# Bank of Uganda

# FINANCIAL STABILITY REPORT

June 2016 | Issue No. 8

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## GLOSSARY

| | |
|---|---|
| ALSI | All Shares Index |
| BCBS | Basel Committee on Banking Supervision |
| DIR | Debt service-to-income ratio |
| EAC | East African Community |
| EMEs | Emerging market economies |
| FSI | Financial Services Index |
| FSR | Financial Stability Report |
| GDP | Gross domestic product |
| IMF | International Monetary Fund |
| LCR | Liquidity coverage ratio |
| NPLs | Non-performing loans |
| NSE | Nairobi Stock Exchange |
| NSFR | Net Stable Funding Ratio |
| RHS | Right hand side |
| ROA | Return on assets |
| ROE | Return on equity |
| UBOS | Uganda Bureau of Statistics |
| USh. | Uganda shilling |
| USE | Uganda Securities Exchange |
| USD | US dollar |

## A Note on Financial Stability

The Bank of Uganda has a mandate to foster macroeconomic and financial system stability. A stable financial system is one in which financial institutions carry out their normal function of intermediating funds between savers and investors, and facilitating payments. By extension, financial instability is a systemic disruption to the intermediation and payments processes, which has damaging consequences for the real economy.

Financial stability analysis involves a continuous assessment of potential risks to the financial system and the development of policies to mitigate these risks. The early detection of risks to the financial system is necessary to give policy makers sufficient lead-time to take pre-emptive action to avert a systemic crisis.

The Financial Stability Report (FSR) is intended to enhance the understanding of financial system vulnerabilities among policymakers, financial market participants and the general public. By making the FSR available to the public, the Bank aims to stimulate debate on policies necessary to manage and mitigate risks to the financial system. A better public awareness of financial system vulnerabilities may itself serve to encourage financial institutions to curb activities which might exacerbate systemic risks and will also help to promote policy reforms to strengthen the resilience of the financial sector.

## FOREWORD AND ASSESSMENT OF FINANCIAL STABILITY

The Bank of Uganda's *Financial Stability Report* analyses the performance and condition of the Ugandan financial system and assesses threats to systemic stability.

The Ugandan banking system faced a difficult year in 2015/16, mainly because of a rise in nonperforming loans (NPLs) from 4 percent of total loans in June 2015 to 8.3 percent in June 2016.Amongst the different sectors of the economy, the construction section sector was the largest single contributor to the rise in NPLs during 2015/16. The provisions necessitated by NPLs contributed to a decline in the banking systems' returns on assets and equity. There was also a sharp deceleration in asset growth of the banking system.

Nevertheless, the banking system remained strongly capitalized, with a core capital adequacy ratio of 19 percent as of June 2016, far higher than the statutory minimum of 8 percent, and this offers a high degree of resilience against systemic distress. The BOU's macro stress tests indicate that the banking system is able to withstand plausible shocks to credit quality because of the large capital buffers it holds.

This *Report* outlines the steps that the BOU is taking to enhance further the resilience of the financial system. From end December 2016, all commercial banks will be required to set aside a capital conservation buffer of 2.5 percent of risk weighted assets (RWA). In addition, domestic systemically important banks (DSIBs) will be required to hold a capital surcharge of 1-3.5 percent of RWA. To enhance the liquidity buffers of banks, the BOU will require all commercial banks to meet the Liquidity Coverage Ratio (LCR) in both foreign currency and local currency starting in January 2017. In May 2016, BOU instituted a limit of 70 percent on the Loan to Value (LTV) Ratio for foreign currency loans for land purchase.

Our overall assessment of financial stability is that, while risks increased in 2015/16 because of the worsening of credit quality, threats to systemic stability remain low because of the banking system's strong capital buffers.

Emmanuel Tumusiime-Mutebile

**GOVERNOR**

# 1. THE MACROECONOMIC ENVIRONMENT AND FINANCIAL DEVELOPMENTS

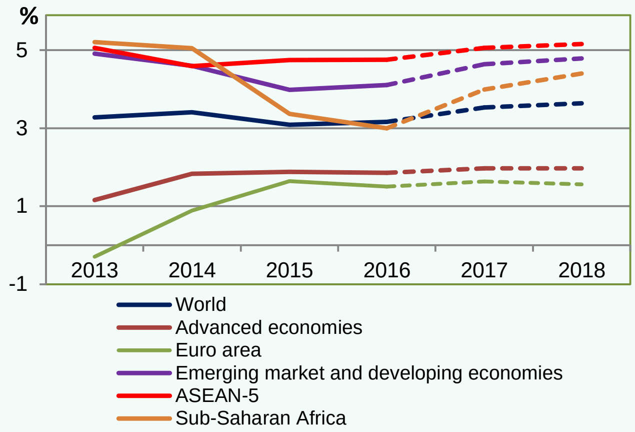
*Macro financial risks to global financial stability remain, driven by sluggish global growth, economic rebalancing in China and the unsettled political climate in many countries. At the regional and national level, risks to financial stability may arise from the slowdown in economic growth, slumping commodity prices and political instability in the neighbouring countries.*

## 1.1 Global economic conditions

The outlook for global financial stability remains uncertain. This reflects the weak growth in both advanced economies as well as a decline in commodity prices, weakness in external demand and geopolitical tensions which have affected growth in many emerging markets. According to the World Economic Outlook for October 2016, global growth is projected to to slow to 3.1 percent in 2016 before recovering to 3.4 percent in 2017 (IMF, WEO October 2016).

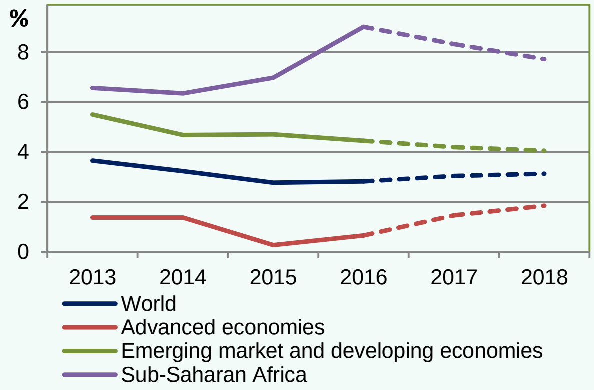
In advanced economies, recovery is expected to remain weak. There is a general picture of uncertainty regarding the direction of growth and policy. The political climate is unsettled in some countries, as a lack of income growth and a rise in inequality have opened the door for populist, inward-looking policies. In addition, the risks from Brexit—the June 2016 U.K. referendum result in favor of leaving the European Union, which initially roiled markets, are yet to fully emerge.

**Chart 1: Actual and Projected annual GDP growth (percent)**



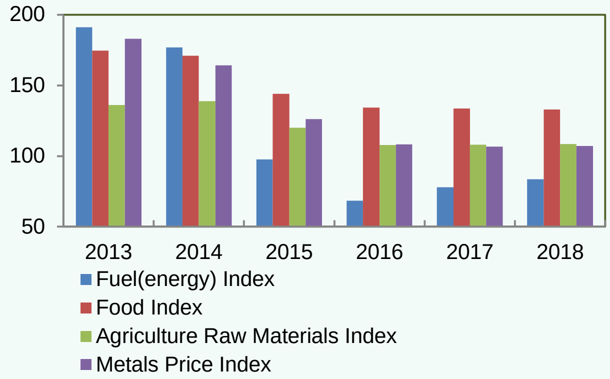

*Source: IMF World Economic Outlook, April 2016. Notes: 2017 and 2018 figures are forecasts.*

**Chart 2: Actual and Projected inflation rates (percent)**



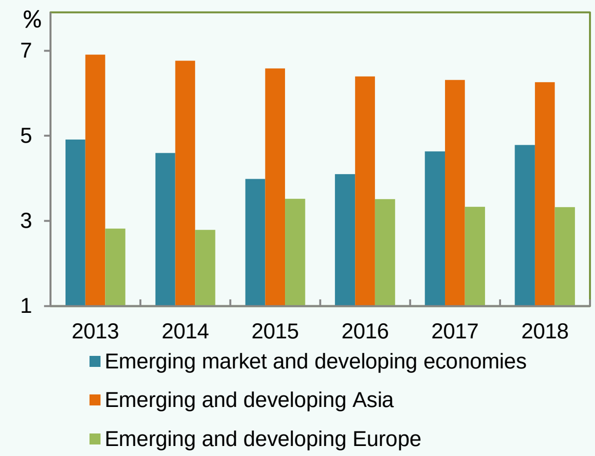

*Source: IMF World Economic Outlook, April 2016. Notes: 2017 and 2018 figures are forecasts.*

**Chart 3: Global commodity price indices, 2005=100**




*Source: IMF World Economic Outlook, April 2016. Notes:* ***2017 and 2018 figures are forecasts.***

**Chart 4: Projected annual GDP growth (percent) for Emerging and developing economies**




*Source: IMF World Economic Outlook, April 2016. Notes:* ***2017 and 2018 figures are forecasts.***

## 1.2 Emerging and developing countries

Growth in emerging market and developing economies (EMDEs) remained modest at 3.5 percent for 2016. While economies in Asia continued to register strong growth and the situation improved slightly for stressed economies such as Brazil and Russia, many economies in the Middle East and sub-Saharan Africa, continued to face challenging conditions.

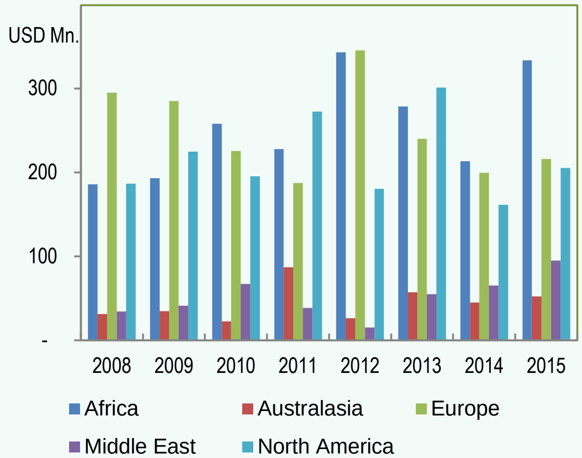
The macro risks in EMDEs include volatile commodity prices, slowdown in global trade, weak capital flows, persistent domestic difficulties and weak exports. In its June 2016 *Global Financial Stability Report* market update, the IMF further warned about the challenge for many emerging market economies in achieving a smooth deleveraging of weakened corporate balance sheets. In such a state, financial institutions are likely to struggle to sustain healthy balance sheets, which may weaken economic growth and financial stability.

The risks in developed and emerging economies are likely to affect Uganda in several ways. In particular, the weak demand for commodities is likely to reduce agricultural export revenues and affect the household and corporate exporters' balance sheets. The average price of coffee, Uganda's largest export earner, dropped from USD 4.4 per kilogram in June 2015 to USD 3.8 per kilogram in June 2016. As a result, the value of Uganda's coffee exports declined by 12 percent from USD 400.5 million in FY2014/2015 to USD 351.9 million in FY 2015/2016 (Statistics Department, Bank of Uganda).

In addition, volatility in global financial markets resulting from global political prospects may result in several shocks including capital outflows as investors dump riskier assets in EMDEs in favor of dollar assets, which are seen as a safe haven.

These developments have not yet affected remittances which are a substantial source of foreign exchange for Uganda. Remittances from abroad increased by 16 percent to USD 1.2 billion in 2015 with those from Europe at 24 percent of the total receipts.

**Chart 5: Remittances sent to Uganda Annually**




*Source: Bank of Uganda, Statistics Department*

### 1.3 Developments in the East Africa region

Growth in all the five economies in the East African Community (EAC) region was positive in 2016 as indicated in Table 1. Overall, this growth is attributed to large scale infrastructure investment, ongoing developments in the mineral and energy sector, and consumer spending.

**Table 1: East African countries' GDP growth rates (percent)**

| | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| Burundi | 4.5 | 4.7 | -4.1 | 3.4 |
| Kenya | 5.7 | 5.3 | 5.6 | 6.0 |
| Rwanda | 4.7 | 7.0 | 6.9 | 6.3 |
| Tanzania | 7.3 | 7.0 | 7.0 | 6.9 |
| Uganda | 4.0 | 4.9 | 5.0 | 5.5 |

*Source: IMF, WEO Database April 2016, Note that 2016 figures are IMF forecasts and Bank of Uganda*

The region's currencies experienced a gradual depreciation against the U.S. dollar, although they stabilized toward the end of the first quarter of 2016. The pass-through of nominal exchange rate depreciation contributed to a rise in inflation in a number of countries, and authorities responded by tightening monetary policy. Going forward, inflation is expected remain low and stable over the medium term.

**Table 2: Annual inflation for East African countries (percent)**

| | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| Burundi | 7.9 | 4.4 | 5.6 | 7.6 |
| Kenya | 5.7 | 6.9 | 6.6 | 6.3 |
| Rwanda | 4.2 | 1.8 | 2.5 | 4.8 |
| Tanzania | 7.9 | 6.1 | 5.6 | 6.1 |
| Uganda | 4.8 | 4.6 | 5.8 | 5.0 |

*Source: IMF, WEO Database October 2016, Note that 2016 figures are IMF forecasts and Bank of Uganda*

The current account balance is forecast to improve in 2016 for all the EAC countries with the exception of Rwanda and Kenya. Kenya has tapped the international bond market, which is more expensive than concessional loans and carries significant refinancing and exchange rate risks. In Burundi and Rwanda, reserve levels fell in defending fixed exchange rates or managed pegs (GEP, June 2016).

**Table 3: Current account balance for East African countries (percent of GDP)**

| | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|
| Burundi | -19.5 | -18.8 | -15.4 | -8.9 |
| Kenya | -8.9 | -10.4 | -8.2 | -8.3 |
| Rwanda | -7.4 | -11.5 | -13.8 | -14.2 |
| Tanzania | -10.6 | -9.5 | -8.7 | -7.7 |
| Uganda | -7.1 | -9.5 | -8.9 | -8.4 |

*Source: IMF, WEO Database April 2016, Note that 2016 figures are IMF forecasts*

However, regional political risks remain a concern for financial stability in the region. The militant insurgencies and terrorist attacks remain a concern in Kenya, with potential spill overs to neighbouring countries. The ongoing political conflict in Burundi and South Sudan[1] could further hurt growth in these countries, with implications for Uganda.

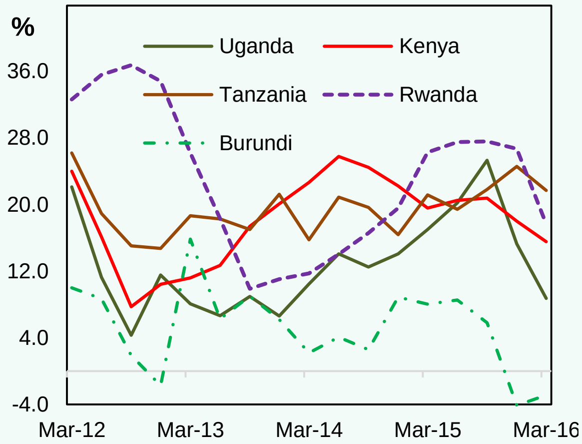
In recent years, South Sudan had become an important export destination for Uganda. At the end of financial year 2015/2016, Uganda's exports to South Sudan stood at USD 309.7 million or 25.1 percent of Uganda's exports to COMESA[2] and 13.5 percent of the total share of exports. Increased security concerns negatively affected the flow of Ugandan goods to the country. This could provide a further shock to Uganda's current account balance owing to a fall in export revenues and a drop in remittances due to reduced employment opportunities.

### *Financial performance of banks in the region*

**Credit growth in the region**

Bank lending in all the East African countries slowed down for the period 2015/2016 with Uganda witnessing the least annual growth rate in private sector credit of 7.6 percent for the period under review. The decline in credit growth partly reflects banks' aversion to risk amidst a decline in loan quality, and a switch to investing in government securities, which are perceived to be less risky.

**Chart 6: EAC annual growth of credit extended to the private sector by banks (percent)**




*Source: EAC Central Banks*

**Credit risk**

Credit risk, as measured by the ratio of non-performing loans to gross loans (NPL ratio), increased across the region. As at June 2016, Burundi had the highest NPL ratio of 18.5 percent followed by Kenya with 8.5 percent and Uganda with 8.3 percent.

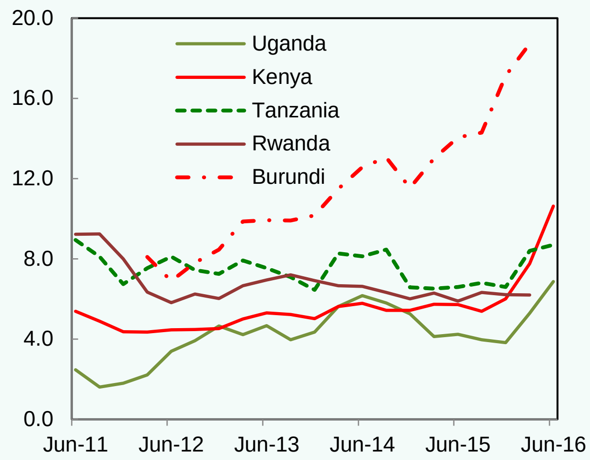
A regional risk assessment done by EAC technical working group on MAST[3] found that the increase in NPLs was also due to a slow-down in economic activity, geopolitical risks, and a rise in foreign currency loans following depreciation pressures.

[1] July 2016, rival factions in South Sudan renewed fighting leading loss of several lives. (http://www.aljazeera.com/news/2016/07/south-sudan-security-council-demands-ceasefire-)

[2] Statistics department, Bank of Uganda

[3] MAST stands for Macroprudential Analysis and Stress Testing

**Chart 7: Trends of NPLs to Total Loans in the EAC (%)**




*Source: EAC Partner States Central Banks*

**Table 4: Commercial bank Profitability ratios for East African countries (%)**

| | Return on Asset (%) | | | |
|---|---|---|---|---|
| | Dec 2012 | Dec 2013 | Dec 2014 | Dec 2015 |
| Kenya | 4.6 | 3.6 | 3.4 | 3.1 |
| Uganda | 3.9 | 2.5 | 2.6 | 2.6 |
| Tanzania | 2.7 | 2.6 | 3.0 | 2.9 |
| Rwanda | 3.3 | 2.6 | 2.8 | 2.8 |
| Burundi | 3.6 | 2.2 | 1.2 | 1.9 |
| | **Return on Equity (%)** | | | |
| | **Dec 2012** | **Dec 2013** | **Dec 2014** | **Dec 2015** |
| Kenya | 29.8 | 28.9 | 26.6 | 25.2 |
| Uganda | 24.2 | 25.2 | 16.1 | 16.0 |
| Tanzania | 22.0 | 20.8 | 22.8 | 22.4 |
| Rwanda | 14.4 | 11.3 | 15.4 | 15.7 |
| Burundi | 24.8 | 14.1 | 7.8 | 11.6 |

*Source: EAC Partner States Central Banks*

### Profitability

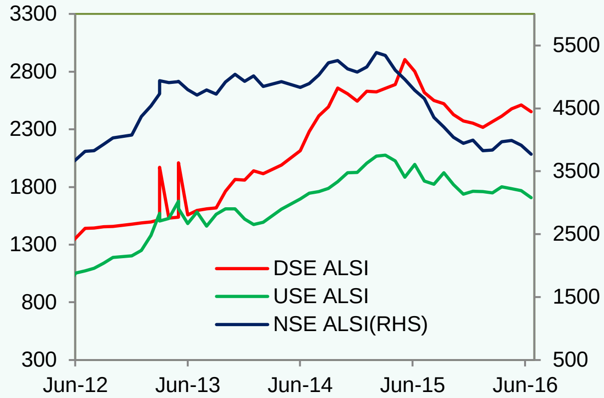
In 2016, the banking sector in the EAC remained profitable with declining trends in the region except for Burundi. Return on assets (ROA) and return on equity (ROE) were highest in Kenya at 3.1 percent and 25.2 percent followed by Tanzania with 2.9 percent and 22.4 percent. The level of profitability partly reflects several factors across the region including a rise in interest income from government securities in some EAC Partner states. Going forward, banks' profitability may decline if banks have to set aside higher provisions due to continued deterioration in loan quality.

### *Regional Equities Markets*

Stock market activity across the region reduced during 2015/16 as compared to 2014/2015. In Uganda, the Uganda Securities Exchange (USE) recorded a total turnover of USh.188.2 billion in 2015/2016 compared to a turnover of USh.310.2 billion in 2014/2015. In Kenya, turnover on the Nairobi Stock Exchange (NSE) declined from KSh. 212.9 billion in FY 2014/2015 to KSh. 181.3 billion in FY 2015/2016.

The drop in turnover was driven by rising interest rates that saw investors shift to the government bond market, and a weak shilling that possibly caused off-shore investors to scale down activity.

**Chart 8: East African stock market indices**

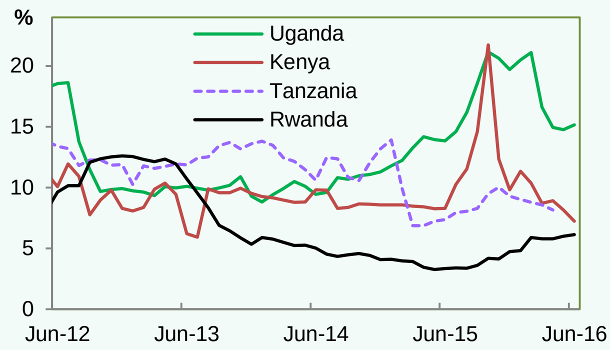



*Source: Nairobi Securities Exchange, Dar-es-Salaam Securities Exchange, Uganda Securities Exchange*

### *Regional Treasury securities markets*

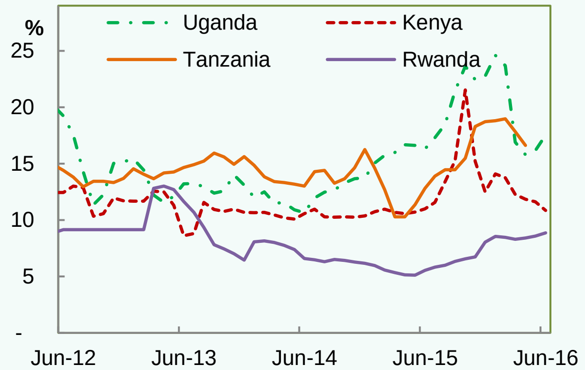
By end June 2016, Treasury bill yields for all East African countries were on average higher than June 2015 July 2015. Yields rose steadily during the year reaching the highest point in February 2016 before declining towards June 2016.. The 91-day and 364-days Treasury bill yield for Uganda increased from 13.9 and 16.3 percent in June 2015 to 15.7 percent and 17.4 percent in June 2016, respectively. In the same period, Rwanda continued to register the lowest Treasury bill rates for 91 day at 5.0 percent and 364 days at 6.6 percent. Foreign investor participation in Uganda rose following the high Treasury bill yields in the period under review.

**Chart 9: EAC yields for 91-day treasury bills (percent)**




*Source: EAC Partner States Central Banks*

**Chart 10: EAC yields for one-year treasury bills (percent)**

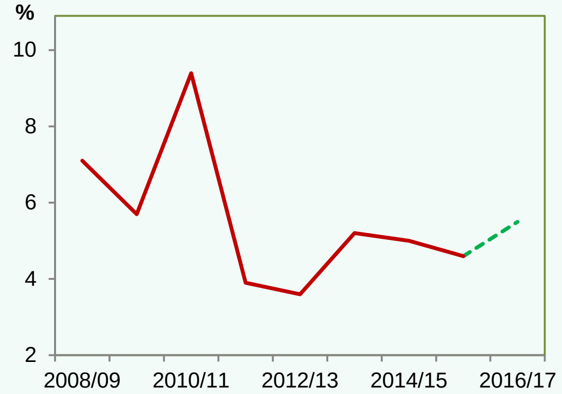



*Source: EAC Central Banks*

## 1.4 Uganda's macro financial environment

Real GDP growth slowed to 4.8 per cent during FY2015/16, compared to a growth rate of 5.1 per cent registered in FY 2014/15. The slowdown in growth was partly on account of the less favorable global economic environment, a decline in exports and speculation over the recently concluded general elections which affected investment decisions. However, real GDP is projected to pick up to 5.5 percent in 2016/17, supported by scaled-up public investment in sectors such as construction, and a recovery in private sector investment.

**Chart 11: Annual real GDP growth rates (percent)**

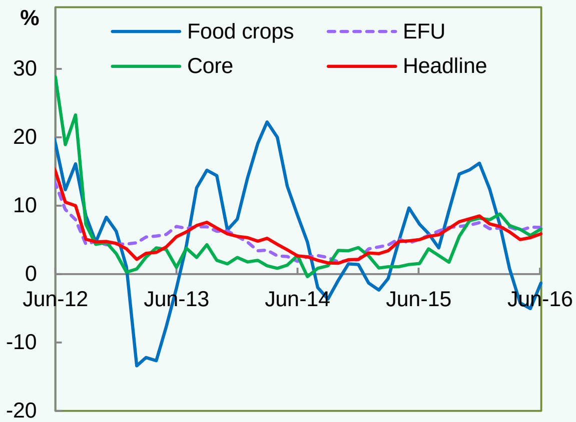



*Source: Uganda Bureau of Statistics*

### *Inflation and interest rates*

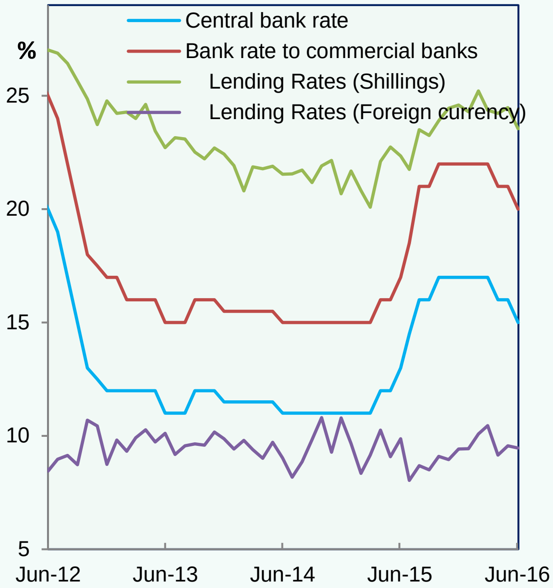
Annual headline inflation rose to 5.9 percent in June 2016 compared to 5.0 percent in June 2015. Inflationary pressures rose in 2015, peaking in December 2015 at 8.5 percent, prompting the Bank of Uganda to increase the policy rate from 13 per cent in June 2015 to 17 per cent by October 2015 which led to a rise in interest rates. By April 2016, the inflation outlook had improved.

**Chart 12: Domestic annual inflation (percent)**




*Source: Bank of Uganda*

**Chart 13: Monthly interest rates (percent)**

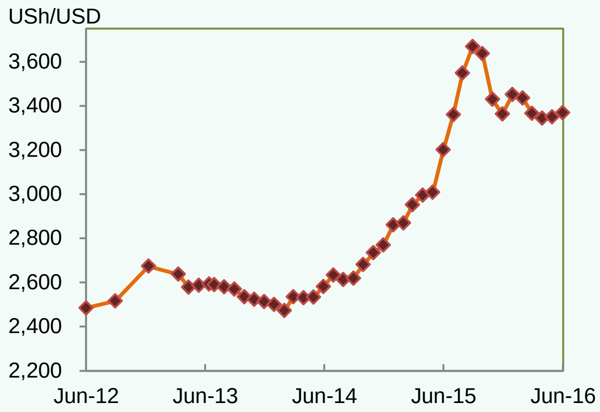



*Source: Bank of Uganda*

### *Foreign exchange market*

Deterioration in the balance of payments and the strengthening of the US dollar globally led to a depreciation of 5.3 percent in the Uganda shilling/US dollar exchange rate between June 2015 and June 2016. The average exchange rate was USh.3368.0 in June 2016 as compared to USh.3199.9 per USD in June 2015.The exchange rate depreciation increased inflationary pressures as traders passed through the prices of imported goods to consumers. In addition, for enterprises and households with bank debt denominated in foreign currency, the depreciation increased their loan repayment burden.

**Chart 14: Monthly average exchange rate for the Ugandan shilling against the US dollar**



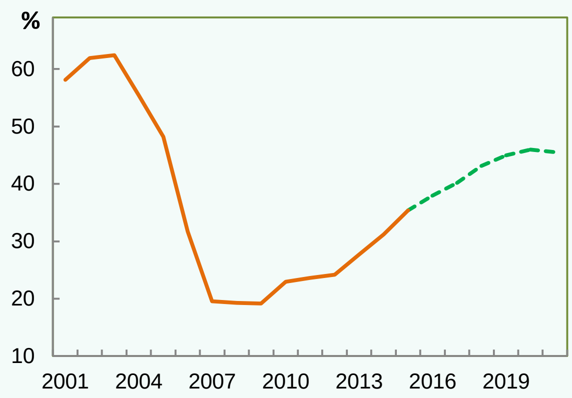

*Source: Bank of Uganda*

### *Government Debt*

Government debt as a percentage of GDP has continued to rise. The ratio of total debt to GDP rose from 27.8 per cent in FY 2013/14 to 32.7 per cent in FY 2014/15. This increase was partly due to the rise in domestic arrears and external borrowing for investment in infrastructure projects in the transport, energy and oil sectors. Projections by the Debt Sustainability Analysis (DSA) update prepared by the IMF and IDA[4] indicate that total public debt will peak in FY2020/21, at about 50 percent of GDP and decline thereafter, as the scaling up process is completed.

Government has built up a large position in arrears to domestic suppliers, which was estimated at USh.1.27 trillion in June 2016. Anecdotal evidence shows that this may have affected the ability of the suppliers to service their debt with the banking sector in 2015/2016. Going forward, government has set aside funds to clear a portion of these arrears and this could improve loan performance.

**Chart 15: Government debt as a percentage of GDP**




*Source: IMF World Economic Outlook, April 2016.*

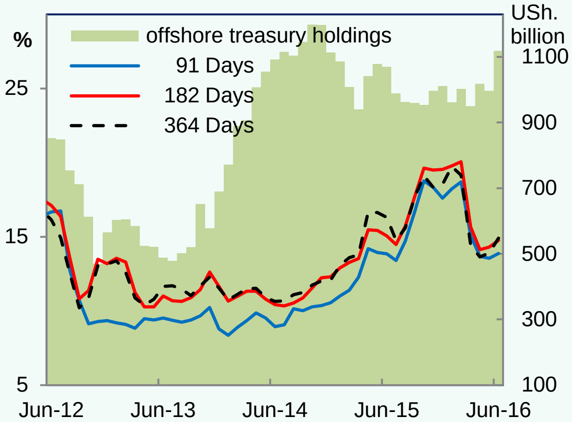
### *Holdings of Treasury securities by Offshore Investors*

The volume of Ugandan Treasury securities held by offshore investors picked up, from USh.1069.9 billion in June 2015 to reach USh.1118.8 billion in June 2016. Of the total exposure, only 59 percent is potentially maturing over the short term defined as 12 months.

Bank of Uganda has sufficient reserves to handle any risks from withdrawal of short term exposures.

[4] IDA- International Development Association

**Chart 16: Treasury bill yields and offshore holdings of treasury securities**




*Source: Bank of Uganda*

## 1.5 Conclusion

The external economic environment continues to be a key influence on the Uganda economy. Global growth remains weak, with substantial downside risks to growth. In Uganda, growth was affected by the weak external economic environment; soft commodity prices; and the slow execution of public investments. Going forward, growth could be affected by further decline in commodity prices and regional macro-politics including the political instability in South Sudan.

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## 2. KEY DEVELOPMENTS IN UGANDA'S BANKING SECTOR

*The banking system remains sound, with liquidity and capital buffers remaining well above the minimum requirement. However, macro financial challenges have led to a significant deterioration in bank loan quality and affected the performance of several systemically important banks.*

### 2.1 Growth of the banking sector

Uganda's banking sector comprised of 25 commercial banks at the end of June 2016. The total assets of commercial banks grew by 5.5 percent to USh.22.9 trillion in the year to June 2016. However, this was lower than the growth rate of 15.9 percent that was recorded in the year to June 2015. During the year to June 2016, banks increased their holdings of government securities by 15.9 percent up from 6.1 percent while lending grew by 3.7 percent compared to 19.7 percent, reflecting a shift from riskier assets to safer assets driven by the decline in asset quality.

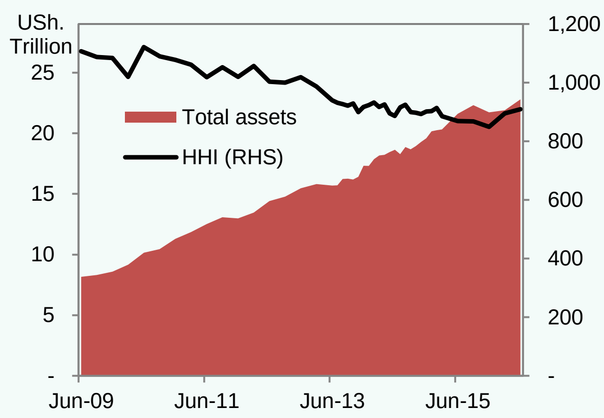
There was a slight increase in concentration in the banking sector, as measured by the Herfindahl-Hirschman Index (HHI)[5], particularly in the last two quarters to June 2016, to 909.3 in June 2016. The slight increase in HHI within Uganda's banking system shows that activities within the sector were concentrated in less banks in the year to June 2016 compared to the previous year to June 2015.

**Table 5: Changes in banks' assets**

| | June 2013 | June 2014 | June 2015 | June 2016 |
|---|---|---|---|---|
| **Assets** | | | | |
| Values (USh. Trillion) | 15.7 | 18.7 | 21.6 | 22.8 |
| Annual growth (%) | 8.9 | 18.8 | 15.9 | 5.5 |
| **Government securities** | | | | |
| Values (USh. Trillion) | 3.1 | 4.0 | 4.3 | 5.0 |
| Annual growth (%) | 20.8 | 29.6 | 6.1 | 15.9 |
| **Loans** | | | | |
| Values (USh. Trillion) | 7.7 | 8.8 | 10.5 | 10.9 |
| Annual growth (%) | 6.4 | 14.4 | 19.7 | 3.7 |

*Source: Bank of Uganda*

**Chart 17: Banks' assets and Herfindahl**




*Source: Bank of Uganda*

### 2.2 Capital Adequacy

Overall, the banking sector remained well capitalised as at the end of June 2016 and all commercial banks, except one bank, met all the

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[5] *Hirschman Herfindahl Index (HHI) is the sum of squares of the market shares of all firms in a sector. HHI below 100 indicates a highly competitive industry while HHI below 1500 indicates an industry that is not concentrated.*

regulatory minimum capital adequacy requirements. The industry's aggregate tier one capital adequacy ratio (tier one capital to risk weighted assets) and the total capital adequacy ratio (total regulatory capital to risk weighted assets) were 19 percent and 21.7 percent respectively at the end of June 2016, higher than 18.8 percent and 21.5 percent respectively, in the previous year.

Banks' total shareholders' capital increased in nominal terms from USh.3.3 trillion to USh.3.7 trillion between June 2015 and June 2016. This was aided by growth in retained earnings for the year by 19.9 percent or USh.295.1 billion.

**Table 6: Capital adequacy ratios**

| | June 2013 | June 2014 | June 2015 | June 2016 |
|---|---|---|---|---|
| **Total Capital adequacy ratio** | 24.3 | 22.8 | 21.5 | 21.7 |
| **Tier 1 Capital adequacy ratio** | 21.3 | 20.3 | 18.8 | 19.0 |
| **Leverage ratio** | 12.2 | 11.2 | 11.0 | 10.8 |

*Source: Bank of Uganda*

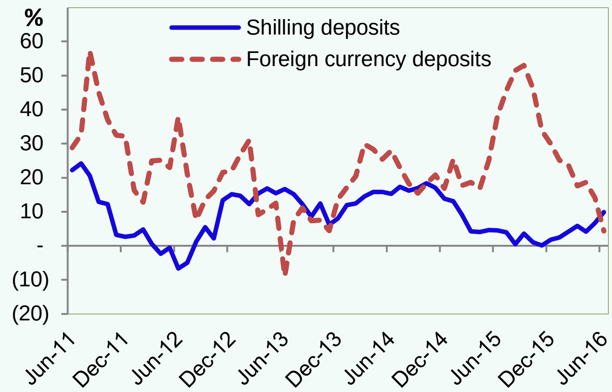
## 2.3 Bank Funding and Liquidity

### *Retail funding*

Customer deposits provided the largest share of banks' funding at 81.5 percent of total liabilities at the end of June 2016. However, deposit growth slowed to 7.5 percent in the year to June 2016, compared to 16.5 percent in the previous year. This was mainly attributed to sluggish growth in foreign currency denominated deposits of 4.3 percent, while shilling deposits grew by 9.9 percent in the year to June 2016 compared to 4.6 percent in June 2015.

The decline in deposit growth occurred amidst a rise in the cost of deposit funding, with the time deposit rate (7-12 months) picking up from 10.4 percent in June 2015 to 12.2 percent at the end of June 2016, while saving deposit rates increased from 3.3 percent to 3.7 percent over the same period.

**Chart 18: Annual growth rate in customer deposits**



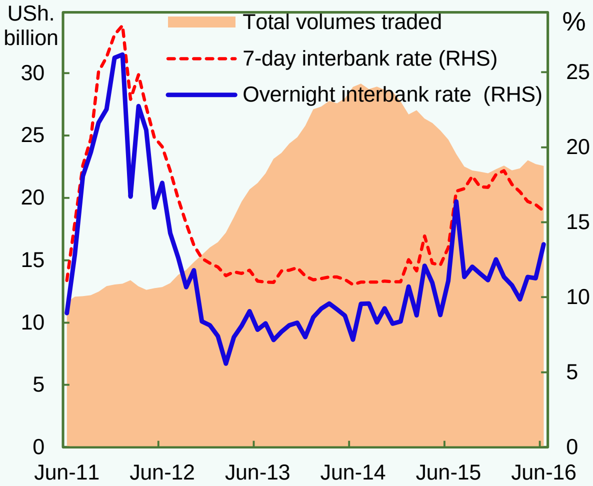

*Source: Bank of Uganda*

### *Wholesale funding*

In the year to June 2016, the interbank market and the swaps market remained the main sources of wholesale funds. Total interbank values traded during the year to June 2016 amounted to USh.22.6 trillion, dropping from USh.24.7 trillion in the previous year to June 2015.

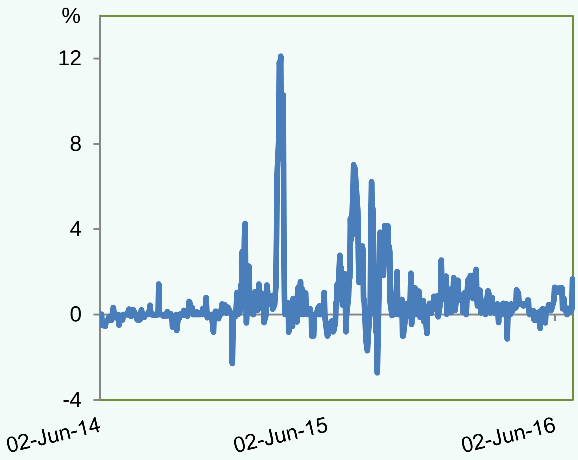
This was accompanied by a continued rise in the overnight and seven-day weighted average rates. Both rates increased by 2.4 percentage points, following the rise in the policy rate (CBR) from 13 percent to 15 percent between June 2015 and June 2016. Nevertheless, risks from wholesale funding remain minimal because it is a small percentage of total bank funding.

**Chart 19: Monthly interbank activity**




*Source: Bank of Uganda*

**Chart 20: Spread between CBR & 7-day interbank rate**




*Source: Bank of Uganda*

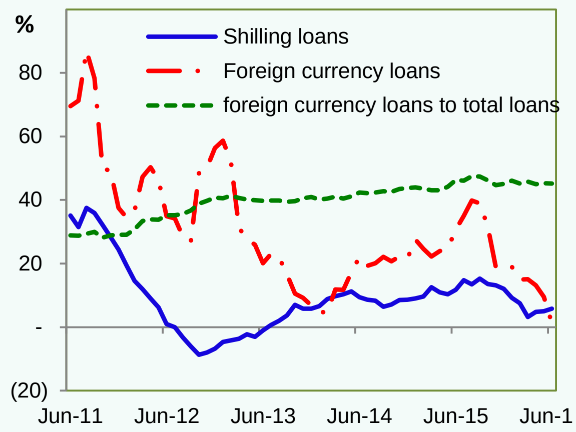
Banks continued to maintain liquidity buffers well above the regulatory minimum. The Liquid Assets-to-Deposits ratio rose to 43.4 percent in June 2016, which is well above the minimum requirement of 20 percent.

## 2.4 Banks' lending activity

Total bank credit grew by 3.7 percent in June 2016, lower than 19.7 percent in the previous year. The downshift in banks' lending was witnessed across all sectors of the economy, except for personal loans. This partly reflects the slowdown of economic activity coupled with banks reduction in lending in light of rising non-performing loans (NPLs).

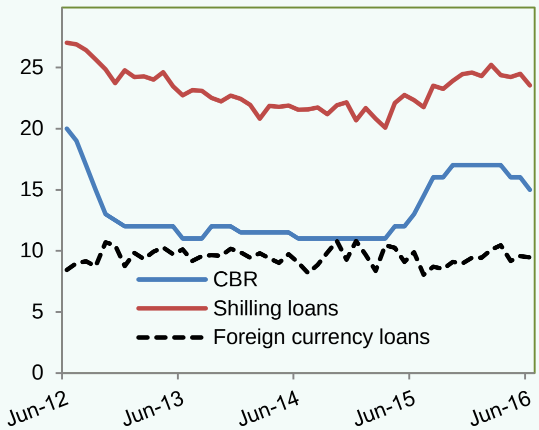
Shilling denominated loans grew by 5.8 percent at the end of June 2016, compared to the 11.7 percent in the previous year. Foreign currency denominated loans rose by 1.3 percent down from 7.7 percent over the same period.

**Chart 21: Annual growth rates of bank credit (percent)**




*Source: Bank of Uganda*

**Chart 22: Average lending rates for bank loans (percent)**




*Source: Bank of Uganda*

***Risks from sectoral lending***

Banks extended credit mostly to the building and construction sector, and trade and commerce, which account for the largest share of overall lending at 23.6 percent and 17.9 percent respectively.

In particular, lending in foreign currency to the building and construction sector has continued to rise. The concentration of foreign currency denominated loans in the building and construction sector is a point of concern. This is because it is termed as a non-tradeable sector and therefore does not have a direct source of foreign currency funds to meet its debt obligations in the same currency. The sector accounted for 27.7 percent of total foreign currency loans at the end of June 2016. As such, further depreciation of the local currency could increase the debt burden to the sector.

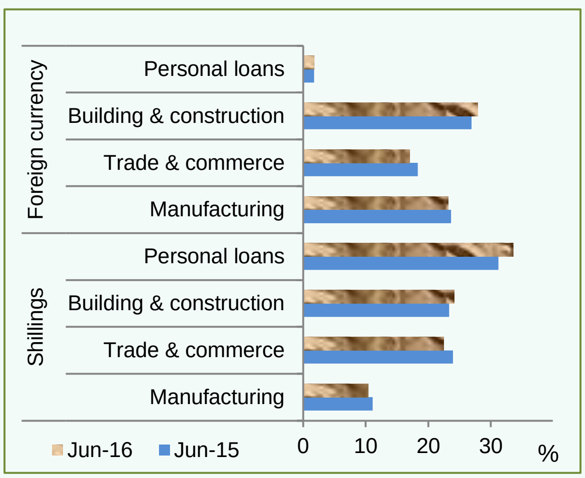
Shilling loans were mainly extended to the personal and households sector, accounting for 33.6 percent of the total shilling credit at the end of June 2016.

**Table 7: Analysis of sectoral bank lending (%)**

| | | June 2013 | June 2014 | June 2015 | June 2016 |
|---|---|---|---|---|---|
| **Manufacturing** | Share | 14.4 | 13.7 | 16.1 | 14.6 |
| | Growth rate | 10 | 8.9 | 40.6 | -5.5 |
| **Trade & commerce** | Share | 20.3 | 20.8 | 19.5 | 17.9 |
| | Growth rate | -0.5 | 16.9 | 12.8 | -4.9 |
| **Building & Construction** | Share | 23.3 | 23.3 | 23.2 | 23.6 |
| | Growth rate | 6.2 | 14.3 | 19.8 | 5.2 |
| **Personal & household loans** | Share | 13.8 | 17.4 | 15.2 | 15.9 |
| | Growth rate | -5.0 | 44.3 | 5.1 | 8.4 |

*Source: Bank of Uganda*

**Chart 23: Share of total loans to main sectors in different currencies**




*Source: Bank of Uganda*

## 2.5 Asset Quality

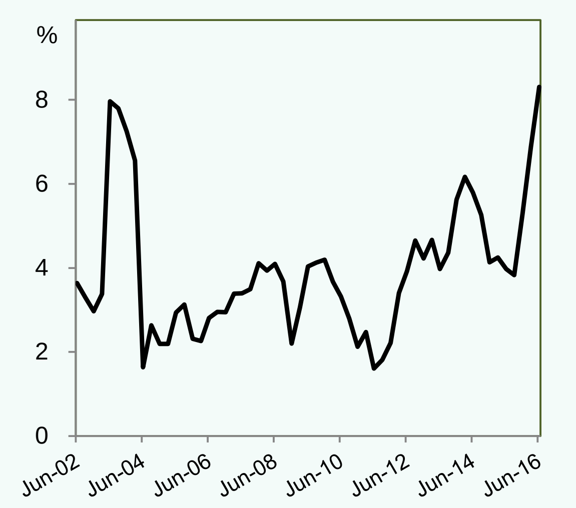
Over the year to June 2016, the banking sector's asset quality deteriorated, as measured by the increasing ratio of non-performing loans to total bank credit (NPL ratio). The aggregate industry NPL ratio increased to the highest recorded NPL ratio in over 15 years, from 4 percent in June

2015 to 8.3 percent in June 2016. Bad loans increased to USh.906.2 billion.

A survey by Bank of Uganda in March 2016 indicated that that the majority of bad loans were due to delayed government payments, insufficient cash flows and diversion of funds which accounted for 24 percent, 22.7 percent, and 14.9 percent respectively, of total non-performing loans.

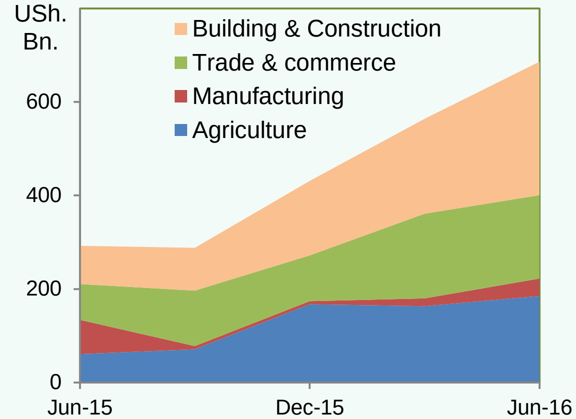
All sectors registered a rise in non-performing loans. However, the largest rise was recorded in the building and construction sector by USh. 203.7 billion, the agriculture sector by USh.124.3 billion and to the trade & commerce sector by USh.101.8 billion.

**Chart 24: Evolution of NPL Ratio**




*Source: Bank of Uganda*

**Chart 25: Break down of non-performing loans by sector**




*Source: Bank of Uganda*

### *Non-performing loans by currency*

Foreign currency denominated NPLs rose by 100 percent to reach USh.410.3 billion, while shilling denominated NPLs increased by 85 percent to USh.393.6 billion. Foreign currency bad loans increased specifically to the building & construction sector and agriculture sector by USh.95.5 billion & USh.87.1 billion respectively.

**Table 8: Sectoral NPL ratios by currency (%)**

| | | June 2015 | Dec 2015 | June 2016 |
|---|---|---|---|---|
| **Agriculture** | Sh. | 4.6 | 6.7 | 11.8 |
| | Fx. | 7.5 | 23.7 | 21.9 |
| **Manufacturing** | Sh. | 7.8 | 0.8 | 6.0 |
| | Fx. | 2.7 | 0.2 | 0.6 |
| **Trade & commerce** | Sh. | 2.6 | 7.1 | 10.8 |
| | Fx. | 5.2 | 1.4 | 7.0 |
| **Building & Construction** | Sh. | 2.6 | 6.7 | 11.6 |
| | Fx. | 4.0 | 5.6 | 10.7 |
| **Personal & household loans** | Sh. | 4.0 | 4.5 | 3.8 |
| | Fx. | 5.7 | 4.8 | 1.9 |
| **Industry ratio** | Sh. | **3.8** | **5.0** | **8.3** |
| | Fx. | **4.2** | **5.6** | **8.3** |

*Source: Bank of Uganda*

### 2.6 Earnings and profitability

The profitability of the banking sector reduced in the year to June 2016. Banks' aggregate net after tax earnings were USh.485.6 billion, down from USh.556.3 billion in the previous year to June 2015. The banking system's return on assets and return on equity dropped from 2.8 percent and 17.7 percent respectively in June 2015 to 2.2 percent and 13.8 percent respectively in the year to June 2016.

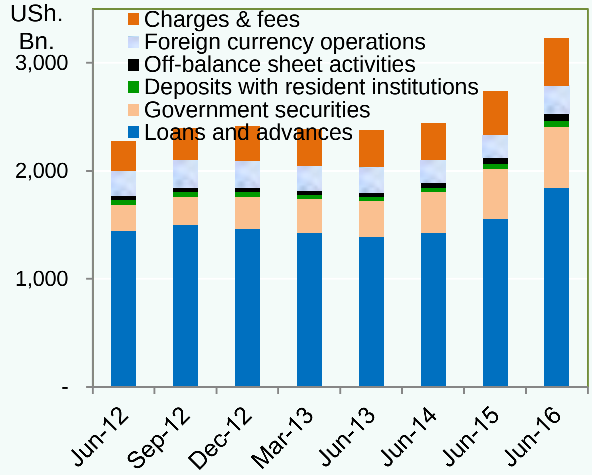
The weakening in profitability over the past year was driven by several factors including higher provisioning for non-performing loans and higher operating costs. Total bank expenses increased by USh.347.7 billion while provisions for bad debts increased by more than 100 percent from USh.153.7 billion in 2014/2015 to USh.364.1 billion in 2015/2016. Nonetheless, the number of loss making banks reduced from 7 banks in the year to June 2015 to 5 banks in the year to June 2016.

**Table 9: Indicators of banking sector profitability**

| | June 2013 | June 2014 | June 2015 | June 2016 |
|---|---|---|---|---|
| **Net Profit After Tax (YoY) (USh. billion)** | 498.1 | 358.8 | 556.3 | 485.6 |
| **No. of loss making banks** | 7 | 8 | 7 | 5 |
| **Net interest margin (%)** | 12.2 | 11.5 | 10.9 | 11.9 |
| **ROA (%)** | 3.3 | 2.1 | 2.8 | 2.2 |
| **ROE (%)** | 20.3 | 12.8 | 17.7 | 13.8 |
| **Cost of deposits (%)** | 4.1 | 3.7 | 3.3 | 3.4 |

*Source: Bank of Uganda*

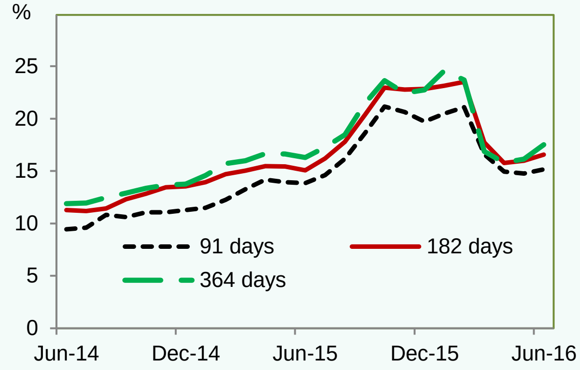
**Chart 26: Banks' sources of income (year-on-year)**




*Source: Bank of Uganda*

Going forward, earnings and profitability might reduce further due to reduction in returns from banks' holdings of government securities coupled with the need for banks to set aside high provisions for bad debts. At the end of June 2016 for example, interest rates on 91-day treasury bills were 15.2 percent, compared to 20.5 percent in January 2016.

**Chart 27: Interest rates on government securities**




*Source: Bank of Uganda*

**BOX 1: Performance of Domestic Systemically Important Banks (DSIBs)**

Uganda's Domestic Systemically Important Banks (DSIBs)[6] comprised three commercial banks at June 2016 i.e. Stanbic bank, Standard Chartered bank and Crane bank. At the end of June 2016, the three DSIBs accounted for 38.8 percent of total bank assets and 37.7 percent of total bank lending.

During the year to June 2016, indicators show that on average, the financial performance of DSIBs declined, mainly on account of one DSIB. DSIBs' average core capital adequacy ratio declined from 15.3 percent in June 2015 to 12.84 percent in June 2016. Similarly, asset quality declined with the average ratio of non-performing loans to total gross loans increasing from 4.6 percent in June 2015 to 13.44 percent in June 2016. At the end of June 2016, monthly liquidity coverage ratio (LCR) results indicate that each individual DSIB held sufficient liquidity to sustain the bank through a 30-day stressful period. The three banks' average LCR stood at 122.1 percent in the month of June 2016, well above the minimum requirement of 100.

**Table 10: Selected financial soundness indicators for DSIBs (percent)**

| | Jun-12 | Jun-13 | Jun-14 | Jun-15 | Jun-16 |
|---|---|---|---|---|---|
| **Total capital adequacy ratio** | 22.84 | 24.91 | 23.5 | 17.1 | 15.09 |
| **Tier 1 capital adequacy ratio** | 20.62 | 22.74 | 22 | 15.3 | 12.84 |
| **NPLs-to-total gross loans ratio** | 4.03 | 5.16 | 5 | 4.6 | 13.44 |
| **Liquidity coverage ratio** | 449.64 | 438.85 | 260.4 | 267.8 | 122.1 |
| **Total DSIBS assets to total industry assets** | 49.71 | 44.67 | 43.45 | 40 | 38.8 |

*Source: Bank of Uganda*

## 2.7 Conclusion

Over the year to June 2016, the performance of the banking sector declined compared to the same period in the previous year. This was driven by the deterioration in asset quality and rise in nonperforming loans, particularly to the construction sector. This affected bank capital and led to the decline in the overall performance of some systemically important banks.

[6] *D-SIBs are defined as banks that have an important impact on the domestic financial system and economy. BOU designates DSIBs at end December of each year.*

# 3. FINANCIAL INFRASTRUCTURE OVERSIGHT AND OTHER FINANCIAL INSTITUTIONS

*This chapter presents the performance of the payments system in Uganda and an assessment of other regulated financial institutions outside the banking sector including the capital markets. The systemic risk posed by the nonbank institutions is still low given the relative small size of these institutions and market activity when compared to the banking sector. Nonetheless, it is important to analyse their performance because of their increasing integral importance and link to the banking sector.*

## 3.1 Payments systems oversight

### 3.1.1 Introduction

Payment systems are an integral part of the economy as they provide a fundamental means of settling transactions. Safe and efficient payment systems are essential for transmission of monetary policy, as well as sustaining financial stability in Uganda. Failure of payment systems, or a participant, can pose significant risks to other participants and the financial infrastructure, transmitting shocks through the financial system and the economy.

To mitigate the risk of payment systems failure and the consequences, Bank of Uganda continues to exercise oversight, to ensure that the payment systems infrastructure remains efficient, resilient and safe.

As at June 2016, Uganda's payment systems infrastructure included: the Uganda National Interbank Settlement System (UNISS) – Uganda's Real Time Gross Settlement system for large value funds transfer; the Electronic Clearing System (ECS) – for cheques, direct debit and credit transfers; and an electronic Central Securities Depository (CSD) – for government securities. Private sector players also provide a number of payment systems and instruments, including mobile money, cross-border money remittance and chip and pin cards.

### 3.1.2 Performance of payment systems

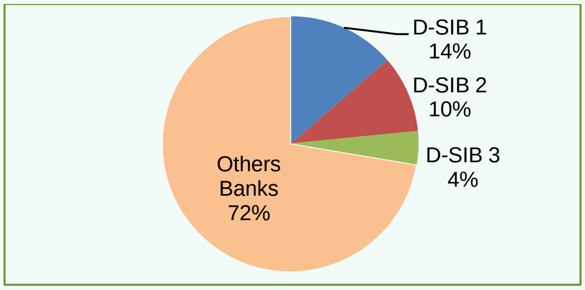
#### *a) Uganda National Interbank Settlement System (UNISS)*

The UNISS, Uganda's real-time gross settlement system, is a systemically important payment system. It is an advanced interbank electronic payment system that facilitates the efficient, safe, secure and real-time transmission of high value funds in the banking sector. Direct access to UNISS is limited to only the 25 commercial banks (Tier 1 financial institutions), and these banks act as intermediaries for other financial institutions.

The system experienced one significant disruption for a period of two days during the year to June 2016.

During the year ended June 2016, the total volume of transactions settled in UNISS – both in Ugandan Shilling (UGX) and foreign currency – was 811,841. There was a high concentration of these transactions among the three Domestic Systemically Important Banks (D-SIB), which were involved in 27.7 percent of the transaction volume.

**Chart 28: D-SIBs' participation on UNISS, by Volume of Transactions**

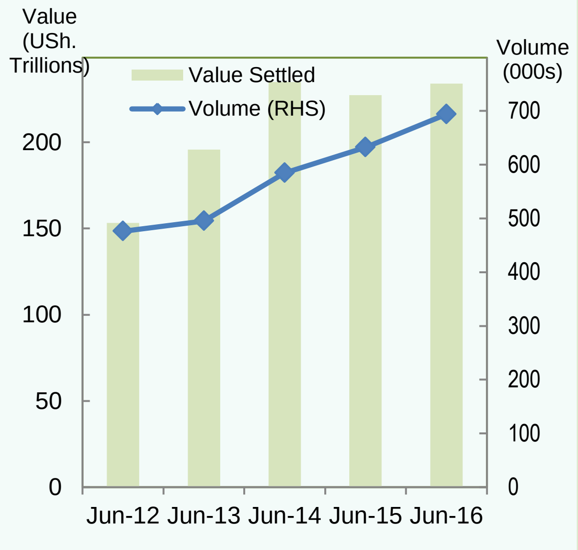



*Source: Bank of Uganda*

**Transactions in Ugandan Shillings**

During the year ended June 2016, the volume and value of transactions settled through UNISS increased by 11.3 percent and 3.0 percent respectively. In nominal value, the transactions rose from 623,370 with a value of USh.227.2 trillion in June 2015 to 693,664 with a total value of USh.234.0 trillion in June 2016.

**Chart 29: UNISS Transactions by volume and value**




*Source: Bank of Uganda*

**Transactions in foreign currencies**

UNISS also settles transactions in key foreign currencies, namely: United States Dollar (USD), European Union Euros (EUR), the Great British Pound (GBP), Kenyan Shilling (KES), Tanzanian Shilling (TZS) and Rwandan Franc (RWF). Transactions in dollars registered the highest activity in terms of both value and volumes settled in the year ending June 2016, with USD 7.0 billion settled in 110,382 transactions.

**Table 11: UNISS volume and values transacted in foreign currencies**

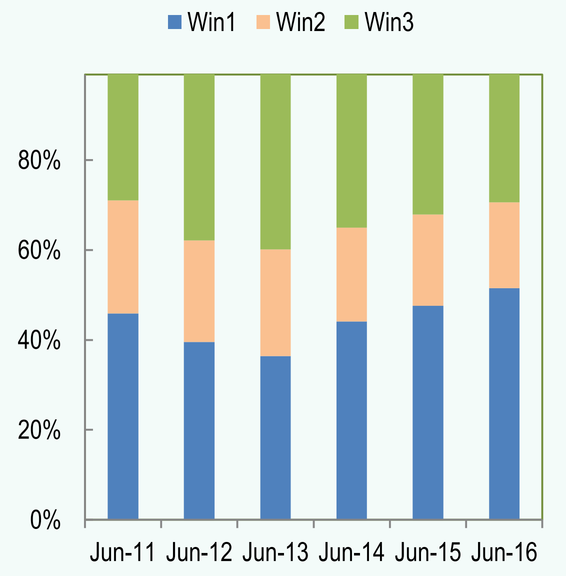
| | Jun-14 | Jun-15 | Jun-16 |
|---|---|---|---|
| **Total value settled (USD millions)** | 6,690 | 8,260 | 7,724 |
| Proportion by currency (value) | | | |
| USD | 97.7 | 93.5 | 90.7 |
| EUR | 1.8 | 2.4 | 4.1 |
| GBP | 0.3 | 0.4 | 0.6 |
| KES | 0.2 | 3.6 | 4.6 |
| TZS | 0.0 | 0.0 | 0.1 |
| RWF | 0.0 | 0.0 | 0.0 |
| **Total volume settled** | 85,761 | 102,381 | 118,177 |
| Proportion by currency (volume) | | | |
| USD | 96.2 | 94.2 | 93.4 |
| EUR | 1.9 | 1.9 | 1.9 |
| GBP | 0.7 | 0.7 | 0.6 |
| KES | 1.1 | 3.0 | 4.0 |
| TZS | 0.1 | 0.1 | 0.2 |
| RWF | 0.0 | 0.0 | 0.0 |

*Source: Bank of Uganda*

***Settlement Windows***

UNISS' settlement schedule runs from 08.30hrs to 16.30hrs, but demarcated into three settlement windows, with transaction charges varying over the settlement windows. To improve efficiency, and encourage early processing of payment instructions, transactions within window 1 (08.30hrs – 13.00hrs) are charged a discounted fee of USh.500; Window 2 (13.00hrs – 15.00hrs) transactions are charged the standard fee of USh.1000; while transactions in Window 3 (15.00hrs – 16.30hrs) are surcharged USh.1,500. The chart below shows that, over time, more payment instructions are settled within the first window.

**Chart 30: UNISS Transactions Volumes by Window (Win)**




*Source: Bank of Uganda*

### *b) East African Payment System (EAPS)*

The East African Payment System (EAPS) is a multicurrency system, which connects the RTGS Systems of the East African Community (EAC) member countries, namely: Kenya, Rwanda, Tanzania and Uganda.

There were no significant disruptions or downtime to EAPS during the year ended June 2016. The volumes and values of transaction continue to register significant growth during the year to June 2016, as compared to the year ending June 2015. Table….below shows that in terms of value, the majority of EAPS transactions were made in Kenyan Shilling: constituting 82.0 percent of inward transactions and 84.8 percent of outward transactions. Rwanda registered the least number of EAPS transactions for the same period.

**Table 12: Performance of EAPS**

| **Year Ended** | **June 2015** | | **June 2016** | |
|---|---|---|---|---|
| | Inward | Outward | Inward | Outward |
| Total value settled (USh. billions) | 317.7 | 193.5 | 625.4 | 678.6 |
| **Proportion by currency (value)** | | | | |
| UGX (percent) | 10.1 | 14.9 | 16.9 | 14.1 |
| KES (percent) | 89.8 | 85.0 | 82.0 | 84.8 |
| TZS (percent) | 0.1 | 0.1 | 1.0 | 1.0 |
| RWF (percent) | 0.0 | 0.0 | 0.1 | 0.1 |
| Total volume settled | 1,585 | 2,944 | 2,571 | 4,853 |
| **Proportion by currency (volume)** | | | | |
| UGX | 69.2 | 50.8 | 56.2 | 30.2 |
| KES | 29.7 | 47.0 | 41.7 | 67.0 |
| TZS | 1.0 | 2.2 | 1.8 | 2.7 |
| RWF | 0.1 | 0.0 | 0.2 | 0.1 |

*Source: Bank of Uganda*

### *c) COMESA Regional Payment and Settlement System*

REPSS is a cross-border clearing system for transfer of funds within the Common Market for Eastern and Southern Africa (COMESA) in both USD and EUR. In the year to June 2016, 181 transactions were made in United States Dollars, equivalent to USD 7.5 million; and 3 Euro transactions were made, totalling EUR 715,000.

### *d) Electronic Clearing System (ECS)*

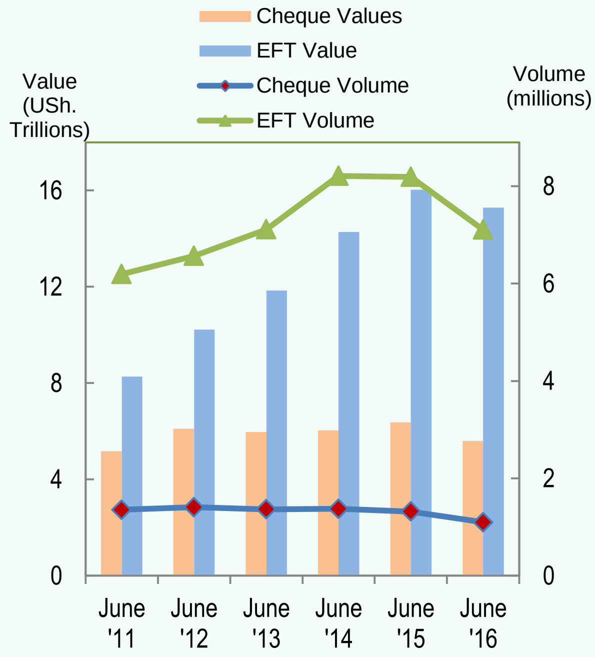
ECS is the system that facilitates the automatic processing of cheques clearing and execution of EFT transactions.

**Transactions in Ugandan Shillings**

During the year to June 2016, there were 1.1 million cheque transactions valued at USh.5.6 trillion cleared through the ECS. This was a decrease in both volume and value, from 1.3 million cheque transactions valued at USh.6.4 trillion cleared in the system during the previous year, ending June 2015. The decrease may be explained by increasing adoption of alternative electronic payment channels, like internet banking and mobile banking.

The total EFT transactions (credits and debits) volume and value cleared through the ECS also dropped. The EFT volume dropped by 13.2 percent from 8.2 million in the year ending June 2015 to the 7.1 million transactions in the year ending June 2016. Similarly, the value of these transactions also dropped by 4.9 percent from USh.16.0 trillion to USh.15.3 trillion over the same period.

**Chart 31: ECS Transaction Values and Volume**




*Source: Bank of Uganda*

**Transactions in foreign currencies**

During the year to June 2016, the ECS cleared 71,578 cheques and 53,831 EFTs in the foreign currencies transacted, that is USD, EUR, GBP and KES. The transactions made in US dollars registered the highest activity with the USD cheque transaction volume at 71,234 with a value of USD 248.1 million, whereas EFT transactions were 52,897 with a value of USD 613.9 million.

**Table 13: ECS Foreign Currency Activity**

| Year Ended | June 2015 | | June 2016 | |
|---|---|---|---|---|
| | EFT | Cheques | EFT | Cheques |
| Total value Cleared (USD equivalent; millions) | 583.9 | 263.4 | 649.5 | 248.9 |
| **Proportion (%) of Value; by currency** | | | | |
| USD | 95.9 | 99.6 | 94.5 | 99.7 |
| EUR | 3.1 | 0.3 | 5.2 | 0.2 |
| GBP | 0.4 | 0.1 | 0.2 | 0.1 |
| KES | 0.7 | 0.0 | 0.0 | 0.0 |
| Total volume Cleared | 40,917 | 73,119 | 53,831 | 71,578 |
| **Proportion (%) of Volume; by currency** | | | | |
| USD | 97.7 | 99.5 | 98.3 | 99.5 |
| EUR | 1.3 | 0.3 | 1.3 | 0.3 |
| GBP | 1.0 | 0.2 | 0.4 | 0.2 |
| KES | 0.0 | 0.0 | 0.0 | 0.0 |

*Source: Bank of Uganda*

### *e) Mobile money*

Mobile money continues to perform well especially in respect of the volume, the value of transactions, and the number of registered users.

**Table 14: Mobile money performance**

| Year Ended | June 2015 | June 2016 | % Change |
|---|---|---|---|
| **Number of transactions (millions)** | 566.5 | 809.1 | 42.8 |
| **Value of transactions (USh. trillions)** | 26.5 | 37.4 | 41.0 |
| **Number of registered customers (millions)** | 19.5 | 19.6 | 0.7 |
| **Number of agents** | 96,463 | 119,581 | 24.0 |

*Source: Bank of Uganda*

Mobile money transactions continued to rise, and innovative solutions promise to propel the services further. During the year to June 2016, some Mobile money operators partnered with other international companies, and have since started providing international money transfers on mobile money accounts.

### *f) Interswitch, Bank branches and ATMs*

**Interswitch**

The Interswitch network links participating banking institutions and enables their customers' access to shared ATMs and Points of Sale (POS) services. As at the end of June 2016, there were 10 commercial banks, 2 credit institutions and 1 Microfinance Deposit-taking Institution connected to the Interswitch network. In addition, Interswitch provides an option for registered MTN mobile money customers to withdraw money from Interswitch's and some member banks' ATMs. As at end of June 2016, the number of interconnected ATMs stood at 320, of which 11 were independently owned by Interswitch.

**Table 15: Interswitch Activity**

| Year Ended | June 2015 | June 2016 | % Change |
|---|---|---|---|
| **Transactions Value (USh. Billions)** | 129.8 | 161.3 | 24.3 |
| **Transaction Volume (Millions)** | 1.6 | 2.2 | 39.2 |
| **ATMs on Interswitch** | 307 | 320 | 4.2 |

*Source: Bank of Uganda*

### Bank branches and ATMs

As at end of June 2016, the total number of bank branches stood at 572 compared to 570 as at end June 2015. The number of automatic teller machines (ATMs) increased to 864 as at June 30, 2016, compared to 834 as at June 30, 2015.

**Table 16: Number of commercial bank branches and ATMs**

| | June 2014 | June 2015 | June 2016 |
|---|---|---|---|
| **Bank Branches** | 561 | 570 | 572 |
| **ATMs** | 803 | 834 | 864 |

*Source: Bank of Uganda*

The growth in ATMs and Interswitch activity indicates a rise in bank intermediation and will increase access to financial services.

### 3.1.3 Risks from Financial Technology

The banking industry has experienced an increase in activity and availability of new products and services, broadly captioned as Financial Technology (fintech). These innovations such as internet banking and mobile payments are changing traditional banking as well as risk exposures. The rise of these innovations raises regulatory concerns about the potential for heightened risk associated with consumer protection, risk management and financial stability.

One key risk arising from the growing roll out of Fintech services relates to the vulnerability of IT systems of banks to cybercrime, whereby criminals can transfer millions of shillings and move money across jurisdictions and borders quickly. Other regulatory concerns relate to data access rights and controls, as well as anti-money laundering (AML). Failures in fintech security have the potential to impact operations, reputations and can undermine public confidence in the financial industry as a whole. The full extent of the threat of cyber-crime is only emerging and is almost certainly going to grow as banks introduce more products.

To address these risks, BOU will continue to be watchful of the risks posed by new products while allowing for innovation and financial deepening. Banks should ensure that they have safe IT systems and adequate controls, and ensure that their level of security is sufficiently robust to withstand the challenge of regulatory risks related to fintech. Ugandan banks are also required to comply with both domestic and international Anti Money Laundering (AML) regulations, KYC rules and market conduct controls.

The recent closure of a bank in Kenya, which had a subsidiary in Uganda, also highlighted the challenges posed by integrated IT systems in the winding up of parent banks while the domestic subsidiary remains operational. Consequently, to ensure uninterrupted business continuity of the subsidiary at all times, Bank of Uganda issued a directive to all commercial banks to install in-country Primary Data Centers and Disaster Recovery Sites.

### 3.1.4 Other Regulatory Issues

Going forward, BOU will pursue additional measures to enhance the resilience and regulation of the payment system infrastructure. First, in November 2016, Bank of Uganda with Technical Assistance from the IMF will start the assessing the systemically important payment systems for compliance with international standards for operation of financial markets infrastructure, as defined by the Basel Committee on Banking Supervision (BCBS) in the *Principles for Financial Market Infrastructures (PFMIs)(2012)*.

Secondly, Bank of Uganda will continue to follow up the enactment of the National Payments System Bill, which will guide the operation and regulation of payment systems in Uganda.

## 3.2 Other Financial Corporations

### 3.2.1 Developments in Capital Markets

***Secondary market activity***

Equity turnover at the USE dipped by 39 percent in the financial year 2015/16 to USh.188.2 billion from USh.310 billion recorded in the previous financial year. Average turnover per session also trended downwards by 39 percent to USh 0.76 billion per session, from USh.1.2 billion per session recorded in the previous financial year. Share volume also declined by 44 percent to 1,030.6 million shares, compared to 1,848.1 million shares previously.

The dip in share volume and equity turnover was driven by a rise in interest rates on government securities, which saw investors shun the equity market for high yielding and low risk government securities. Additionally, investors remained on the side-lines in the pre and post-election periods owing to uncertainty.

Bucking the trend, domestic market capitalization shot up by 19 percent to close the period at USh.4.5 trillion from USh 3.7 trillion that was recorded previously. The USE Local Counter Index (LCI) also moved in tandem with the domestic market capitalization, climbing by 19 percent to 387.3 points from 324.4 points at the close of the previous financial year. The rise in both market capitalization and the USE LCI was triggered by a massive price rally on the BAT-Uganda counter and gains posted on the Uganda Clays and Umeme counters.

**Table 17: Equity Market Indicators**

| | 2015/16 | 2014/15 | Change (%) |
|---|---|---|---|
| Equity Turnover (USh. Billion) | 188.17 | 310 | -39 |
| Average Turnover per session (USh. Billion) | 0.8 | 1.2 | -39 |
| Share Volume (Million) | 1,030.6 | 1,848.1 | -44 |
| Domestic market Capitalization (USh. Trillion) | 4.5 | 3.7 | 19 |
| USE Local Counter Index (Points) | 387.3 | 324.4 | 19 |

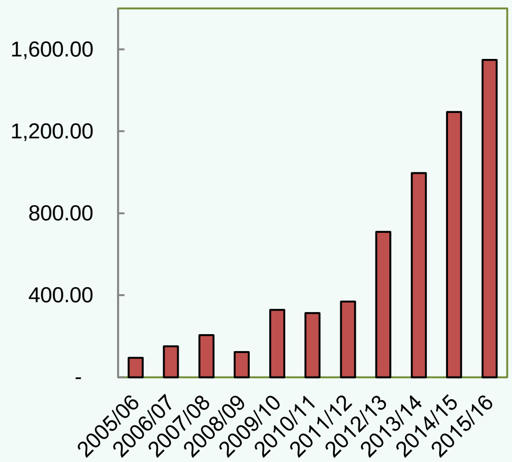
*Source: USE Market Reports*

***Fund Management***

The total funds under management by fund managers licensed by CMA stood at USh 1.6 trillion as at the end of the financial year 2015/16. This was an increase of 20 percent from USh.1.3 trillion at the end of the fiscal year

2014/15. The increase in funds under management was as a result of the appreciation in value of underlying assets as well as the recruitment of new members by schemes whose funds are under management. The top three fund managers in terms of funds under management accounted for 81% of the total funds under management, making the sub-sector highly concentrated.

**Chart 32: Fund Management**




*Source: Capital Markets Authority*

### *Capital Markets Outlook for 2016/17*

Capital markets are expected to recover in the financial year 2016/17 buoyed by the potential decline in interest rates. This is could lead some investors to shift to the equities market from the government bond market that had attracted investors in the last half of the previous financial year due to high yields on government securities. In addition to that, the continued recovery of the economy and sound macro-economic policy will augur well for trading activities in the capital markets. The launch of trading activity at Uganda's second exchange (ALTX Exchange) is expected to boost the level of activity in Uganda's capital markets.

### 3.2.2 The Retirement Benefits Sector

In the year to June 2016, the total assets of Schemes grew by 25 percent from USh.5.2 trillion in 2014 to USh.6.5 trillion in 2015. Return on assets was rose to 14 percent reflecting relatively favourable market conditions for investors during the year and a drop in the expense ratio[7] from 2.2 percent in 2014 to 1.3 percent in 2015.

In terms of portfolio allocation, 69.3 percent of investments were in government securities, 18 percent in quoted equities, 2.5 percent in corporate bonds, and 5.9 percent in fixed deposits.

**Table 18: Overall Industry Investment Portfolio**

| | Investment Class Category | Amount (USh.) | % share |
|---|---|---|---|
| 1 | Government Securities | 4,202,220 | 69.3 |
| 2 | Corporate Bonds | 152,236 | 2.5 |
| 3 | Term Fixed Deposits | 354,561 | 5.8 |
| 4 | Investment Property | 136,143 | 2.2 |
| 5 | Quoted Equity | 1,073,965 | 17.7 |
| 6 | Private Equity | 74,893 | 1.2 |
| 8 | Guaranteed Funds | 20,685 | 0.3 |
| 9 | Other Investments | 51,239 | 0.8 |
| | **TOTAL** | **5,489.3** | **100** |

*Source: URBRA*

[7] *The **expense ratio** is a measure of the total costs associated with managing and operating a fund.*

### *National Social Security Fund (NSSF)*

The value of NSSF assets as at June 2015 was USh.5.5 trillion. This was a significant increase in the Fund value up from USh.4.4 trillion in June 2014. A total of 67.8 percent of NSSF's investments were in government securities and about 15 percent in quoted equity.

**Table 19: NSSF's Investment Portfolio as at June 2015**

| | Investment Class Category | Amount (USh. Bn) | % share |
|---|---|---|---|
| 1 | Government Securities | 3,720. 6 | 67.8 |
| 2 | Corporate Bonds | 138.8 | 2.5 |
| 3 | Quoted Equity | 824.4 | 15.0 |
| 4 | Unquoted Equity | 74.9 | 1.4 |
| 5 | Fixed & Term Deposits | 251.1 | 4.6 |
| 6 | Investment Property | 135.8 | 2.5 |
| 7 | Others | 343.6 | 6.3 |
| | **TOTAL** | **5,489.3** | **100** |

*Source: URBRA*

### 3.2.3 The Insurance Sector

The total assets of the industry were USh.1.1 trillion as at 31st December 2015, up by 24.3 percent from the previous year's position of USh.915.1 billion. Non-Life (General) insurance accounted for 80 percent of total industry assets during the period under review.

Industry assets were offset by liabilities of USh.738.9 billion up 31.9 percent from USh.560.2 billion at the previous year. Industry net assets were USh.398.7 billion up 12.3 percent from USh.354.9 billion in the previous year.

The growth in premiums from the life insurance sector was higher than that of the Non-Life sector. The life sector grew by 35.7 percent in 2015 while Non-life and Health Maintenance Organizations (HMOS) grew by 21.5 percent and 0.3 percent respectively.

However, the penetration of insurance in the population continues to be low. The contribution of total insurance premiums to GDP, which measures insurance penetration, in real terms was only 0.8 percent at end December 2016.

**Table 20: Premium Incomes for Insurance sector**

| Year | Premium Income | Growth rate (%) | Insurance Penetration (%) |
|---|---|---|---|
| 2011 | 296.6 | | 0.65 |
| 2012 | 352.0 | 18.7 | 0.66 |
| 2013 | 463.0 | 31.5 | 0.85 |
| 2014 | 504.8 | 9.0 | 0.86 |
| 2015 | 611.1 | 21.0 | 0.76 |

*Source: Insurance Regulatory Authority (IRA)*

### *Other Indicators of Financial Performance for the Insurance sector*

- ✓ The Industry aggregate premium levels amounted to USh.611 billion in December 2015, of which non–life business accounted for USh.464.4 billion while life business accounted for USh.99.8 billion in 2015.

- ✓ Reinsurance premium ceded for non-life business amounted to USh.216.5 billion while reinsurance premium ceded for life business amounted to USh.17.1 billion in .2015

- ✓ Net earned premium for the industry in the year ended December 2015 was USh.237.7 billion for non-Life business and USh.80.3 billion for life business, up 16.7 percent and 27.1 percent respectively from the previous year respectively.

- ✓ Notably the loss ratio for the Industry in the year ended December 2015 was 44.4 percent for non–life business, up from 40.1 percent in the previous year while the loss ratio for life business was 49.2 percent up from 34.4 percent in the previous year. The loss ratio is the ratio of total losses incurred (paid and reserved) in claims plus adjustment expenses divided by the total premiums earned.

- ✓ In terms of profitability, underwriting profit for General Business was USh.8.1 billion down from the previous year USh.23.5 billion.

- ✓ Available for sale Investments and Held to maturity investments for Insurance Companies grew by 15.8 percent from USh.189.8 billion in the previous year to USh.219.7 billion in the current year. This reflected availability of very attractive investment opportunities in the domestic markets.

- ✓ Several products in the pipeline are expected to improve insurance penetration. These include buying of products through mobile money, banc assurance and Takaful Insurance.

### 3.3 Conclusion and Outlook

During the year to June 2016, systemic risks from payment systems remained moderate, and all systemically important systems operated without any significant disruption, except for UNISS as noted previously in this chapter. The performance of the other financial corporations was mixed, with capital markets affected by the reduction in turnover, while the retirement benefits sector and insurance sector improved were boosted by a rise in interest income. The rise of financial technology also raises regulatory concerns about the potential risks for financial stability.

# 4. THE OUTLOOK FOR FINANCIAL STABILITY

*The outlook for financial stability is shaped by two factors; the risks faced by the banking system and the system's resilience in the face of those risks. Overall, risks to systemic stability increased in the year to June 2016, driven mainly by challenges from the macro-economy, decline in asset quality of banks and decline in performance of systemically important banks. Stress tests results however show that the sector has adequate capital buffers to withstand these shocks going forward.*

## 4.1 Summary of risks facing the banking sector

### a) Risks from the Macro-economy

The external economic environment and the slowdown in the domestic economy were a key influence on the performance of the banking system in the year to June 2016. Global growth remains weak, with substantial downside risks to growth. The domestic economy expanded by 4.8 percent in FY 2015/16 in real terms, lower than 5.1 percent in 20014/2015. This in part reflected soft commodity prices, the slow execution of public investments, decline in household consumption and regional macro-politics including the political instability in South Sudan. These challenges had a negative effect on the balance sheets of households and corporations resulting in a rise in nonperforming loans.

There are signs that the economy may have passed the low point in the growth cycle, with the quarterly GDP series indicating that real output was stronger in Q4-2015/16.

### b) Credit risk

***The rise of nonperforming loans***

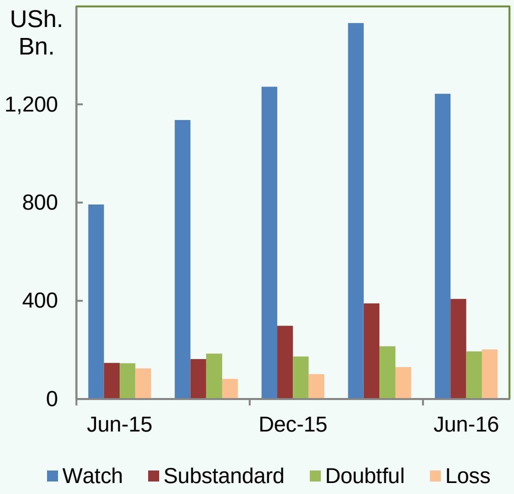
The decline in asset quality in the banking sector in the year to June 2016 poses a risk to the performance of banks. The industry NPL ratio has been on an upward trend since June 2015, and more than doubled from 4 percent in June 2015 to 8.3 percent in June 2016. Indicators show that bad loans rose in all the economic sectors, particularly in the building and construction sector and the trade and commerce sector.

A survey by Bank of Uganda in May 2016 indicated that the rise in NPLs was partly due to the reduction in economic output as indicated above, delayed payments by government, diversion of funds by borrowers and to a smaller extent, exchange rate depreciation.

These challenges also affected the performance of domestic systemically important banks (DSIB's). Two of the three D-SIBs had NPL ratios above the industry average of 8.3 percent in June 2016, leading to a drop in their profitability.

Going forward, bank loan quality will remain a concern for banking sector stability in the short term at least, due to several factors. First, it is likely to take time to fully address the impact of the factors highlighted above. Secondly, indicators show that ***watch loans***, the category of loans that are a step from NPLs, are still increasing. Watch loans grew by 56 percent from USh.796.0 billion to USh.1,243.2 billion in the year to June 2016. Further deterioration of these watch loans will result in a rise in non-performing loans. Any further rise in NPLs will have a negative impact on bank lending and bank profitability moving forward.

**Chart 33: Breakdown of Bank NPLs**

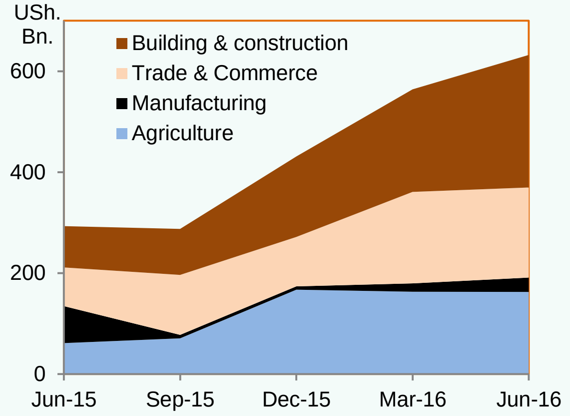



*Source: Bank of Uganda*

### *Exposure to the real estate sector*

A key aspect in the credit risk of the commercial banks is the rising exposure to the real estate sector. In the five years to June 2016, there was a strong rise in lending to the real estate sector, which accounted for 25 percent of total loans in 2016. In addition, NPLs to the real estate sector rose by 99.6 percent or USh.180.7 billion during the year to June 2016.

**Chart 34: Sectoral Growth in NPLs**




*Source: Bank of Uganda*

Several factors affected the performance of the real estate sector. As discussed in our last *Report,* anecdotal information obtained by BOU indicated that some commercial banks had encouraged their clients to contract foreign currency denominated real estate loans especially for commercial real estate and land purchase, to hedge against rising interest rates on shilling loans. This increases the likelihood of default risk in the event of exchange rate depreciation.

The commercial real estate (CRE) segment has faced unique risks. A survey undertaken by BOU in August 2016 that covered banks and the borrowers in the CRE market revealed the following;

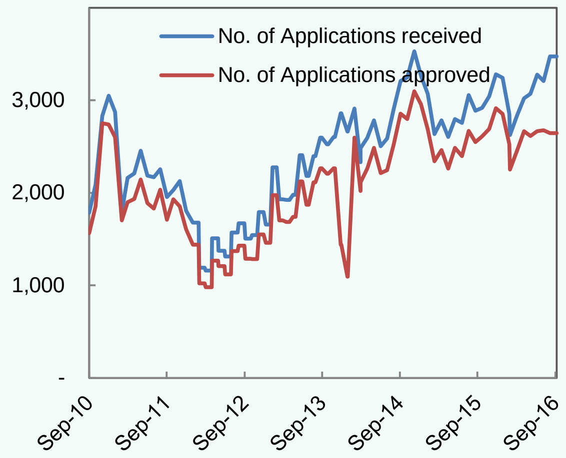
- The occupancy rate for commercial real estate (high end apartments, office blocks and shopping arcades) has reduced over the past 5 years. Between 2012 and 2016, the average occupancy rate reduced from 85 percent in 2012 to 52 percent in 2014, which affected the annual returns and loan payment.

- Many banks reported that they have challenges related to overvaluation of real estate by property valuers. In a number of incidents, some banks were unable to realize full loan recovery after foreclosure, because the appraised value was far higher than the market value.

- Many of the commercial real estate borrowers covered by the survey, charge rent in US dollars. During 2015 and 2016, the depreciation of the exchange rate and other factors affected the ability of tenants to pay rent denominated in dollars. Borrowers reported that they reduced monthly rent charges to cope with falling tenancy rates, which further affected loan payment.

To manage the above risks, banks appear to have reduced lending to the real estate sector. Indicators show that loan applications approved by banks have reduced as banks become risk averse due to rising bad loans.

**Chart 35: Real Estate Loan Applications and Approvals**




*Source: Bank of Uganda*

Bank of Uganda has engaged banks on the need for banks to enhance the credibility of property valuations. BOU will continue to monitor potential risks banks face from real estate lending and tackle any systemic threats. In addition, stress tests show that most banks have adequate buffers to withstand shocks from the sector.

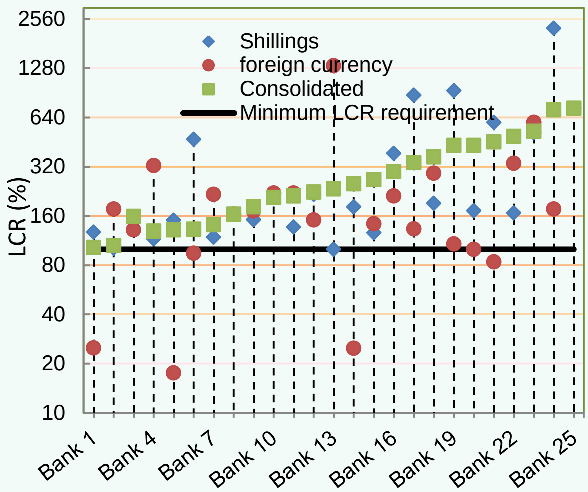
### c) Bank Liquidity

Overall, the banking sector has adequate liquidity buffers. However, one indicator of bank liquidity, the Basel III Liquidity Coverage Ratio (LCR)[8], showed mixed results. In June 2016, all banks met the Liquidity Coverage Ratio (LCR)

[8] *The LCR is a Basel III measure which requires banks to hold high quality liquid assets to withstand a 30 day stress scenario.*

requirement of 100 percent on a consolidated basis (taking into account both shillings and foreign currency assets and liabilities). However, six banks did not meet the minimum LCR requirement in foreign currency due to holding high short-term foreign currency obligations backed by insufficient foreign currency liquid assets.

**Chart 36: LCR results for June 2016**




*Source: Bank of Uganda*

These banks may be exposed to liquidity and market risks if they need to convert their shilling assets into foreign currency in order to meet their obligations.

## 4.2 Stress test results for the banking sector

Bank of Uganda carries out quarterly stress tests to assess the resilience of the banking sector to plausible systemic risks. The framework of these tests is based on work by Cihak[9] to identify the breaking point for each risk. Shocks are applied to selected variables until banks fail to meet a predefined prudential threshold. The stress tests for June 2016 focused on the two main potential sources of vulnerabilities for the Ugandan banking sector; credit and liquidity risks.

### *Credit risk*

Credit shocks were conducted to assess the effect a further deterioration in asset quality would have on bank capital for the next year. The ratio of non-performing loans to total loans is taken as the main measure of credit risk.

The first credit risk test tests the resilience of banks to the highest quarterly increase in the NPL ratio recorded between June 2015 and June 2016, which was 1.6 percent for the quarter ending March 2016. The test assumes constant credit growth, no change in core capital for the projection period, and 20 percent provisioning on new non-performing loans. The results show that all banks except one, have adequate capital buffers to absorb this deterioration in loan quality.

[9] *Cihak, M. "Introduction to applied stress testing" (2007) IMF Working Paper No. WP/07/59*

**Chart 37: Stress test results of shock to banks' aggregate credit**

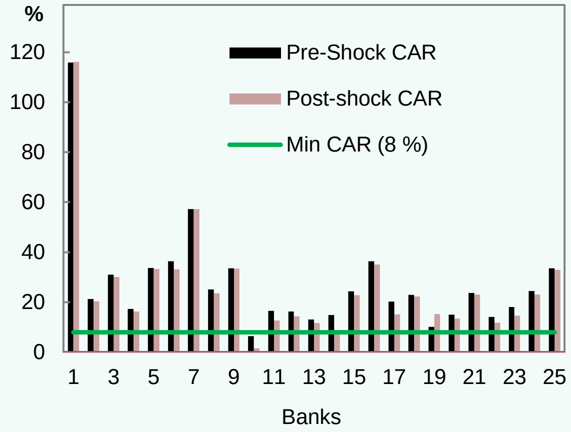
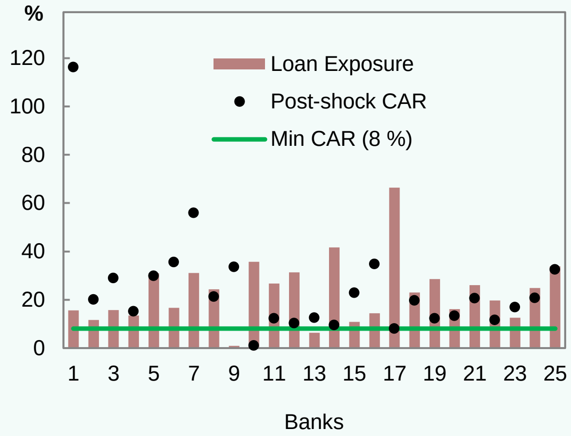



**Chart 38: Stress test results of shock to banks' loans to the building and construction sector**




The second test assesses the resilience of commercial banks to a shock in the building and construction sector which registered the largest increase in the volume of non-performing loans in the year to June 2016. Results show that it would take 50.1 percent of the existing performing loans to become non-performing for the first bank to become undercapitalized[10].

### *Liquidity risk*

Although indicators show that overall liquidity risk for banks remained stable in the year to June 2016, concerns remain about the potential risks from a reversal of callable funds and whether some banks have adequate liquid assets to fund their short to medium-term funding activities in a period of stressed liquidity.

The first stress test for liquidity risk simulated a bank run to determine the impact of a sudden withdrawal of customer deposits. The resilience of banks to liquidity risk is judged by their ability to withstand a liquidity drain without resorting to external liquidity support in a 7-day period. This test does not consider assumptions about rollovers, increases in borrowings and maturity extensions.

The results revealed that liquid assets of twelve banks would be depleted over a 7-day period of distress, assuming a daily withdrawal rate of 5 percent for demand and savings deposits and 3 percent for term deposits. Compared to June 2015, the results suggest that as at the end of June 2016, banks were more sensitive to liquidity risk since the bank run test resulted in more bank failures with a similar reduction in deposits.

*[10] A commercial bank is considered to be undercapitalized if its core capital as a share of risk weighted assets falls below the regulatory minimum of 8 percent, and/or its ratio of total regulatory capital to risk weighted assets falls below 12 percent (FIA 2004).*

**Table 21: Summary of stress test results for liquidity risk**

| | Key indicators | Day 3 | Day 5 | Day 7 |
|---|---|---|---|---|
| **June 2014** | Liquid assets to total deposits (%) | 38.8 | 33.1 | 26.9 |
| | Reduction in total deposits (%) | 12.6 | 20.0 | 26.8 |
| | No. of banks failing tests | 0 | 4 | 8 |
| **June 2015** | Liquid assets to total deposits (%) | 38.6 | 32.8 | 26.5 |
| | Reduction in total deposits (%) | 12.7 | 20.2 | 27.1 |
| | No. of banks failing tests | 2 | 5 | 9 |
| **June 2016** | Liquid assets to total deposits (%) | 35.1 | 29.0 | 22.3 |
| | Reduction in total deposits (%) | 12.7 | 20.3 | 27.1 |
| | No. of banks failing tests | 5 | 9 | 11 |

*Source: Bank of Uganda*

The second liquidity stress test assesses resilience of the banking system to a sudden withdrawal of the single largest depositor and the 3 largest depositors in each bank. If the largest depositor in each bank withdrew its deposits, 2 banks would not have adequate liquidity buffers to absorb this shock whereas if the 3 largest depositors in each bank withdrew their deposits, 7 banks' liquid assets-to-total deposits ratio would fall below the 20 percent regulatory minimum.

## 4.3 Looking ahead: prospects for financial stability

Overall, micro and macro risks to financial stability increased in the year to June 2016. A number of vulnerabilities emerged related to several adverse internal and external economic shocks and worsening of loan quality, including in systemically important banks. The resilience of banks to meeting the LCR requirement in foreign currency has also emerged as a concern.

Looking forward, the operating environment is likely to remain challenging for banks in the short term. However, BOU's macro stress tests indicate that threats to systemic stability remain low because of the banking system's strong capital buffers.

In order to enhance the resilience of the banking sector going forward, Bank of Uganda took several steps in FY 2015/2016.

- First BOU took action by requiring banks to set aside a capital conservation buffer of 2.5% of RWA and additional capital for DSIBs of 1-3.5% of RWA by December 2016.

- BOU implemented several supervisory measures on DSIBs including more intrusive inspections and reviews, signing MOUs with the Board of Directors, calling for new capital and the takeover of the management of one DSIB which was severely undercapitalized in October 2016.

- In a bid to enhance the liquidity buffers of banks, BOU will require that all commercial banks meet the Liquidity Coverage Ratio (LCR) in foreign currency and local currency starting in January 2017.

- In May 2016, BOU instituted a limit of 70 percent on the Loan to Value Ratio (LTV) for foreign currency loans for land purchase.

## 5. STATISTICAL APPENDICES

**TABLE 1: Selected quarterly financial soundness indicators for East African countries (*percentage ratios*)**

| | | June 2014 | Sept 2014 | Dec 2014 | Mar 2015 | June 2015 | Sept 2015 | Dec 2015 | Mar 2016 | June 2016 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Regulatory Capital to Risk-Weighted Assets** | Uganda | 22.8 | 22.5 | 22.2 | 23.2 | 21.3 | 20.1 | 21 | 21.8 | 22.2 |
| | Kenya | 17.6 | 17.8 | 19.2 | 19.2 | 18.9 | 18.7 | 18.6 | 18.8 | 18.1 |
| | Tanzania | 17.8 | 18.1 | 17.7 | 19.1 | 17.7 | 18 | 18.9 | 20.2 | 20 |
| | Rwanda | 23.6 | 24 | 24 | 25.9 | 24.3 | 24.2 | 22.5 | 25.0 | 23.3 |
| | Burundi | 21.3 | 18.1 | 17.3 | 20.5 | 19.5 | 19.2 | 18.1 | 22.3 | 20.8 |
| | | | | | | | | | | |
| **NPLS to Total Gross Loans** | Uganda | 5.8 | 5.3 | 4.1 | 4.3 | 4 | 3.8 | 5.3 | 6.9 | 8.3 |
| | Kenya | 5.7 | 5.4 | 5.4 | 5.8 | 5.7 | 5.4 | 6.8 | 7.7 | 8.5 |
| | Tanzania | 8.2 | 8.4 | 6.8 | 6.7 | 6.7 | 6.8 | 6.6 | 8.4 | 8.7 |
| | Rwanda | 6.6 | 6.3 | 6 | 6.3 | 5.9 | 6.3 | 6.2 | 6.2 | 7.0 |
| | Burundi | 12.7 | 12.5 | 11.1 | 12.4 | 13.3 | 14.3 | 17.9 | 18.3 | 18.5 |
| | | | | | | | | | | |
| **Return on Assets (ROA)** | Uganda | 2.8 | 2.8 | 3.6 | 3.6 | 3.8 | 2.7 | 2.6 | 2.8 | 2.7 |
| | Kenya | 3.7 | 3.6 | 3.4 | 3.5 | 3.3 | 3.3 | 3.1 | 3.4 | 3.3 |
| | Tanzania | 2.9 | 2.9 | 2.6 | 3.1 | 2.9 | 2.7 | 2.9 | 3.49 | 3.02 |
| | Rwanda | 2.8 | 1.9 | 1.9 | 2.6 | 2.4 | 2.8 | 2.7 | 2.8 | 2.6 |
| | Burundi | 0.1 | 0.5 | 1.0 | 0.5 | 2.6 | 2.6 | 1.9 | 2.5 | 1.7 |
| | | | | | | | | | | |
| **Return on Equity (ROE)** | Uganda | 12.8 | 17 | 22 | 21.9 | 24.6 | 17.1 | 16 | 16.8 | 16.6 |
| | Kenya | 30.9 | 28.5 | 26.6 | 28 | 28.3 | 27.4 | 25.2 | 27.7 | 27.2 |
| | Tanzania | 15.5 | 15 | 13.1 | 16.2 | 15.1 | 13.5 | 22.2 | 18.2 | 15.4 |
| | Rwanda | 12.1 | 10.9 | 10.5 | 14 | 17.3 | 15.8 | 14.8 | 14.7 | 13.7 |
| | Burundi | 15.0 | 10 | 10 | 9 | 16.2 | 16.1 | 11.5 | 15.4 | 10.7 |
| | | | | | | | | | | |
| **Foreign Currency Denominated Assets to Total Assets** | Uganda | 30.4 | 30.5 | 31.8 | 36.4 | 38.1 | 41.3 | 37.5 | 36.2 | 35.1 |
| | Kenya | 14.9 | 15.8 | 15.4 | 15.6 | 16.4 | 17.3 | 16.7 | 17.1 | 16.4 |
| | Tanzania | 29.3 | 29.6 | 30.3 | 31.7 | 34.3 | 34.9 | 34.7 | 33.6 | 32.0 |
| | Rwanda | 19.7 | 17.7 | 20.9 | 15.9 | 15.7 | 20.0 | 15.6 | 15.2 | 16.8 |
| | Burundi | 18.6 | 15.4 | 16.3 | 14.7 | 15.9 | 15.8 | 19.5 | 16.5 | 14.5 |

*Source: Central banks of Burundi, Kenya, Rwanda, Tanzania and Uganda*

**TABLE 2: Commercial banks' quarterly financial soundness indicators (*percentage ratios*)**

| | June 2014 | Sept 2014 | Dec 2014 | Mar 2015 | June 2015 | Sept 2015 | Dec 2015 | Mar 2016 | June 2016 |
|---|---|---|---|---|---|---|---|---|---|
| **Capital Adequacy** | | | | | | | | | |
| Regulatory capital to risk-weighted assets | 22.8 | 22.5 | 22.2 | 23.2 | 21.3 | 20.1 | 21 | 21.8 | 21.7 |
| Regulatory tier 1 capital to risk-weighted assets | 20.3 | 19.9 | 19.7 | 20.8 | 18.8 | 17.6 | 18.6 | 19.1 | 19 |
| Leverage ratio | 11.2 | 11.1 | 11 | 12.1 | 11 | 10.6 | 11.1 | 11.4 | 10.8 |
| | | | | | | | | | |
| **Asset quality** | | | | | | | | | |
| NPLs to total gross loans | 5.8 | 5.3 | 4.1 | 4.3 | 4 | 3.8 | 5.3 | 6.9 | 8.3 |
| NPLs to total deposits | 4.1 | 3.7 | 3 | 3.1 | 2.9 | 2.8 | 3.9 | 4.9 | 5.8 |
| Sectoral distribution of gross loans (%) | | | | | | | | | |
| Agriculture | 9.1 | 9.4 | 9.4 | 9.5 | 9.3 | 9.3 | 9.5 | 9.9 | 9.8 |
| Mining and quarrying | 0.3 | 0.5 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 |
| Manufacturing | 13.7 | 11.1 | 14.2 | 16.1 | 16.1 | 15.8 | 14.8 | 14.7 | 14.6 |
| Trade | 20.8 | 17.8 | 19.7 | 17.9 | 19.5 | 19.6 | 18.7 | 17.7 | 17.9 |
| Transport and comm. | 5.4 | 4.7 | 5.3 | 5.2 | 5.2 | 5.9 | 5.8 | 6.6 | 7.1 |
| Building and construction | 23.2 | 23.2 | 23.2 | 23.6 | 23.2 | 23.5 | 24.1 | 24.3 | 23.6 |
| Personal loans | 17.4 | 17.1 | 16.4 | 15.8 | 15.2 | 14.8 | 15.2 | 15.6 | 15.9 |
| Others | 9.2 | 14.8 | 9.4 | 9.8 | 9.3 | 1.4 | 1.5 | 1.6 | 1.3 |
| Large exposures to total capital | 96.4 | 109.7 | 113.2 | 104.5 | 126.4 | 139.3 | 123.5 | 123.9 | 121.5 |
| | | | | | | | | | |
| **Earnings & profitability** | | | | | | | | | |
| Return on assets | 2.1 | 2.2 | 2.6 | 2.5 | 2.8 | 2.7 | 2.6 | 2.8 | 2.2 |
| Return on equity | 12.8 | 13.1 | 16.1 | 15.6 | 17.7 | 17.1 | 16 | 16.8 | 13.8 |
| Net interest margin | 11.5 | 11.3 | 11 | 11 | 10.9 | 11 | 11.3 | 11.6 | 11.9 |
| Cost of deposits | 3.7 | 3.7 | 3.6 | 3.4 | 3.3 | 3.2 | 3.3 | 3.4 | 3.4 |
| Cost to income | 75.8 | 74.8 | 68.7 | 68.7 | 68.7 | 68.5 | 69.2 | 68.4 | 67.9 |
| Overhead to income | 41.9 | 41.1 | 40 | 40.1 | 42.9 | 42.7 | 41.9 | 41.1 | 37.4 |
| | | | | | | | | | |
| **Liquidity** | | | | | | | | | |
| Liquid assets to total deposits | 46.5 | 41.8 | 44 | 44.2 | 46.4 | 45.4 | 46.4 | 42.5 | 43.4 |
| Total loans to total deposits | 70.8 | 71.1 | 71.4 | 73.1 | 72.8 | 73.6 | 73.1 | 71.6 | 70.2 |
| | | | | | | | | | |
| **Market Sensitivity** | | | | | | | | | |
| Foreign currency exposure to regulatory tier 1 capital | -6.8 | -1.4 | -6.9 | -5.4 | -5.7 | -3.4 | -5.9 | -7.6 | -6.2 |
| Foreign currency loans to foreign currency deposits | 65 | 66.3 | 64.5 | 58.8 | 61.3 | 60.5 | 59.2 | 60.5 | 60.4 |
| Foreign currency assets to foreign currency liabilities | 95.4 | 95.2 | 97.1 | 102.9 | 101.4 | 102.7 | 101.8 | 97.4 | 96.7 |

*Source: Bank of Uganda*

**TABLE 3: Commercial banks' quarterly balance sheet**

| | Jun 14 | Sep 14 | Dec 14 | Mar 15 | Jun 15 | Sep 15 | Dec 15 | Mar 16 | Jun 16 |
|---|---|---|---|---|---|---|---|---|---|
| **ASSETS (USh. Billion)** | | | | | | | | | |
| Cash & cash assets | 589.1 | 598.8 | 786.6 | 714.4 | 738.5 | 799.4 | 811.3 | 748.8 | 698.3 |
| Balances with BOU | 2263.5 | 1920 | 2104.8 | 1760.7 | 2025.4 | 2241.9 | 1982.6 | 2157.6 | 2727.7 |
| Due from financial institutions | 1853.4 | 1604.9 | 1502.4 | 2449.3 | 2583.2 | 2621.7 | 2634.8 | 2390.3 | 2244.8 |
| Government securities | 4037.3 | 4428.5 | 4463.1 | 4242.4 | 4283.6 | 3901.4 | 4064.8 | 4542.6 | 4965.8 |
| Total gross loans & advances | 8783.9 | 8955.2 | 9431 | 9875.8 | 10517.5 | 9851.7 | 9501.8 | 9435.2 | 9646.6 |
| LESS: Provisions | -371.9 | -319.9 | -229.3 | -259.5 | -250.4 | -231.5 | -285.6 | -401.5 | -570.6 |
| Net loans & advances | 8412 | 8635.3 | 9201.7 | 9616.3 | 10267.1 | 9620.2 | 9216.2 | 9033.7 | 9076.0 |
| Net fixed assets | 761.7 | 756.8 | 821.3 | 853.3 | 886.5 | 914.2 | 925.9 | 995.3 | 992.5 |
| Other assets | 722.5 | 732.9 | 706.2 | 680.9 | 817.6 | 769.9 | 691.9 | 713.2 | 776.2 |
| **TOTAL ASSETS** | **18639.5** | **18677.2** | **19586** | **20317** | **21601.9** | **22313.2** | **21722.2** | **21896.0** | **22794.4** |
| | | | | | | | | | |
| **LIABILITIES (USh. Billion)** | | | | | | | | | |
| Deposits | 12406.4 | 12592.9 | 13219 | 13518 | 14450.9 | 15247 | 14821.1 | 14937.4 | 15538 |
| Due to financial institutions | 991.2 | 756.8 | 563.4 | 513.3 | 686.8 | 543.3 | 654 | 455.7 | 526.5 |
| Administered funds | 1080.7 | 1095.5 | 1187.6 | 1512.8 | 1622.3 | 1661.4 | 1255.9 | 1212.3 | 1194.6 |
| Other liabilities | 1262.6 | 1191.5 | 1425.7 | 1450 | 1515 | 1390.8 | 1398.1 | 1647.4 | 1812.5 |
| **TOTAL LIABILITIES** | **15696.6** | **15636.6** | **16395** | **16994** | **18275.1** | **18843** | **18129.1** | **18252.8** | **19072** |
| | | | | | | | | | |
| **CAPITAL (USh. Billion)** | | | | | | | | | |
| Paid-up capital | 1329.7 | 1284.2 | 1287.4 | 1314.1 | 1336.6 | 1337.9 | 1346.8 | 1346.8 | 1391.3 |
| Share premium | 90.7 | 92.4 | 102.3 | 103.4 | 110.1 | 111.5 | 115.4 | 115.4 | 145.9 |
| Retained reserves | 1173 | 1171.4 | 1174.3 | 1664.2 | 1480 | 1476.7 | 1446.6 | 1839.7 | 1775.0 |
| Other reserves/subordinated debt | 153.4 | 141 | 139.2 | 122.4 | 130.3 | 124.7 | 143.2 | 176.9 | 196.1 |
| Profit – Loss (current year) | 196.2 | 351.6 | 487.4 | 119.3 | 269.8 | 419.9 | 541.1 | 164.4 | 214.2 |
| **TOTAL SHAREHOLDERS' FUNDS** | **2942.9** | **3040.6** | **3190.7** | **3323.4** | **3326.8** | **3470.7** | **3593.0** | **3643.2** | **3722.6** |
| | | | | | | | | | |
| **OFF BALANCE SHEET ITEMS (USh. Billion)** | | | | | | | | | |
| Letters of Credit | 376.4 | 409.7 | 469 | 486.5 | 487.8 | 565.4 | 494.0 | 431.2 | 390.0 |
| Guarantees & performance bonds | 1386.1 | 1537.3 | 1573.8 | 1541.6 | 1672.3 | 1819.6 | 1841.3 | 2143.6 | 2280.5 |
| Unused loans/overdrafts commitment | 1137 | 1108.7 | 1162.5 | 986.2 | 1047.5 | 1504.9 | 1325.9 | 1484.2 | 2020.7 |
| Other off balance sheet items | 340 | 356.5 | 376.7 | 425.4 | 228.7 | 175.9 | 168.4 | 172.0 | 97.6 |
| **TOTAL OFF BALANCE SHEET ITEMS** | **3239.8** | **3412.2** | **3582** | **3439.6** | **3436.2** | **4065.8** | **3829.6** | **4231.1** | **4788.8** |

*Source: Bank of Uganda*

**TABLE 4: Commercial banks' quarterly income statement, year-on-year figures**

| | Jun 14 | Sep 14 | Dec 14 | Mar 15 | Jun 15 | Sep 15 | Dec 15 | Mar 16 | Jun 16 |
|---|---|---|---|---|---|---|---|---|---|
| **INCOME (USh. Billion)** | | | | | | | | | |
| Interest income | | | | | | | | | |
| Advances | 1427 | 1442 | 1464.1 | 1519.9 | 1551.3 | 1642.4 | 1722 | 1780.3 | 1839.8 |
| Government securities | 379.5 | 391.6 | 416.1 | 440.4 | 465.8 | 481.3 | 497.6 | 531.4 | 570.1 |
| Deposits abroad | 16.8 | 11.7 | 8.6 | 8 | 9.7 | 10.7 | 12 | 14.7 | 14.9 |
| Other | 111.9 | 136.6 | 132 | 116 | 98.2 | 70.8 | 68.8 | 77.3 | 95.1 |
| Charges, fees & commissions | 340.4 | 360.3 | 376.1 | 381.4 | 403 | 413.3 | 419.3 | 429.1 | 436 |
| Foreign exchange income | 210.6 | 203.4 | 197.6 | 204.1 | 210.8 | 251.8 | 257.6 | 262.8 | 264 |
| Other income | 161.4 | 165.6 | 207.7 | 224.2 | 207.3 | 155.3 | 147.9 | 185.6 | 198.6 |
| **TOTAL INCOME** | **2647.7** | **2711.3** | **2802.3** | **2894** | **2946** | **3093.1** | **3196.6** | **3352.4** | **3487.5** |
| | | | | | | | | | |
| **EXPENSES (USh. Billion)** | | | | | | | | | |
| Interest expense on deposits | 425.8 | 434 | 438.5 | 441.4 | 441.2 | 449.4 | 467.6 | 490.1 | 509.2 |
| Other interest expenses | 139.3 | 147.8 | 154.3 | 159.9 | 162.6 | 178.3 | 189.8 | 192.3 | 189.6 |
| Provisions for bad debts | 332.1 | 330.2 | 212.2 | 224.6 | 153.8 | 172.3 | 217.7 | 231.1 | 364.1 |
| Salaries, wages, staff costs | 551.5 | 575 | 583.9 | 601 | 612.1 | 626.8 | 646.9 | 660.5 | 684.5 |
| Premises, depreciation, transport | 244.8 | 253 | 253.9 | 261.3 | 262.1 | 278.6 | 296.5 | 306.7 | 321.7 |
| Other expenses | 471.9 | 479.6 | 494.8 | 523.2 | 543.3 | 586.5 | 612.6 | 642.6 | 664.0 |
| **TOTAL EXPENSES** | **1833.2** | **1889.3** | **1925.4** | **1986.8** | **2021.2** | **2119.6** | **2213.5** | **2292.2** | **2368.9** |
| ADD: Extraordinary credits/charges | 0 | 0 | 0 | 0 | 0 | 0 | 0.0 | 0.0 | 0.0 |
| Net profit before tax | 482.4 | 491.7 | 664.7 | 682.6 | 771 | 801.1 | 765.3 | 829.1 | 754.5 |
| LESS: Corporation tax | 123.6 | 112.5 | 179.5 | 195.8 | 214.8 | 245.4 | 224.1 | 242.8 | 268.8 |
| **NET PROFIT AFTER TAX** | **358.8** | **379.2** | **485.2** | **486.8** | **556.3** | **555.7** | **541.2** | **586.3** | **485.6** |

*Source: Bank of Uganda*