financial Stability Report
GBP	Great Britain Pound
IMF	International Monetary Fund
LCR	Liquidity Coverage Ratio
LIBOR	London Interbank offered rate
NPLs	Non-performing loans
NSSF	National Social Security Fund
ROA	Return on average assets
ROE	Return on average equity
SFI	Supervised Financial Institution
USD	United States Dollar
Ushs	Uganda Shilling