BANK OF UGANDA

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1.0. OVERVIEW OF MONETARY, FINANCIAL AND ECONOMIC DEVELOPMENTS

1.1. Monetary Policy and Developments

During the fiscal year 2001/02, monetary policy continued to aim at maintaining stability in prices, and the domestic money and foreign exchange markets. No major shocks were witnessed in the economy over the year. However, monetary policy management faced the challenge of mopping up the excess liquidity injection arising from increased government expenditures driven by poverty reduction donor inflows. This required an appropriate mix of policy instruments that minimized instability both in the domestic money and foreign exchange markets.

Monetary policy was conducted through variation of net issues of treasury bills, Repurchase Agreements (REPOs) and net sales of foreign currency in the Interbank Foreign Exchange Market (IFEM). In conducting monetary policy using the IFEM, the BOU distinguished its actions into intervention and sterilization objectives. In addition, adjustments in policy interest rates were used to indicate the desired monetary policy stance of the authorities. The reserve requirement remained at 9.0 percent on time and savings deposits, and 10.0 percent on demand deposits.

Base money grew by 18 percent to Shs 661.6 billion by the end of June 2002 on account of the increase in net foreign assets, which more than offset the fall in net domestic assets. Broad money (M3) increased by 21.6 percent to Shs 1925.4 billion. This growth was much faster than 17.6 percent realized in financial year 2000/01. Broad money M2 (that excludes foreign currency deposits) grew at 24.9 per cent, compared to 15.2 percent growth of the previous year. The stock of outstanding private sector credit rose by 1.8 percent, compared to 9.4 percent of financial year 2000/01. The slower growth in credit is largely explained by stronger recovery efforts, given that gross extension of credit grew significantly during the year.

Although there was a rapid rise in interest rates at the beginning of the year, interest rates on all maturities of Treasury bills had declined by the end of the year. The discount rate on the 91-day Treasury bill paper was 5.3 percent at the end of June 2002, compared to 6 percent at the of end-June 2001. Commercial bank interest rates had also declined by the end of the year, with the weighted average lending and deposit rates on shillings recorded at 17.6 percent and 2.2 percent compared to 21.7 percent and 3.2 percent, respectively, in June 2001.

1.2. Financial Sector Developments

Enhanced supervision and closure of insolvent financial institutions led to improved performance, restored public confidence and led to a significant improvement in the safety and soundness of the financial sector during the year. Among the key developments were the following: (i) Resolution of Uganda Commercial Bank Limited (UCBL) was finalised in February 2002. This is meant to strengthen the corporate governance of UCBL and introduce greater competition into the financial sector. (ii) The new Financial Institutions Bill, which seeks to rectify weaknesses in the current banking legislation, was gazetted as Bill No. 6 in May 2002, and awaits approval by parliament. (iii) Uganda underwent an IMF/World Bank supported Financial Sector Assessment Program. The objective of the program was to identify strengths, potential vulnerabilities, and risks in Uganda's financial system and to determine the role of the financial system in the development process. Uganda became the first African country to have a comprehensive financial sector assessment.

The strength and confidence built in the banking system led to improved performance of banks. This was evidenced by a number of developments: (i) The capital adequacy of the banking system (as measured by the proportion of total capital to risk weighted assets) improved to 24 percent in June 2002 from 23 percent in June 2001. (ii) Private sector deposits with commercial banks increased by 23.1 percent to Shs 1,518.2 billion. (iii) Total assets grew by 19 percent to Shs 2367 billion, and (iv) The quality of assets of banks improved substantially as commercial banks intensified recovery efforts, and as commercial courts were strengthened. The proportion of non-performing loans to total loans reduced to 4 percent in 2001/02 down from 8.2 percent in 2000/01. However, the need for accumulation of capital, the continued matching of gross extensions to recoveries, and the concentration of assets in less risky ventures constrained extending credit to the private sector.

1.3. Fiscal Developments

During the fiscal year 2001/02, the government financial position deteriorated, with the budget deficit excluding grants rising to 12.6 per cent of GDP from 11.2 per cent of GDP in 2000/01. Increases in expenditure were the main reasons for the worsening of public finances. However, due to continued strong support for Uganda's poverty reduction programmes, the larger budget deficit was financed by external inflows in form of grants and highly concessional loans.

1.4. External Sector Developments

The poor performance of commodity prices in the international market continued to impact on the external sector. However, an increase in private transfers and an improvement in the financial account, mitigated the negative effects arising from the continued fall in coffee receipts and an increase in outflows for payments for services and income, such that the overall balance of payments registered a surplus of US$ 25.1 million. Foreign exchange reserves increased by 17 percent to US$ 866.4 million by the end of 2001/02. This level of reserves was sufficient to cover 6.4 months of imports and non-factor services. Over the same period, the current account deficit (excluding grants) narrowed from 14.3 percent of GDP in 2000/01 to 13.2 percent of GDP, mainly due to an increase in private transfers.

The Government has largely followed its debt management strategy, which requires new borrowing to be highly concessional. The stock of external debt as at end-June 2002 was estimated at US$ 3,782.9 million. About 82 per cent of the external debt was owed to multilateral institutions, 9.8 percent to non-Paris Club bilateral creditors, and 3.0 per cent to Paris Club creditors. Actual debt service payments in 2001/02 declined owing to the HIPC debt relief. The ratio of debt service (maturities including IMF) to total exports of goods and non-factor services was recorded at 24.1 per cent in 2001/02 down from 26.6 per cent in 2000/01.

The exchange rate remained stable, marginally appreciating by 0.5 per cent compared with 6.5 percent depreciation in 2000/01. The appreciation in exchange rate was largely on account of increased donor inflows and relatively better performance of the non-coffee export sector. The BOU maintained its presence in the foreign exchange market in order to ensure its stability and to sterilise liquidity injections arising out of increased Government expenditure. Net sales through intervention and sterilisation amounted to US$ 196.9 million in 2001/02. However, the BOU distinguished its intervention and sterilization actions in the Inter-bank Foreign Exchange Market (IFEM), with effect from April 2 2002. If BOU intervenes in the IFEM, it only announces its presence in the market, but it does not announce the amounts offered for purchase or sale. On the other hand, if the BOU goes into the IFEM for sterilization purposes, it does not announce its presence. The average Nominal Effective Exchange Rate (NEER) appreciated by 2.3 percent while the Real Effective Exchange Rate (REER) depreciated by 0.4 percent during the review period. However, on an end-period basis, the NEER depreciated by 6.9 percent while the REER depreciated by 9.8 percent. The fast depreciation of the NEER and REER on the end year basis is attributed to a large appreciation of the Euro relative to the US$ dollar, between February 2002 and June 2002.

1.5. Real Sector Developments

Real GDP grew by 5.6 per cent per annum in 2001/02, a slightly lower growth when compared to 6.0 percent recorded in 2000/01. In 1999/00 there was a slack in GDP growth following a fall in world coffee prices and a rise in oil prices, which among others affected the expansion of productive sectors of the economy. But as a result of prudent macroeconomic management and strong performance in the non-coffee export sector, the economy generally recovered in the years that followed. Overall, monetary GDP in 2001/02 grew by 6.4 per cent while non-monetary GDP grew by 4.3 per cent. All sectors recorded growth rates of no less than 5.0 percent, with the transport and communications sector growing fastest at 10 per cent.

Inflationary pressures remained subdued for most of the period under review. This was due to prudent macroeconomic management and good weather conditions which facilitated food production. The annual headline inflation rate averaged - 2.0 per cent, much lower than 4.5 per cent recorded for the fiscal year 2000/01. Food crop prices dropped substantially, with the biggest fall in annual food crop inflation of -28.5 percent recorded in December 2001. The underlying inflation rate averaged 3.5 percent lower than 5 percent for the fiscal year 2000/01.

2.0. MONEY AND BANKING DEVELOPMENTS

2.1. Money and Banking

2.1.1. Base Money

Base money, defined as commercial bank deposits at Bank of Uganda plus currency issued plus commercial bank holdings of BOU securities, grew by 18.2 per cent over its June 2001 level. Excluding commercial bank holdings of BOU instruments, base money grew by 14.6 per cent from Shs 549.6 billion to Shs 630.0 billion. This compares to 24.2 percent registered in the preceding year. The growth in base money in 2001/02 was on account of the increase in net foreign assets, which more than offset the fall in net domestic assets. Table 1 depicts developments in base money over the period.

Table 1: Monetary Authority Balance Sheet (billion Shs at end of the period).

	1998 June	1999 June	2000 June	2001 June	2002 June
Net Foreign Assets	452.0	585.0	614.8	792.3	1090.6
Net Domestic Assets	-81.3	-195.3	-136.2	-270.5	-475.3
Claims on Government (net)	-249.1	-225.0	245.2	203.0	12.6
Claims on Private Sector	15.9	10.7	29.8	35.9	-[1]
Claims on Parastatals	27.5	28.0	4.0	4.3	4.0
Claims on Commercial Banks	7.9	57.6	44.9	37.8	46.3
Other Items (net)	140.3	1.6	-385.4	-477.7	-491.9
Base Money (including holding of BOU Instruments)	378.6	447.3	523.5	559.6	661.6
Base Money	373.1	432.5	442.4	549.6	630.0
Currency Outside BOU	269.8	317.2	335.5	386.7	447.9
Commercial Bank Reserves	103.3	115.3	106.9	162.9	182.1
Commercial Bank BOU Instruments	5.5	14.9	32.2	10.0	31.60
Changes (%)					
Net Foreign Assets	66.4	29.4	5.1	28.9	37.6
Net Domestic Assets	-52.3	140.1	-30.3	98.6	75.7
O/w Claims on Government (net)	-32.7	-9.6	-209.0	-17.2	-93.8
Claims on Private Sector	-1.2	-32.7	178.5	20.5	-
Claims on Commercial Banks	0.5	629	-22.0	-15.8	22.5
Base Money	12.5	15.9	2.3	24.2	14.6
Base Money (including holding of BOU Instruments)	14.1	18.1	17.0	6.9	18.2

Source: Bank of Uganda

[1] Reclassified in June 2002 to: Parastatals (barter and crop finance), Other Items; assets (other advances) and liabilities (non-government, non-bank deposits).

The reserves of commercial banks held at BOU, grew by 11.8 percent to Shs 182.1 billion by the end of June 2002; and commercial bank investments in BOU instruments rose from Shs 10.0 billion to Shs 31.6 billion between June 2001 and June 2002. The components of base money are discussed in the sections that follow.

2.1.2. Money Supply

Broad Money (M3), which includes Currency in Circulation (CIC) and private sector deposits including foreign exchange accounts, grew by 21.6 per cent or Shs 341.7 billion in 2001/02 compared to 17.6 percent growth recorded in 2000/01. In particular, foreign currency deposits grew by 11.4 percent, CIC grew by 16.3 percent, demand deposits grew by 27.9 per cent and time deposits grew by 30.5 percent. Broad Money (M2), which includes currency in circulation and bank deposits excluding foreign exchange, grew by 24.9 per cent over the same period. Table 2 shows the developments in money supply and the factors contributing to its growth over the review period.

2.1.3. Net Foreign Assets

The net foreign assets of the banking system increased by 28.2 percent or Shs 341.7 billion during 2001/02. The net foreign assets of BOU rose by 37.6 percent to Shs 1090.6 billion. A major part of the increase in foreign assets reflected donor support to the budget. At the level of commercial banks, net foreign assets grew by 10.4 percent to Shs 462.1 billion over the same period. Table 2 summarises the developments.

2.1.4. Net Domestic Assets

The net domestic assets of the banking system (excluding revaluation) increased by 13.6 percent to Shs 536.0 billion as at the end of June 2002, when compared to June 2001. The government position with the banking system at the end of June 2002 was a borrowing amounting to Shs 482.0 billion, an increase of 4.6 percent or Shs 21.3 billion over the borrowing at the end of June 2001. Claims on the private sector grew by 1.8 percent or Shs 11.4 billion between June 2001 and June 2002 (Table 2).

2.1.4. Money Supply

Broad Money (M3), which includes Currency in Circulation (CIC) and private sector deposits including foreign exchange accounts, grew by 21.6 per cent or Shs 341.7 billion in 2001/02 compared to 17.6 percent growth recorded in 2000/01. The components of M3 grew as follows: Foreign currency deposits grew by 11.4 percent, CIC grew by 16.3 percent, demand deposits grew by 27.9 per cent and time deposits grew by 30.5 percent. Broad Money (M2), which includes currency in circulation and bank deposits excluding foreign exchange, grew by 24.9 per cent over the same period. Table 2 shows the developments in money supply and the factors contributing to its growth over the review period.

2.1.5. Financial Depth

Financial indicators in 2001/02 depict a continued build up of confidence in the banking system following the disruption caused by the closure of banks during the period 1998-1999. Monetary GDP as a percentage of total GDP increased slightly to about 80 percent in 2001/02 from 79.5 in 2000/01. The ratio of Broad Money (M2) to GDP increased from 12.9 per cent to 15.3 per cent over the same period. The ratio of currency in circulation as a proportion of Broad Money (M2) was 27.3 per cent slightly down from 29.6 a year earlier, and currency in circulation as a proportion of GDP increased from 3.8 per cent to 4.2 per cent. As a ratio of M2, financial savings rose from 30.2 per cent in 2000/01 to 31.3 percent. These developments are summarised in Table 3.

Table 2: Monetary Survey: June 1998-June 2002 (billion Shs, at end of the period).

	2000 June	2001 June	2002 June	Change June 2001 – June 2002	
				Absolute	Percentage
Net Foreign Assets	**906.3**	**1,211.0**	**1552.6**	**341.6**	**28.2**
Bank of Uganda	614.8	792.3	1090.6	298.2	37.6
Commercial Banks	291.8	418.6	462.1	43.4	10.4
Net Domestic Assets	**1,012.0**	**1,106.8**	**1136.1**	**29.2**	**2.6**
O/w Claims on Government (net)	414.6	460.6	482.0	21.3	4.6
Claims on Private Sector	580.4	634.9	646.4	11.4	1.8
Other Items (net)	**-571.5**	**-734.1**	**-763.3**	**29.2**	**4.0**
NDA (net of revaluation)	**489.1**	**471.8**	**536.0**	**64.2**	**13.6**
Broad Money (M2)	**1,036.3**	**1,193.4**	**1490.6**	**297.1**	**24.9**
Currency in Circulation	306.7	350.2	407.2	57.0	16.3
Private Demand Deposits	413.1	482.9	617.5	134.6	27.9
Private Time & Savings Deposits	305.8	352.5	460.1	107.5	30.5
Certificates of Deposit	10.8	7.9	5.8	-2.0	-26.0
Broad Money (M3)	**1,347.2**	**1,583.7**	**1925.4**	**341.7**	**21.6**
Foreign Exchange Deposits	310.8	390.2	434.8	44.5	11.4

Source: Bank of Uganda

Table 3: Measures of Financial Depth and Developments of the Banking Sector.

	1997/98	1998/99	1999/00	2000/01	2001/02
GDP (billion Shs)	7,013.7	7,693.1	8,446.7	9,255.9	9739.4
Monetary GDP (billion Shs)	5,469.4	6,110.1	6,689.9	7,361.6	7785.3
Broad Money (M2, billion Shs)	873.1	952.7	1,036.3	1,193.4	1490.6
Financial Savings[2] (billion Shs)	465.9	360.4	316.6	308	308.6
Currency in Circulation (billion Shs)	239.5	284.7	306.7	350.2	407.2
Monetary GDP / Total GDP (%)	78.0	79.4	79.2	79.5	79.9
Broad Money (M2) / Total GDP (%)	12.4	12.4	12.3	12.9	15.3
Financial Savings/M2 (%)	35.4	32.3	30.6	30.2	31.3
Financial Savings/GDP (%)	6.6	4.7	3.7	3.3	3.2
Currency in Circulation/M2 (%)	27.4	29.9	29.6	29.3	27.3
Currency in Circulation/GDP (%)	3.4	3.7	3.6	3.8	4.2

Source: Bank of Uganda and Uganda Bureau of Statistics

[2] Financial savings are defined as: total time and saving deposits plus certificates of deposits.

2.2. The Treasury Bill Market and Interest Rates

The Treasury Bill (TB) was the main instrument of monetary policy used during the year. Treasury bills amounting to Shs 961.4 billion at face value were issued at a cost of Shs 886.33 billion. Net issues amounted to Shs 61.9 billion, reflecting a tightened monetary policy. The stock of treasury bills increased by 57.5 percent to Shs 928.5 billion at the end of June 2002. As in previous years, commercial banks accounted for the bulk of the stock of TBs held at 77.7 percent. Table 4 and Appendix 20 indicate the developments in the TB market.

Table 4: Developments in the Treasury Bill Market, 2000/01-2001/02.

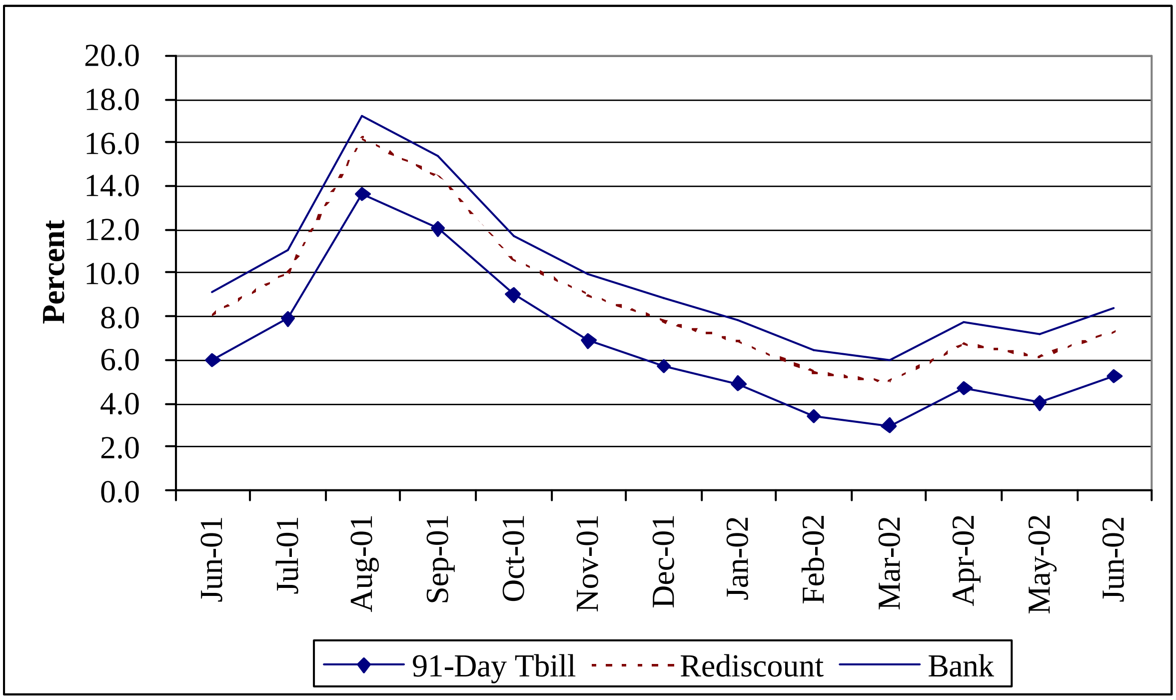
	2000/01 FY	2001/02 Q1	2001/02 Q2	2001/02 Q3	2001/02 Q4	2001/02 FY
Stock of Treasury Bills (bill. Shs)	**589.4**	**608.17**	**697.63**	**712.75**	**928.50**	**928.50**
91 Day Treasury Bill Factors						
Average Price	96.6	97.21	98.21	99.06	98.84	98.33
Annualised Discount Rate (%)	13.2	11.94	7.18	3.75	4.66	6.70
Annualised Discount Yield (%)	14.3	12.31	7.32	3.79	4.71	6.81
Reference Rate (%)	14.8	11.08	7.89	3.76	4.74	4.71
Rediscount Rate (%)	18.4	13.55	9.15	5.76	6.91	6.91
Net Issues	**30.8**	**(26.29)**	**38.40**	**(9.62)**	**59.42**	**61.90**
Total Issues	**893.0**	**230.99**	**252.62**	**223.91**	**253.91**	**961.44**
91 Days	211.3	33.50	30.99	30.98	31.97	127.44
182 Days	185.8	43.50	44.00	42.98	44.98	175.46
273 Days	220.3	62.00	56.65	58.97	67.98	245.59
364 Days	275.6	92.00	120.99	90.98	108.98	412.95
Total Receipts	**786.3**	**203.29**	**231.71**	**212.84**	**238.50**	**886.33**
91 Days	205.4	32.52	30.45	30.71	31.62	125.29
182 Days	168.1	40.31	42.06	41.86	43.61	167.85
273 Days	188.2	54.20	52.16	55.95	63.91	226.23
364 Days	225.4	76.26	107.04	84.33	99.36	366.97
Total maturities	**225.4**	**257.29**	**214.22**	**233.53**	**194.49**	**899.54**

Source: Bank of Uganda

2.2.1. Treasury Bill Rates and Policy Rates

Towards the end of the FY 2001/02, there was a change in the mix of instruments of monetary policy, with a bias towards sales of foreign exchange and the use of Repurchase Agreements (REPOs). Consequently, the annualised yield on the 91-day TB fell from 6.0 per cent in June 2001 to 5.3 per cent in June 2002. The annualised yield on the 182-day TB fell from 9.2 percent to 6.7 percent, the yield on the 273 day TB fell from 10.3 percent to 8.7 per cent and the yield on the 364 day TB fell from 10.5 percent to 10.0 per cent, over the same period. The policy rates followed a similar trend to that of the 91-day TB rate. The rediscount rate and bank rate fell from 8.1 percent and 9.1 per cent to 7.3 percent and 8.3 percent, respectively. Chart 1 and Appendix 28 trace the developments in policy rates.

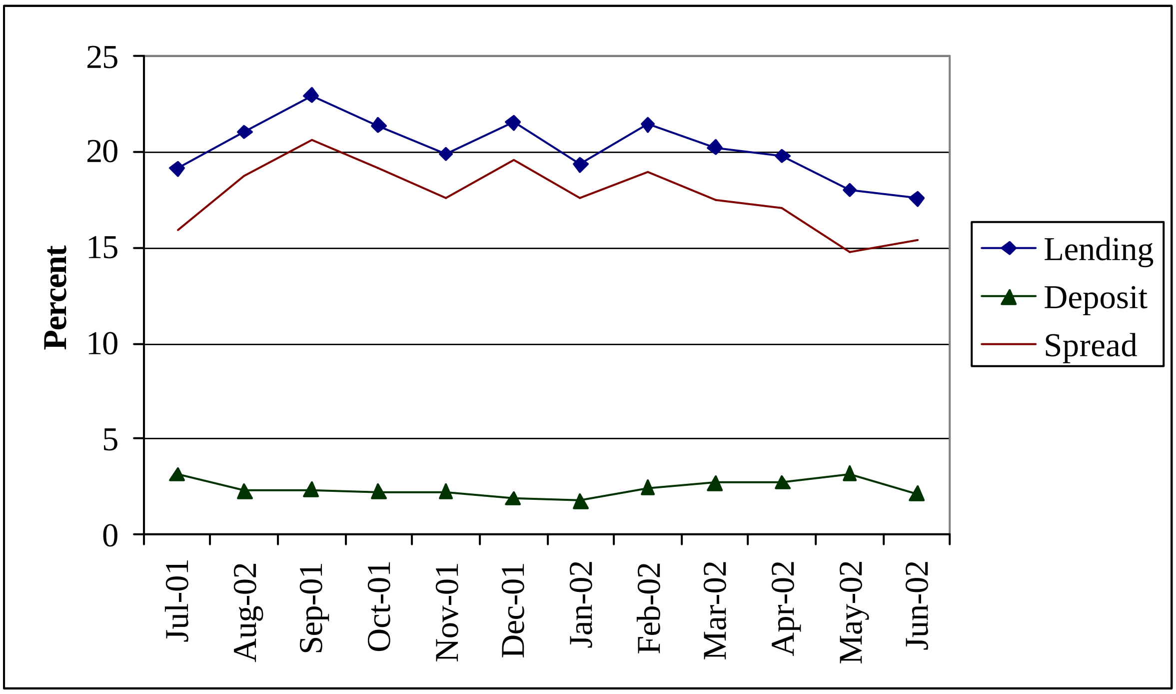
Chart 1: Developments in Policy Interest Rates, 2001/02.



2.2.2. Commercial Bank Rates

Commercial bank rates also followed a similar trend to that of the TB rates. The weighted average rate for the shilling deposits fell from 3.2 percent in June 2001 to 2.2 percent in June 2002. The weighted average rate for shilling denominated loans fell from 21.7 per cent to 17.6 per cent. The average deposit rate for foreign currency deposits remained constant at 1.9 per cent over the period, and the lending rate for foreign currency denominated loans fell from 14.7 per cent to 12.4 percent. The spread between the average lending and deposit rates (in the shilling market) declined from 18.6 percent to 15.4 percent. Chart 2 and Appendix 29 trace the developments in commercial bank rates and the spread between them.

Chart 2: Commercial Bank Interest Rates and Spread, 2001/02.



2.2.3. The Interbank Market

Over the review period, there was increased activity in the inter bank shilling market. The total volumes traded in the market increased by 8 percent from Shs 290.4 billion in 2000/01 to Shs 313.6 billion in 2001/02. Further more, due to increased competition in the banking industry, prime lending rates in commercial banks declined during the year. Out of the 17 banks, 7 were charging prime lending rates of less than 14 percent at the end of June 2002.

3.0. FINANCIAL SECTOR POLICIES AND DEVELOPMENTS

3.1. The Financial System

The closure of insolvent financial institutions in 1998/99 and enhanced supervision of the surviving institutions led to an improvement in the performance, the safety and soundness of the financial sector during the year. This has in addition restored public confidence in the financial sector in the subsequent years. An important development towards sustained reform was the completion of the resolution of the Uganda Commercial Bank Limited (UCBL), in February 2002. This constituted the sale of 80 percent shares of UCBL to Stanbic (U) Ltd, with an agreement that on completion of the merger process of the two banks, 20 percent of shares in the new bank will be floated for public purchase on the Uganda Securities Exchange (USE). The privatisation of UCBL is meant to strengthen its corporate governance and introduce greater competition into the financial sector. This is expected to lead to greater mobilisation of deposits and extension of credit.

Furthermore, the new Financial Institutions Bill, which awaits approval by the parliament, is a critical development for the financial system. The new Bill, which will be enacted in 2002/03, is an update of Uganda's financial institution legislation to international best practices as set out in the Basle Core Principles for Effective Supervision. The Bill seeks to maintain a regulatory and supervisory environment that encourages innovation and efficient competition in financial services and does not require excessive risk-taking by financial institutions in order to generate competitive returns.

The strength and confidence built in the banking system was evidenced by improved performance of banks. The capital adequacy of the banking system (as measured by the proportion of total capital to risk weighted assets) improved to 24 percent in June 2002 from 23 percent in June 2001. Total assets grew by 19 percent to Shs 2367 billion, and the quality of assets of banks (as measured by the proportion of non-performing loans to total loans) improved to 4 percent from 8.2 percent, over the same period. However, both the need for accumulation of capital, the continued matching of gross extensions to recoveries, and the concentration of assets in less risky ventures like Treasury bills constrained extending credit to the private sector. During the year 2001/02, the stock of credit grew by only 1.8 percent compared to 9.4 percent in 2000/01. The shift in portfolio behaviour meant that banks remained liquid, with an overall liquid-asset ratio of 66 percent by the end of June 2002, compared to 63 percent at the end of June 2001.

Lease financing, which is another form of financing private sector investment, increased during the period under review. The total volume of leasing activity for the banking system rose to Shs 15.8 billion over the year 2001/02 from Shs 5.6 billion during 2000/01. Other innovations in the financial system included extension of the Automatic Teller Machine (ATM) network to cover a wider geographical part of the country. In addition, micro finance institutions totaling to over 500 in number continued to grow across the country. These extend credit and other financial services to micro and small enterprises. A draft law to regulate and supervise these entities has been prepared and is due for enactment in 2002/03.

3.2. Commercial Bank Activities

3.2.1. Assets

The total assets of commercial banks increased by 21 percent to Shs 1818 .4 billion at the end of June 2002 from Shs 1495.9 billion recorded in June 2001. Specifically, there was growth in the net foreign assets of commercial banks of 10.4 percent to Shs 462.1 billion during the financial year. Domestic assets increased by 25.9 percent to Shs 1356.3 billion. Outstanding claims on the private sector went up by a modest 1.8 percent from Shs 634.9 billion to Shs 646.4 billion, while net claims on the Bank of Uganda increased by Shs 51.7 billion to Shs 199.8 billion at the close of the financial year. Cash in vaults increased by Shs 4.1 billion to Shs 40.7 billion while net claims on Government rose by 82.2 per cent to Shs 469.4 billion. This mainly reflected increased Treasury bill holdings by commercial banks. Other Items Net (OIN) was recorded at Shs –303.9 billion as at end June 2002, down from Shs –269.4 billion recorded as at end June 2001. Table 5 below summarises the developments in commercial bank assets during the review period.

Table 5: Commercial Bank Assets (billion Shs, at end of the period).

	2001 June	2002 June	Absolute Change June 2001-June 2002	Percentage Change June 2001–June 2002
Foreign Assets	**418.6**	**462.1**	**43.4**	**10.4**
Domestic Assets	**1077.3**	**1356.3**	**279.0**	**25.9**
Claims on Private Sector	634.9	646.4	11.4	1.8
Claims on Government (net)	257.7	469.4	211.7	82.2
Claims on Bank of Uganda (net)	148.1	199.8	51.7	34.9
Cash in Vaults	36.6	40.7	4.1	11.2
Other Items (net)	-269.4	-303.9	-34.4	12.8

Source: Bank of Uganda

3.2.2. Liabilities

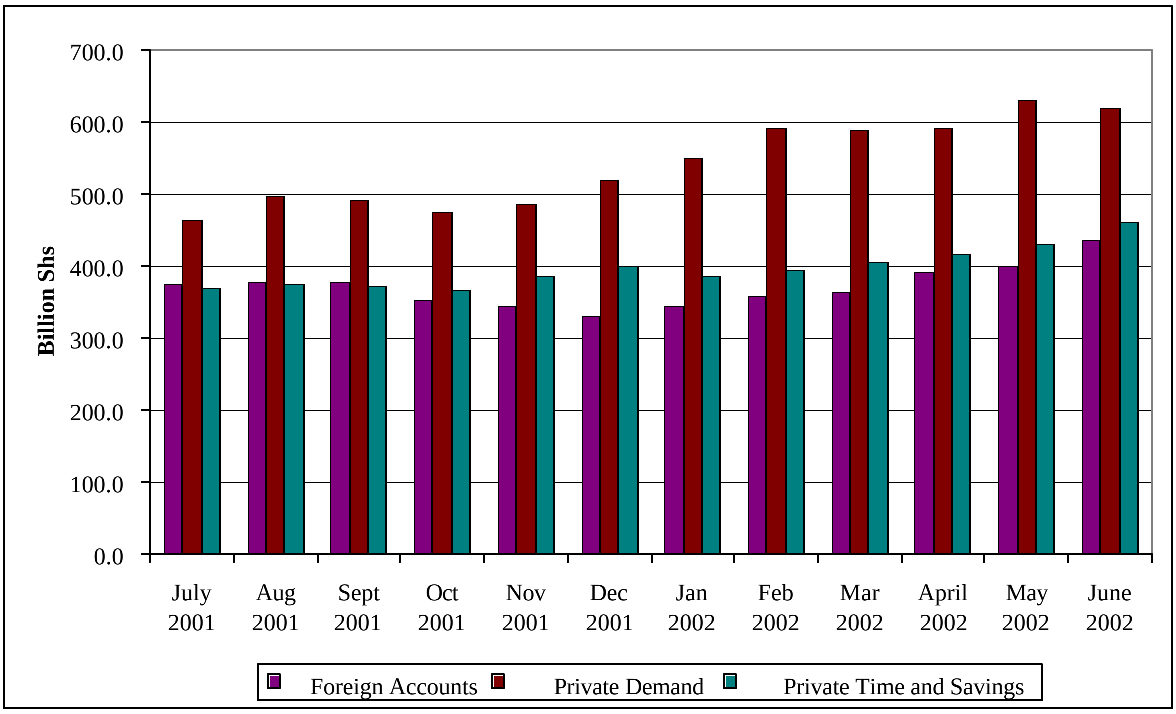
During the year, private deposits with commercial banks went up by 23.1 percent to Shs 1,518.2 billion. This growth was slightly lower than the previous year's rate of 25.6 per cent. Time and Savings deposits increased by 30.5 percent to Shs 460.1 billion reflecting in part the continued restoration of confidence in the financial sector. Private demand deposits increased by 27.9 percent to Shs 617.5 billion, during the review period, compared to a 16.9 percent increase during the previous year. Foreign exchange deposits increased by 11.4 percent to Shs 434.2 billion, compared to an increase of 25.6 percent last year. Table 6 and Chart 3 indicate the movements in commercial bank deposits.

Table 6: Non- Bank Deposits with Commercial Banks (billion Shs, at end of the period).

	June 2001	June 2002	Absolute change June 2001-June2002	Percentage change June 2001-June 2002
Foreign Exchange Deposits	390.2	434.2	44.0	11.3
Demand Deposits	482.9	617.5	134.6	27.9
Time & Savings Deposits	352.5	460.1	107.6	30.5
Certificates of Deposit	7.9	5.8	-2.1	-26.6
Total Deposit Liabilities	**1,233.5**	**1,518.3**	**284.1**	**23.1**

Source: Bank of Uganda

Chart 3: The Evolution of Deposits of Commercial Banks (July 2001-June 2002).



3.2.3. Outstanding Loans and Advances to the Private Sector

Table 7 indicates outstanding loans and advances to the private sector categorised by economic sector. It shows that the stock of credit increased by a modest 1.8 percent from Shs 634.9 billion in June 2001 to Shs 646.4 billion in June 2002.

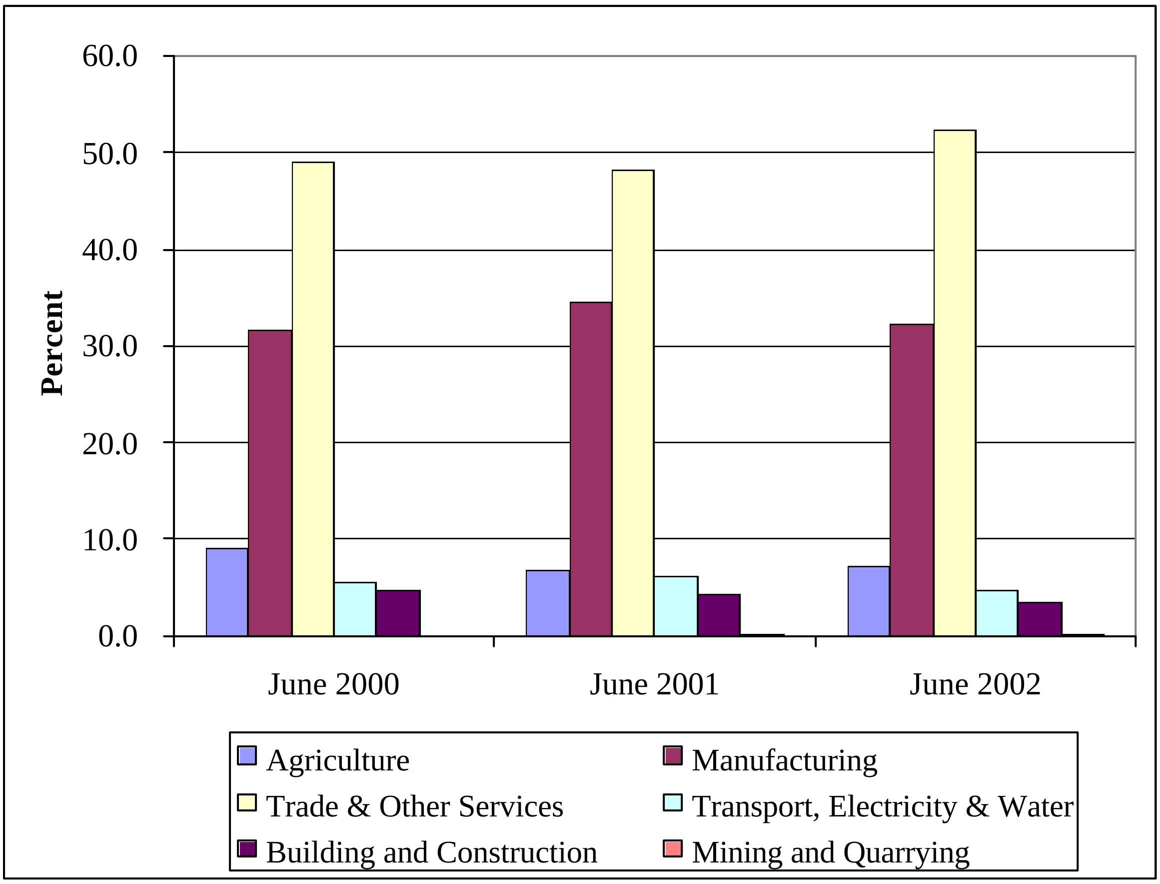
Table 7: Outstanding Loans and Advances to the Private Sector (billion Shs, at end of the period).

SECTOR	June 2001	June 2002	Absolute Change June 2001-June 2002	Percentage Change, June 2001-June 2002
Agriculture	54.7	71.4	16.7	30.5
Manufacturing	223.4	170.3	-53.1	-23.8
Trade and other services	297.4	351.6	54.2	18.2
Transport, Electricity & Water	35.1	29.5	-5.6	-16.0
Building & Construction	26.3	22.8	-3.5	-13.3
Mining and Quarrying	2.5	3.29	0.79	31.6
Total	**634.9**	**646.4**	**11.4**	**1.8**

Source: Bank of Uganda

The evolution of outstanding credit was not uniform across sectors during the year. In particular, increases were recorded in three sectors; agriculture (30.5 percent), trade and other services (18.2 percent) and mining (31.6 percent). However, decreases in outstanding credit were recorded in manufacturing (23.8 percent), transport, electricity and water (16 percent) and building and construction (13.3 percent). The services sector continued to account for the largest share of credit from banks at 54.4 percent by the end of the review period. Chart 4 shows the percentage distribution of loans to the private sector.

Chart 4: The Distribution of Loans and Advances to the Private Sector (percent).



3.3. Non-Bank Financial Institutions (NBFIs)

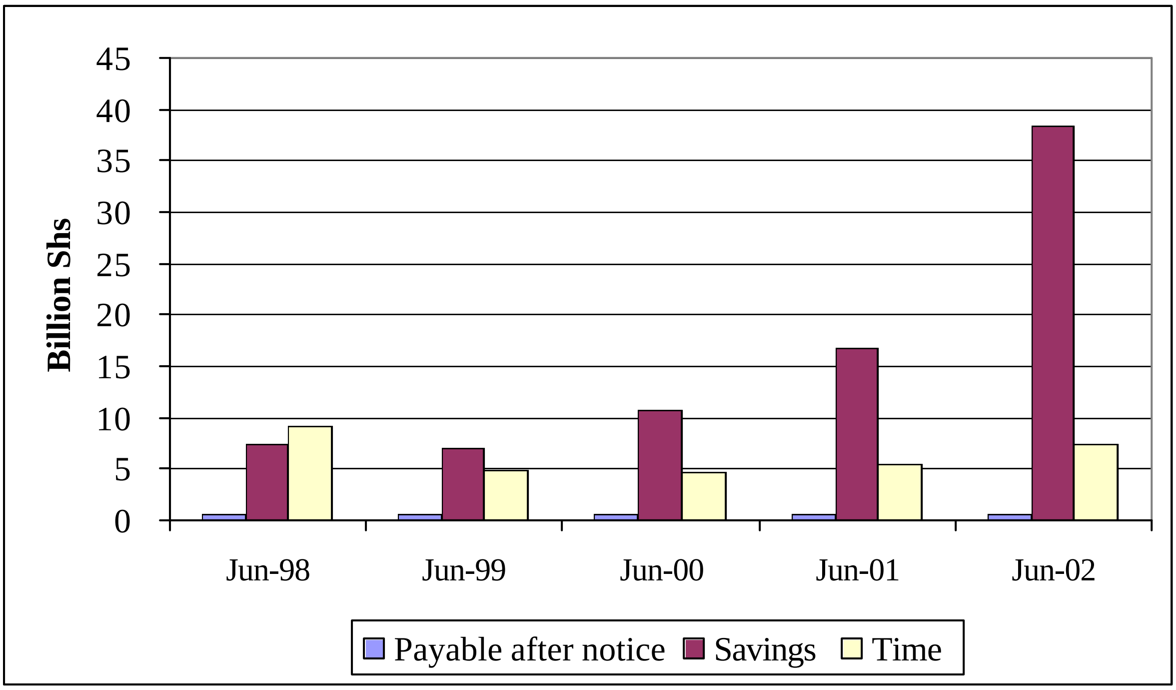
3.3.1. Assets

The financial year 2001/02 witnessed continued growth in the activities of Non-Bank Financial Institutions. This is reflected by a 43 per cent growth in total assets from Shs 80.9 billion in 2000/01 to Shs 115.6 billion. This growth was higher than the 21.8 per cent in 2000/01. The growth in 2001/02 was mainly due to entry of a new financial institution in the market and the restored confidence in the financial system.

3.3.2. Liabilities

During the financial year 2001/02 total deposits of the credit institutions increased by 70.1 per cent to Shs 64.5 billion. Total private sector deposits grew by 105.3 per cent to Shs 46.4 billion, compared to 41.8 per cent growth during the preceding year. Private time deposits rose by 39.1 per cent to Shs 7.50 billion while savings deposits increased by 129.7 per cent to Shs 38.30 billion. These increases were far higher than growths of 14.1 percent and 56.2 per cent in time and savings deposits, respectively, in the previous financial year. Chart 5 shows the developments in the deposits of NBFIs.

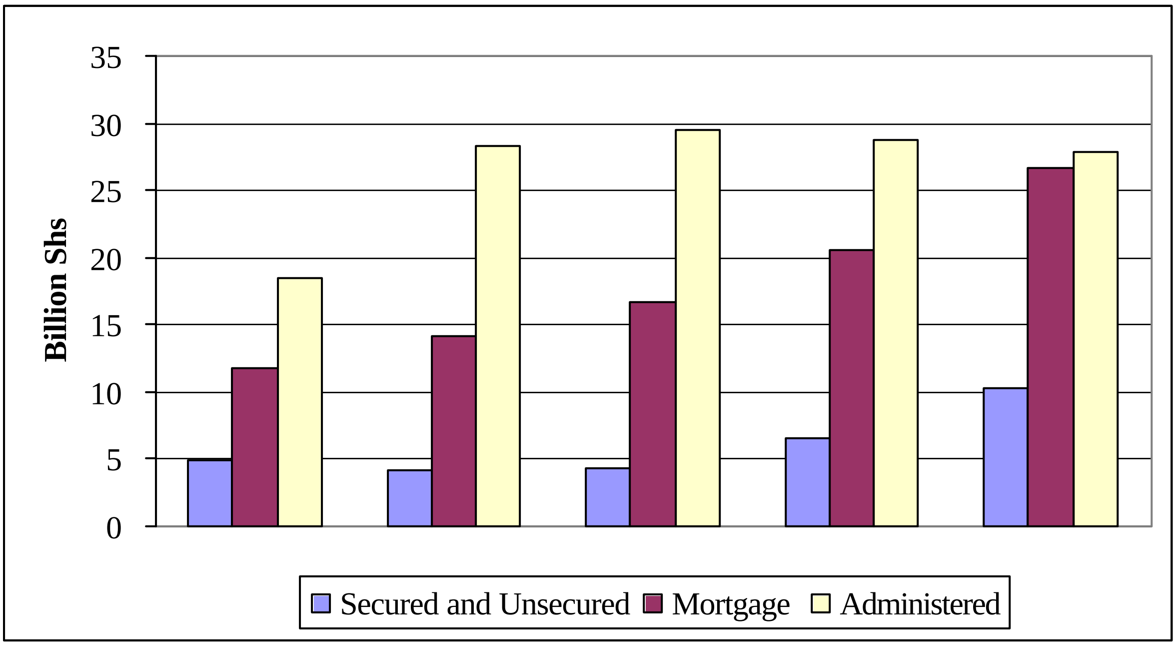
Chart 5: Private Sector Deposits of Non-Bank Financial Institutions.



3.3.3. Loans and Advances to the Private Sector

In the financial year 2001/02, the stock of outstanding loans and advances increased by 16 per cent to Shs 64.7 billion. The increase was mainly bolstered by growth in secured and unsecured loans and mortgage loans (Chart 6). The building and construction sector continued to claim the biggest share of credit from the NBFIs at 84.4 percent.

Chart 6: Outstanding Loans and Advances of Non- Bank Financial Institutions.



3.3.4. Liquidity

During 2001/02, the liquidity position of NBFIs improved by 89.7 percent to Shs 33.2 billion of liquid assets (Table 8). The balances of NBFIs at commercial banks grew by 14.3 per cent to Shs 16.5 billion. Investments in other stocks and shares rose tremendously from Shs 0.1 billion at the end of June 2001 to Shs 7.2 billion, and holdings of Government securities more than tripled, from Shs 1.9 billion to Shs 7.7 billion.

Table 8: The Liquidity of Non-Bank Financial Institutions (billion Shs).

	June 1998	June 1999	June 2000	June 2001	June 2002
Cash in Vaults	0.09	0.25	0.41	1.07	1.84
Treasury Bills	1.13	1.42	2.82	1.88	7.66
Balance with Commercial Banks	9.06	5.49	7.31	14.46	16.53
Investments, other Stocks & Shares	0.86	0.04	0.04	0.07	7.19
Total	**11.15**	**7.20**	**10.58**	**17.47**	**33.23**

Source: Bank of Uganda

4.0. FISCAL OPERATIONS

4.1. Overview

During the fiscal year 2001/02, the government financial position deteriorated, with the budget deficit excluding grants rising to 12.6 per cent of GDP from 11.2 per cent of GDP in 2000/01. The deterioration in the government position was mainly on account of increased expenditure on poverty reduction programs. Table 9 and Appendix 18 indicate the developments in Government fiscal operations.

4.2. Revenue Performance

Central government revenue (including grants) increased by about 8.8 per cent to Shs 2,048.7 billion in 2001/02 from Shs 1,882.4 billion in 2000/01. This growth is lower than 22.3 per cent recorded in 2000/01. As a share of GDP, government revenue remained at about 21 percent as it was in 2000/01.

Excluding grants, government revenue increased by 15.5 percent to Shs 1,251.0 billion up from Shs 1,083.5 billion recorded in 2000/01 when government revenue grew by 7.4 percent. In terms of GDP, the revenue collection amounted to 12.8 percent compared to 11.8 percent in 2000/01. The higher growth in domestic government revenue is explained by inclusion of non-tax revenue collected by government departments in the revenue estimates for 2001/02. This was not the case in 2000/01 when government departments could retain their non-tax revenue and use it to finance their expenditures.

Income tax revenue which contributes about 22.4 per cent of the total revenue, performed much better compared to last financial year. This was mainly due to significant increases in wages of civil servants and the elastic nature of this tax. However, fuel duty, which accounts for about 20 per cent of the total revenue declined. This was attributed to the tax rate on fuel being specific and constant for the last four years, and unadjusted for inflation.

Taxes on imports also fell short of their target mainly due to an unforeseen appreciation of the shilling against the US dollar during the first half of the year. The reversal of tax policies announced at the commencement of the fiscal year leading to exemption of hotels from paying VAT on accommodation, and the waiver of the 10% import duty on selected raw materials also contributed to a shortfall in other revenues.

Receipts from grants amounted to Shs 797.7 billion or 8.2 percent of GDP in 2001/02. This was slightly lower than Shs 798.9 billion or 8.7 percent of GDP received in 2000/01, as a result of delayed disbursements by some donors. The rest of non-tax revenues increased from Shs 16.4 billion or 0.2% of GDP to Shs 41.4 billion or 0.4 of GDP over the same period. The increase was mainly attributed to inclusion of passport fees, which are now collected by URA, as well as the payment of dividends from BOU.

4.3. Government Expenditure

Government expenditure and net lending increased to 25.4 percent of GDP in 2001/02 from 23 percent of GDP realised in 2000/01. The increase was mainly explained by an increase in expenditure on domestic development (81 percent), wages and salaries (25.8 percent) and other recurrent (27.8 percent). However, development expenditure was lower than programmed since non-priority program areas experienced budget cuts due to revenue shortages and supplementary expenditures in some votes mainly public administration.

Table 9: Uganda - Fiscal Operations, 2000/01 – 2001/02 (billion Shs).

	2000/01 Outturn	2001/02 Estimates	2001/02 Prov.Outturn
Revenue and Grants	**1,882.4**	**2,179.6**	**2,048.7**
Revenue	1,083.5	1,299.7	1,251.0
Grants	798.9	879.9	797.7
Total Expenditure	**2,110.9**	**2,585.6**	**2,474.9**
Recurrent Expenditure	**1,139.1**	**1,413.3**	**1,436.1**
Wages and Salaries	434.1	548.9	546.3
Interest	126.0	155.3	150.8
Other Recurrent	578.3	709.0	739.0
Development Expenditure	**998.0**	**1146.0**	**1,043.5**
Domestic	334.5	494.3	605.5
External	663.4	651.7	438.0
Net Lending and Investment	-26.1	33.7	-4.7
Overall Deficit/Surplus	**-228.5**	**-405.9**	**-426.2**
Excl. Grants	**-1,027.5**	**-1285.9**	**-1223.9**
Financing	**228.5**	**405.9**	**426.2**
Foreign (net)	324.5	826.8	503.7
Domestic (net)	-95.9	-420.9	-77.4
Banking System	-46.4	-294.2	34.4
Non Bank	-142.6	126.7	-111.8
GDP at Factor Cost (current prices)	**9,157.0**	**10472.0**	**9,739.0**
Memorandum Items (% of GDP)			
Total Revenue	21.2	20.8	21.0
Domestic Revenue	11.8	12.4	12.8
Grants	8.7	8.4	8.2
Expenditure	23.1	24.7	25.4
Recurrent	12.4	13.5	14.7
Development	10.9	10.9	10.7
Overall Deficit	-2.5	-3.9	-4.4
Overall Deficit (excluding grants)	-11.2	-12.3	-12.6

Source: Ministry of Finance, Planning and Economic Development.

4.4.The Budget Deficit and its Financing

The budget deficit excluding grants rose from 11.2 per cent of GDP in 2000/01 to 12.6 percent of GDP in 2001/02. Including grants, the deficit widened from 2.5 per cent of GDP in 2000/01 to 4.4 percent of GDP in 2001/02. The deficit was mainly financed by external financing equivalent to Shs 503.7 billion or 5.1 per cent of GDP. Consistent with the national debt strategy, the external borrowing was contracted on highly concessional terms. The government also borrowed Shs 34.4 or 0.4 percent of GDP from the banking system although it made a net repayment of Shs 111.8 billion to the non-bank public.

5.0. The External Sector

5.1. Balance of Payments

The overall balance of payments registered a surplus of US$ 25.1 million (see Table 10 and Appendix 8). The surplus was largely explained by an increase in private transfers and an improvement in the financial account during the year. The current account deficit (excluding official grants), narrowed from US$ 806.0 million or 14.3 per cent of GDP in 2000/01 to US$ 796.5 million or 13.2 per cent of GDP in 2001/02. This development was mainly influenced by the large increase in private transfers. The deficit in the trade balance increased to US$ 607.5 million from US$ 513.5 million during the previous year. This was largely as a result of a large increase in the value of imports.

5.1.1. Merchandise Exports

Total exports of goods increased by 3.8 percent to US$ 475.5 million, from US 458.3 million in 2000/01. As a ratio of GDP, exports were about 8 per cent of GDP in the current and preceding years. The increase in exports was mainly attributed to improved performance of the non-coffee sector. The value of non-coffee exports increased by 19 per cent to US 384.8 million, largely on account of an increase in volumes and in some cases an increase in the price of some products. In particular, the value of fish export receipts rose by 61.3 percent to US$ 107.5 million, due to an increase in volumes and prices. There was also an increase in the value of exports of maize (113.0 per cent), cotton (27.9 percent), tobacco (16.7 percent), and flowers (20.3 percent) although there was a fall in their unit prices.

There was however, a fall in the value of electricity exports by 16.4 percent to US$ 13.9 million due to reduced volumes. Gold export earnings fell by 3.1 percent to US$ 56.7 million. Although tea export volumes continued to increase, its value reduced by 25.3 percent to US$ 26.9 million due to a fall in its unit price. Similarly export receipts from hides and skins and cobalt dropped by 13.4 percent and 14.4 percent to US$ 19.7 million and US$ 11 million, respectively, due to a fall in their unit prices.

Coffee exports receipts declined by 22.2 percent to US$85.3 million. The realized unit price of coffee from the world market fell from US$ 0.64 per Kg in 2000/01 to US$ 0.45 per Kg in 2001/02 although volumes rose by 11.1 percent to 3.16 million 60-kg bags. Appendix 9 indicates the developments in exports.

5.1.2. Merchandise Imports

During 2001/02, total imports rose by 11.5 percent to US$ 1083.0 million from US$ 971.8 million in 2000/01. The value of oil imports dropped by 8.4 percent to US$ 124.7 million, partly due to lower international oil prices that prevailed during the year. The importation of non-oil products by the private sector, however, went up by 11.5 per cent to US$ 670.9, reflecting increased economic activity.

5.1.3. Services and Income Accounts

Payments for services abroad were higher than earnings by US$ 329.0 million during the review period, implying that Uganda remained essentially a net importer of non-factor services. Income outflows were also higher than inflows by US $ 180.6 million. Consequently, total outflows of services and income exceeded inflows by US $509.6 million.

5.1.4. Current Transfers

Net current transfers amounted to US$ 695.9 million, an increase of 33.1 percent from US$ 523.0 million recorded in the previous period. Private unrequited transfers continued to constitute a substantial component of foreign exchange inflows into Uganda's economy. These transfers more than tripled their 2000/01 level of US$ 102.2 million, when they increased to US$ 320.6 million in 2001/02. However, official transfers that include BOP support and project aid decreased by 10.8 percent to US$ 375.3 million in 2001/02 from US$ 420.82 million in 2000/01.

5.1.5. The Capital and Financial Account

The capital and financial account recorded a surplus of US$ 446.3 million in 2001/02 up from a surplus of US$ 326.6 million in 2000/01. This improvement is mainly explained by an increase in medium and long-term inflows.

5.1.6. International Reserves

The level of foreign exchange reserves held by BOU increased from US$ 738.7 million in 2000/01 to US$ 866.4 million in 2001/02. The increase was in part due to the increased disbursement of donor funds. In terms of months of coverage of imports of goods and non-factor services, the reserves increased to 6.4 from 6.1.

Table 10: Balance of Payments, 1999/00 - 2001/02 (million US $).

	99/2000	2000/01	2001/02
A. Current Account Balance	**-403.0**	**-385.2**	**-421.2**
Trade Balance	**-519.8**	**-513.5**	**-607.5**
Total Exports (f.o.b)	459.9	458.3	475.5
Total Imports (f.o.b)	-979.7	-971.8	-1083.0
Services and Income (net)	**-355.8**	**-394.7**	**-509.6**
Services Account	-231.5	-259.7	-329.0
Income Account	-124.2	-135.0	-180.6
Current Transfers (net)	**472.5**	**523.0**	**695.9**
General Government	366.8	420.8	375.3
Private transfers	105.7	102.2	320.6
B. Capital and Financial Account	**299.6**	**326.6**	**446.3**
Capital Account	**0.0**	**0.0**	**0.0**
Financial Account (excluding financing items)	**299.6**	**326.6**	**446.3**
o/w Direct Investment	168.7	143.8	161.5
Other liabilities/investments			
o/w Medium and Long-term loans	109.8	203.4	315.7
Short-term (net)	21.1	-20.5	-30.9
C. Overall Balance	**-103.4**	**-58.6**	**25.1**
D. Financing Items	**103.4**	**58.6**	**-25.1**
Use of IMF Credit (net)	-15.5	-20.9	-32.9
Change In Gross Reserves	40.6	-33.3	-104.8
Exceptional Financing	77.9	109.7	109.2
Errors and Omissions	0.5	3.0	3.5
Memorandum Items:	**99/2000**	**2000/1**	**2001/2**
Average exchange rate (Shs per US$)	1512.8	1762.9	1754.6
Total Goods and Non-Factor Service exports	663.2	676.4	699.3
Nominal GDP at Factor cost (Billion Shs)	8849.0	9962.0	10611.0
GDP at Factor cost (US $ Million)	5849.5	5650.9	6047.7
Current Account Balance (Excluding Grants)	-769.8	-806.0	-796.5
Current Account Balance as a percentage of GDP	-6.9	-6.8	-7.0
Current Account Balance (Excl. Grants) as a %age of GDP	-13.2	-14.3	-13.2
BOP overall balance as a percentage of GDP	-1.8	-1.0	0.4

Source: Bank of Uganda

5.2. External Debt

5.2.1. External Debt Management

The Government has largely followed its debt management strategy, which requires new borrowing to be highly concessional. A minimum of about 80 percent of new borrowing should be on IDA terms or better (40-year maturity, 10-year grace period and 0.75 interest rate). The remaining new borrowing should also be on highly concessional terms (23-year maturity, 6-year grace period and 2 percent interest rate). Efforts to obtain relief from non-Paris Club bilateral creditors on terms comparable with those provided by the Paris Club members are on going.

5.2.3. External Debt Profile

Uganda's stock of outstanding and disbursed external debt is estimated at US$ 3782.9 million at the end of June 2002. This is an increase of approximately US$ 387.7 million in nominal stock from US$ 3395.2 million at the end of June 2001. As a ratio of GDP, the debt stock was 68 percent at the end of June 2002, compared to 65 percent in June 2001. About 82 per cent of the external debt was owed to multilateral institutions, 9.8 percent to non-Paris Club bilateral creditors, and 3.0 per cent to Paris Club creditors. The developments regarding Uganda's debt profile from June 1998 through to June 2002 are shown in Table 11 below. Chart 7 shows the share of the total debt outstanding and disbursed by creditor.

Table 11: Uganda – Outstanding Public Debt by Creditors, 1998 – 2002 (US$ million, at the end of the period)

Creditor Category	1998	1999	2000	2001	2002
	June	June	June	June	June
Multilateral	2826.8	2782.6	2930.60	2892.9	3102.7
Non-Paris Club Bilateral	423.6	361.7	345.30	341.3	371.7
Paris Club Bilateral	324.4	288.2	259.10	122.9	115.0
Commercial	33.4	40.7	27.70	18.0	34.6
Other Loan Category	22.6	26.3	26.20	20.1	158.9
Grand Total	**3631.0**	**3499.5**	**3588.9**	**3395.2**	**3782.9**
Memorandum Items					
GDP at Factor Cost	6179.5	5790.8	5583.8	5250.4	5549.5
Exchange Rate (Shs/USD)	1149.7	1362.0	1512.8	1762.9	1754.9
Debt Service	173.7	176.4	176.8	167.2	153.8
Debt Service/XGNFs (%)	27.4	24.2	27.2	26.6	24.1
Debt Service/GDP (%)	1.4	1.1	1.2	0.7	0.6
Debt Stock/GDP (%)	58.8	60.4	64.3	64.7	68.2

Notes:

i) XGNFs implies Exports of Goods and Non-factor Services.

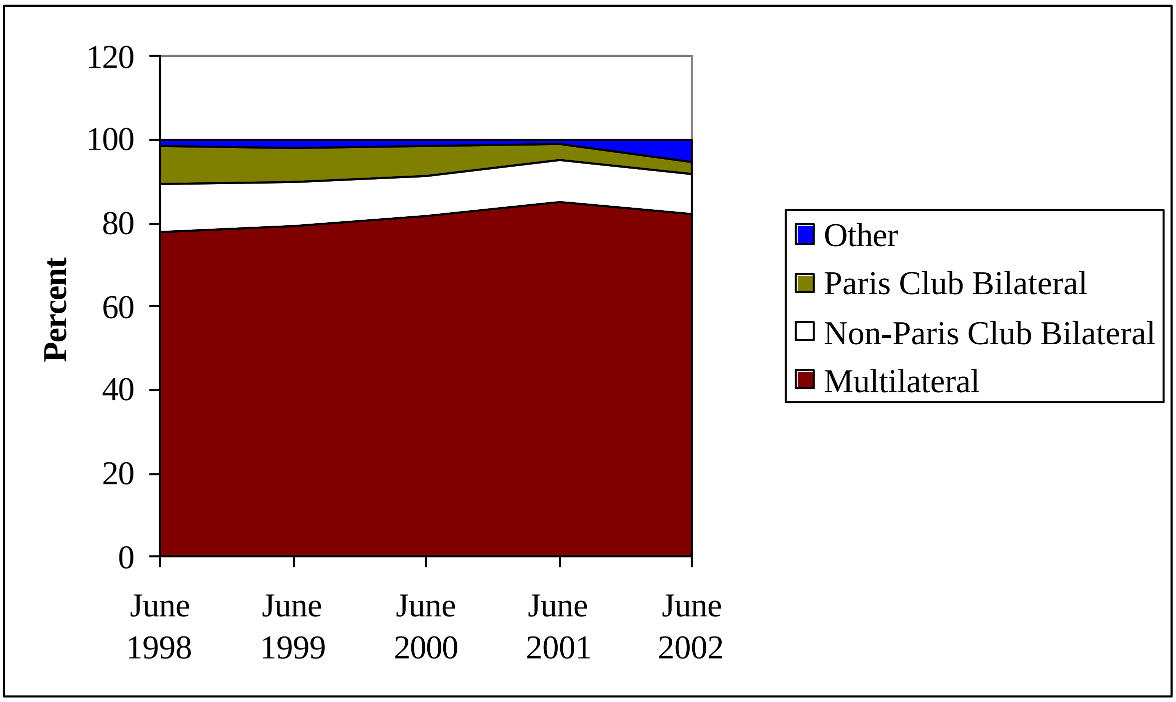
ii) Figures for June 2002 are estimates.

Source: Bank of Uganda and Ministry of Finance, Planning and Economic Development.

5.2.4. Debt Service

Total debt service declined to US$ 153.8 million in 2001/02 from US$ 167.2 million in 2000/01. Actual debt service payments in 2001/02 declined substantially owing to the HIPC debt relief of US$ 71.91 million. The ratio of debt service (maturities including IMF) to total exports of goods and non-factor services was recorded at 24.1 per cent in 2001/02 down from 26.6 per cent in 2000/01 (Table 11).

Chart 7: Uganda - Share of Outstanding Public Debt by Creditor, 1998 - 2002.



***Note*:** Other consists of commercial and other loans.

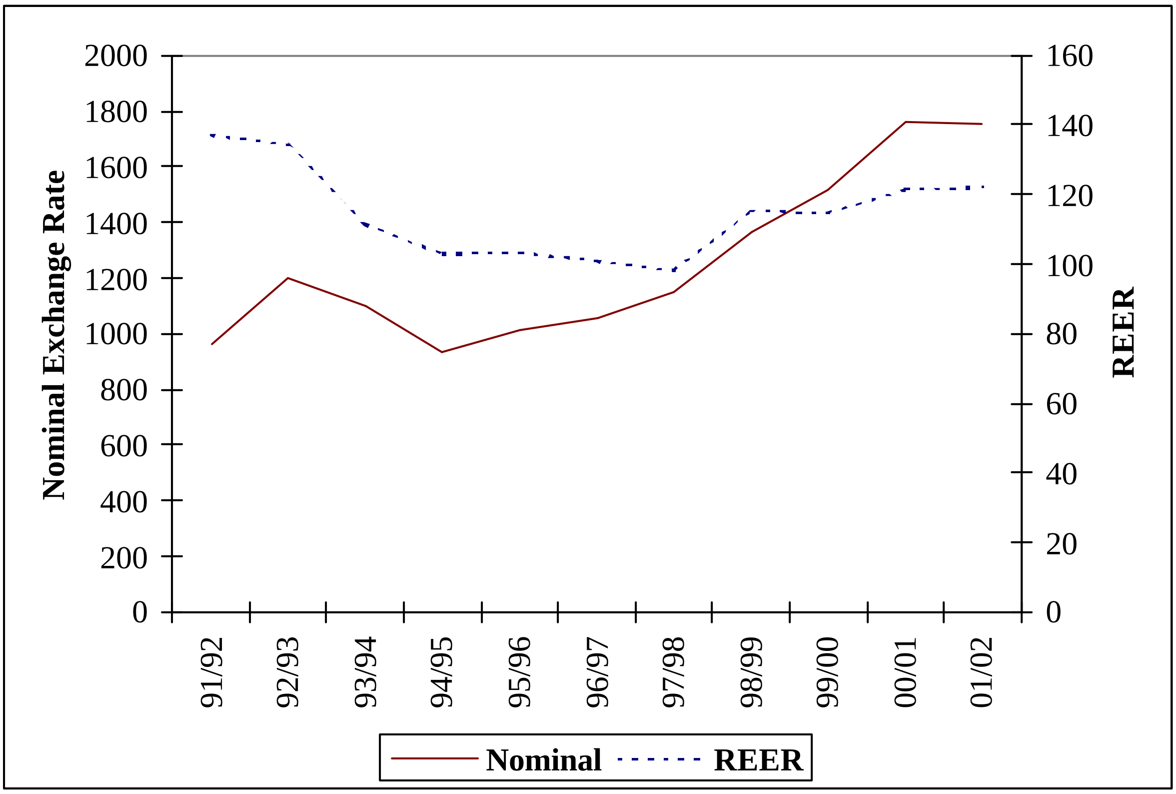
5.3 The Foreign Exchange Market and Exchange Rates

The exchange rate remained stable during most of the period under review. Compared to a depreciation of 16.5 per cent recorded in 2000/01, the inter-bank weighted average mid rate appreciated by only 0.5 per cent in 2001/02. The appreciation in the exchange rate was largely on account of increased donor inflows and a relatively better performance of the non-coffee export sector. The BOU had to increase net sales of dollars in the foreign exchange market in order to mop up liquidity injections arising from Government expenditure on poverty reduction financed by donor resources. This action has the potential impact of appreciating the nominal and real exchange rate thus causing a loss in export sector competitiveness.

In order to minimize the adverse effects of the appreciating real exchange rate on the competitiveness of the export sector, BOU distinguished its presence in the Inter-bank Foreign Exchange Market (IFEM) into intervention and sterilization actions with effect from April 2 2002. When BOU intervenes in the IFEM, it only announces its presence in the market on the Uganda Investment Services (UIS) screen, but it does not announce the amounts offered for purchase or sale. On the other hand, if the BOU goes into the IFEM for sterilization purposes, it does not announce its presence. It only concludes a bilateral transaction with the commercial bank quoting the best competitive rate on the UIS screen.

On a period average basis, the Nominal Effective Exchange Rate (NEER) appreciated by 2.3 percent while the Real Effective Exchange Rate (REER) depreciated by 0.4 percent during the FY 2001/02. However, measured on an end-period basis, the NEER depreciated by 6.9 percent while the REER depreciated by 9.8 percent. Chart 8 traces the developments in the nominal and Real Effective Exchange Rates.

Chart 8: Movements in the Nominal and Real Exchange Rates.



Note: Data used is based on period averages.

5.3.1. Foreign Exchange Volumes

Transactions volumes in the IFEM amounted to US$3.71 billion in 2001/02 compared to US$ 2.46 billion in 2000/01. Interbank purchases amounted to US$ 1.76 billion against interbank sales of US$ 1.95 billion. Foreign exchange inflows to the market during the financial year were mainly composed of the usual sources of capital transactions, private remittances, BOU interventions and proceeds of exports from Uganda.

The BOU maintained its presence in the foreign exchange market in order to ensure stability and to sterilise liquidity injections arising out of increased Government expenditures on poverty reduction financed mainly from donor funds. Net sales through intervention and sterilisation amounted to US$ 196.9 million in 2001/02 compared to net sales of US$ 174.3 million recorded in 2000/2001. Within the fiscal year, the BOU continued to enhance transparency in the conduct of transactions in the IFEM, by requiring all authorised dealer banks to post their respective indicative market quotes electronically via Reuters. The rates would serve as a basis for fair market accessibility by all authorised dealers on a real time basis. In the same vein, intervention operations by the BOU were posted transparently on the same medium so as to provide real time information for participants in the foreign exchange market.

6.0. REAL ECONOMIC ACTIVITY

6.1. Economic Growth

The Ugandan economy has been recovering from a slack that began in the fiscal year 1999/00 due to exogenous factors such as a fall in world coffee prices, drought and a rise in world prices of oil. During the year 2001/02 overall Gross Domestic Product (GDP) grew by 5.6 percent in real terms, about the same rate as 6 percent for the year 2000/01. Monetary GDP grew by 5.5 percent, while non-monetary GDP grew by 4.3 percent. Macroeconomic stability, a strong performance of the non-coffee sector, improved weather conditions and efforts to control pests and diseases allowed for the modest growth. Growth was highest in the transport and communications sector, at 10.0 percent in 2001/02. Table 12 indicates the growth rates by sector.

Table 12: Percentage Growth Rates by Sector at Constant 1997/98 Prices.

Sector	1998/99	1999/00	2000/01	2001/02
Agriculture	5.8	5.6	4.6	4.8
Manufacturing	13.7	3.5	8.9	5.0
Mining and Quarrying	5.9	4.8	5.9	7.8
Electricity and Water	6.0	8.7	9.3	6.4
Construction	8.9	1.5	2.8	6.2
Wholesale and Retail Trade	9.2	1.9	6.3	5.5
Transport and communications	7.0	7.3	8.2	10.0
Community services	4.5	8.6	7.5	5.9
Owner-occupied dwellings	8.5	8.0	8.0	7.0
Total GDP	**7.0**	**5.5**	**6.0**	**5.6**
Per capita GDP	**4.3**	**2.9**	**3.5**	**3.3**

Source: Uganda Bureau of statistics

6.1.1. Agriculture

The agricultural sector grew by 4.8 percent in 2001/02, about the same rate as 4.6 percent in 2000/01. In particular cash crop production recovered from a decline in growth of 4.7 percent in 2000/01 to a 3.4 percent growth. Food crop production which contributed about 67 percent of the overall agricultural output increased by 4.6 percent, which was mainly attributed to favourable weather conditions and control of pests. Livestock, forestry and fishing, which together contributed about 23 percent of the total agricultural output grew by 5.7 percent, 5.4 percent and 6.2 percent, respectively. The share of agriculture in GDP declined to 41 percent in 2001/02 from 42 percent in 2000/01. Growth in monetary agriculture (5.5 percent) was higher that in the non-monetary agriculture (3.8 percent).

6.1.2. Manufacturing

Manufacturing production grew by 5.0 percent compared to 8.9 percent in the previous financial year. In particular, formal and informal manufacturing grew by 5.5 percent and 3.9 percent, respectively, in 2001/02 compared to 10.7 percent and 4.7 percent, respectively in 2000/01. Growth in the sector was mainly attributed to an increase in the production of textiles, bricks and cement, soap, edible oils and soft drinks, largely on account of increased demand for these products. Demand for bricks and cement is associated with increased activity in the construction sub-sector. The share of the manufacturing sector in total GDP has been about 10 percent of GDP in the last three fiscal years.

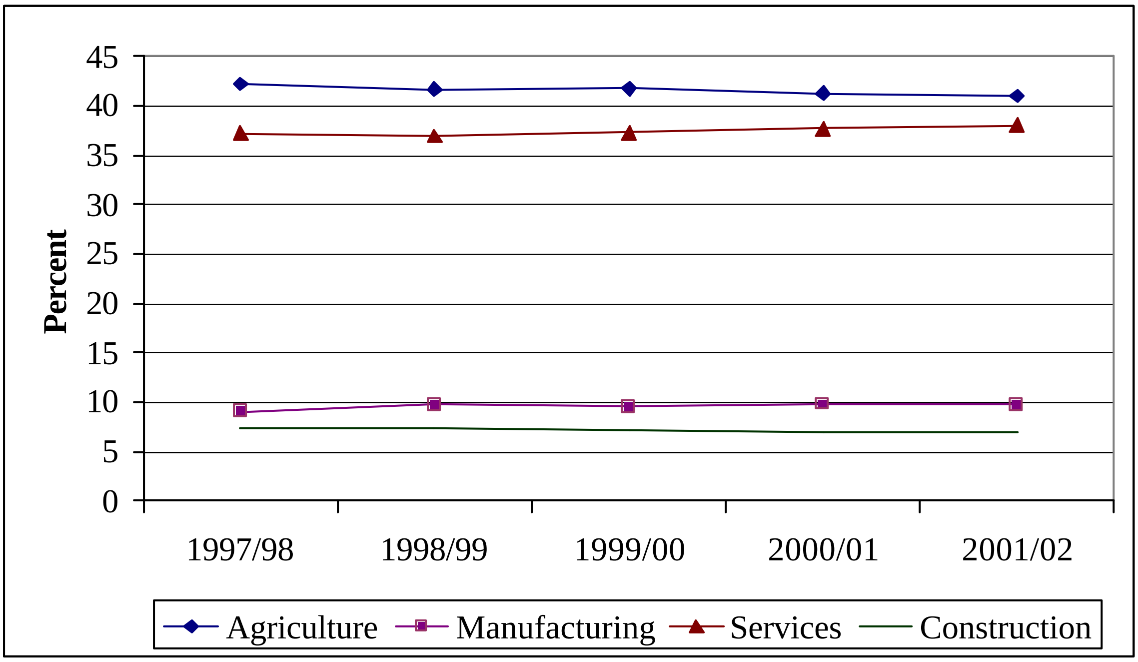
6.1.3. Construction

The construction sector performed relatively well in 2001/02 compared to 2000/01. In particular, monetary construction posted a higher real growth rate of 6.6 percent in 2001/02 compared to 2.9 percent realised in 2000/01. As was the case in 2000/01, growth in the construction sector was mainly driven by road and private building construction.

6.1.4. Services

The services sub-sector continued to account for a high share of GDP (about 38 percent). Transport and communications services increased by 10 percent in 2001/02 compared to 8.2 percent in 2000/01. This growth is largely on account of an increase in road transport and communication services, which grew by 8.5 percent and 25.8 percent, respectively. Wholesale and retail trade, hotels and restaurants and community services achieved modest growth rates at 5.5 percent, 5.4 percent and 5.9 percent, respectively, although this was a slow down in growth compared to 6.3 percent, 6.1 percent and 7.5 percent, respectively, during 2000/01. Further, electricity and water services grew by 6.4 percent in 2001/02, a slow down compared to 9.3 percent growth in 2000/01. Trends in the structural composition of economic activity by sector are shown in Chart 9.

Chart 9: The Structural Composition of Economic Activity by Sector (percent).



Note: Services consist of wholesale and retail trade, hotels and restaurants, transport and communications, community services, and electricity and water.

6.2. Domestic Prices

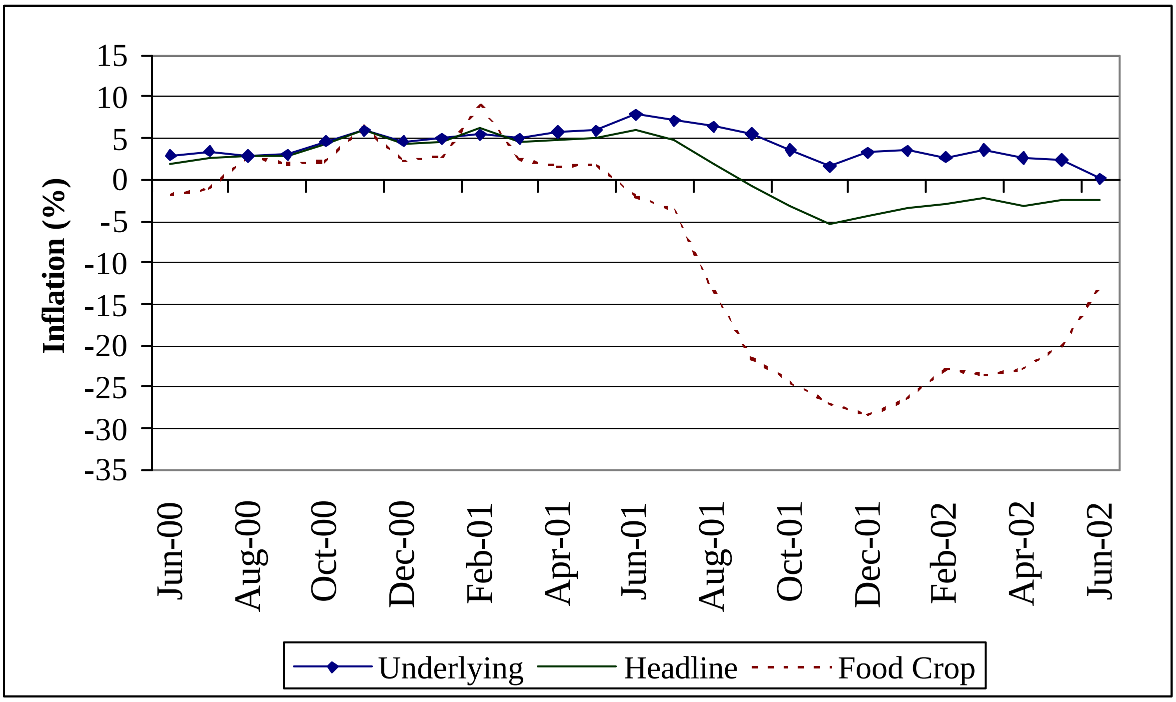
Prudent macroeconomic management, in particular fiscal discipline on the side of government and cautious monetary policies pursued by the monetary authorities helped to keep inflation low, during the fiscal year 2001/02. In addition, the country experienced favourable weather conditions, which resulted into increased food crop production. Consequently, food crop inflation in 2001/02 turned out negative.

The annual headline inflation rate averaged –2.0 per cent, well below the 4.5 per cent posted for the fiscal year 2000/01. Inflationary pressures were subdued most of the year, as the rates remained negative except during July and August 2001.

The annual headline inflation rate was highest in the first quarter of 2001/02, when it averaged of 2 per cent. It dropped to an average of - 4.3 per cent per annum during the quarter ended December 2001. During the third and fourth quarters of the financial year it averaged about - 3.0 per cent.

The annual underlying inflation rate averaged 3.5 percent; lower than 5 percent for the fiscal year 2000/01. In the first quarter of the year, the underlying inflation rate averaged 6.3 percent. It declined to 2.8 per cent during the period October 2001 - December 2001, increased slightly to 3.2 per cent during the third quarter before dropping to 1.7 per cent in the last quarter of the year. Underlying inflation rates largely depend on the prices of imported finished products and raw materials. These are in turn affected by the movements in the foreign exchange rate. During the review period, the exchange rate appreciated, hence, contributed to keeping the underlying inflation under control. Chart 10 below shows the pattern of inflation from June 2000 to June 2002 (see also Appendix 31).

Chart 10: Developments in Annual Inflation: July 2000 – June 2002.



PART III

OPERATIONS

DEVELOPMENTS IN THE NATIONAL PAYMENT SYSTEM

During the year, several significant developments took place in the payment system. Among others were the following: i) the electronic cheque clearing was implemented, ii) a number of draft laws to regulate the activities of the payment system were prepared, iii) the East African Central Bank Governors resolved to establish large value transfer systems in each country, and iv) a credit transfer standard, which is due for review by the banks, was developed.

Electronic Clearing System (ECS) Project

Following a seven-month pilot testing phase, the Electronic Clearing System (ECS) Project was successfully implemented on 2nd May 2002. All clearing banks now submit cheque data to the clearinghouse in electronic form. The electronic data is then fed into the ECS for derivation of net clearing positions, and generation of inward electronic cheque data for each bank. The new system is superior to the old manual system in several aspects, including data capture efficiency and risk management.

Promotion of Credit Clearing and Credit Transfer Standard

In order to expand the country's payment instrument base, enhance efficiency and strengthen risk management, a credit transfer standard was developed with a view to promoting the use of credit transfers. The standard will soon be reviewed and agreed to by the banks. Thereafter, all Electronic Fund Transfers (EFT) will be required to conform to the standard.

Establishment of a Payment Card Switch

As a way of diversifying the payment instrument mix in the country, BOU and Uganda Bankers Association held discussions with two private investors who expressed interest in setting up a switching system in the country. A functional switch will enable bank customers to withdraw funds from any ATM, irrespective of one's bank branch. It should also support both credit and debit cards. Further, with appropriate functionality, it should enable prepayments for utility services at the ATMs.

Payment System Draft Laws

A consultant commissioned by the Bank to review the payment system legal framework has submitted draft laws on the Bills of Exchange, Law of Evidence, Law of Contract, National Payment System Oversight Law, Internet and Electronic Commerce Law, and Cross Border Payments. These draft laws will be reviewed by stakeholders before submitting them to the Minister of Finance for presentation to Parliament and subsequent enactment into laws.

DEVELOPMENT FINANCING

The Development Financing Department was established within BOU in 1977, although its position was legalized in 1986 with the setting up of a Development Finance Fund (DFF). The major objective of development financing is to facilitate the flow of institutional credit to productive sectors of the economy, and contribute to building capacity of identified financial institutions. Its mandate is to facilitate the flow of funds to the private sector and manage several lines of credit and related other programmes on behalf of the Government and the BOU. Since 1983, eight credit lines and 6 support programmes targeting various sectors of the economy have been managed. In 2001/02 the active lines of credit were: the European Investment Bank (EIB) second phase of Apex Private Loan Scheme, the Export Refinance Fund, Export Promotion Fund, and the Distressed Flower Project Fund that was established in September 2000, to support flower projects that were in difficulties. Of the programmes, the Rural Financial Services Component (RFSC) and the Export Credit Guarantee Scheme (ECGS) are still operational.

During the period under review, the Development Finance Fund (DFF) ceased operations, together with Investment Term Credit Refinance Fund (ITCRF) and the Cotton Sub-Sector Development Project (CSDP), the role of the Development Finance department was relegated only to recoveries of reflows.

Although launched in December 2000, the Export Credit Guarantee Scheme (ECGS) became only effective in April 2001. Since then, the ECGS guaranteed 78 loans to 16 exporting companies. Principal loans extended by the accredited financial institutions amounted to Shs 23.6 billion, of which BOU guaranteed 75% or Shs 17.8 billion. The balance of the credit risk of 25% or Shs.5.8 billion was borne by the financial institutions. The single most significant contribution under the programme was the export of 31,000 metric tons of maize to Zambia at a time when that country was facing acute famine.

During 2001/02 one further workshop was organised to review the logical framework that formed the basis of systematic implementation of Rural Financial Services Component (RFSC). The Memoranda of Understanding (MOU) that were signed with Commercial Micro-finance Limited, Uganda Institute of Bankers and Micro and Small-Scale Enterprise Policy Unit (MSEPU) of the Ministry of Finance, Planning and Economic Development (MFPED), were implemented. Where difficulties were encountered, adjustment to the MOUs was made.

To date, activities covered under RFSC include a national survey of micro finance institutions undertaken by MSEPU, development of training materials by UIB, and a feasibility study on distance learning at UIB that was undertaken with assistance of a Danish Business College. However, support to one financial institution to undertake rural expansion stalled due to failure of the institution to raise the requisite capital.

Following complete disbursement of Apex II in July 2001, under which additional 52 projects received funding amounting to Euros 25 million, Government negotiated a further loan of Euros 40 million from the European Investment Bank (EIB), the agreement of which was signed in December 2001. This loan, which will only become effective as soon as parliamentary approval is given, is meant to assist the establishment and financing of small and medium sized private sector investment. Such investments include new projects, expansion, modernization, restructuring and diversification of existing facilities, and protection of the environment. The areas covered include: agro-industry, fishing/fish processing, mining/quarrying, tourism/hotels, horticulture/floriculture, manufacturing, health, education, and service activities.

In the year 2001/02, the BOU participated in IFAD exercise of identifying gaps in the financial sector and means of extending the outreach to the rural areas. In addition, BOU also got involved in the negotiation and the launching of a refinance facility called the Energy for

Rural Transformation (ERT), by which government intervention provides electricity to remote rural areas.

BANKING OPERATIONS

In May 2002, the BOU implemented the Electronic Cheque Clearing in Kampala Bankers' Clearing House. Together with the National Payment System Secretariat (NPSS), the BOU plans to embark on the implementation of the Electronic Funds Transfer (EFT) and the extension of the ECS to the rest of the country. It is greatly envisaged that the implementation of these projects will enhance the efficiency of the National Payment System and encourage demand for non-cash instruments.

Meanwhile, the growth in volumes and values of financial instruments cleared in both the Kampala Bankers' Clearing House and Up-Country Clearing Centers registered up swings. Up country clearing continued progressively on a recovery trend compared to the decline of 1998/99 and registered a remarkable increase of 10.7 per cent from 46,982 items in 2000/01 to 52,028 items in 2001/02. Kampala Bankers' Clearing House activities also moved in tandem, registering growth of 7.8 per cent from 1,302,427 items to 1,404,165 over the same period.

Summing up, both the up-country and Kampala clearing activity, financial instruments increased both in volume and value. The total number of items increased by 7.9 per cent from 1,349,409 in 2000/01 to 1,456,193 in 2001/02 while the value increased by 8.2 per cent from Shs 5,950,301 million to Shs 6,435,624 million.

CURRENCY OPERATIONS

Performance of Currency Notes

The upgraded shilling notes; 1000, 5000 and 10,000 performed very well against the threat of counterfeits. The BOU received fewer cases of counterfeits in the upgraded currency notes. The performance of the 20,000-shilling banknotes against counterfeits continued to be excellent. The Bank did not receive any substantial case of counterfeiting against coins.

Support of Cash Payment System

The BOU received increased demand for currency notes and coins during the financial year 2001/02. The withdrawals by commercial banks grew by 21.1 per cent as compared to those of the year 2000/01. In the same period, deposits from commercial banks grew by 21.5%. The BOU was able to conveniently meet all cash requirements of the financial sector during the year.

Shredding and briquetting

The BOU used the modern method of destruction by shredding and briquetting. The share of destruction of currency notes by shredding and briquetting was 100% of the total.

Projects

The construction of Gulu currency centre was completed and the centre was finally relocated from the Uganda Commercial Bank building to the new site on 15th July 2002. The construction of Arua currency centre was also started and completion is expected in the financial year 2002/03.

DOMESTIC FINANCIAL MARKET OPERATIONS

During the period under review, the activities of BOU in the domestic financial markets related to the formulation of policy proposals regarding the short and long term development, regulation and operation of both government and private sector securities. The BOU ensured that government debt securities were issued at appropriate time, properly recorded and promptly redeemed on due date.

The Issuance of Government Securities

The securities issued during the year consisted of Treasury bills and non-market securities for purposes of mopping up liquidity arising out of the redemption of the 1st tranche of the UCB recapitalization bond and privatization proceeds. The four maturities of treasury bills were issued weekly. In addition, BOU continued to lay the groundwork for issuance of government bonds. The delay was largely on account of legal impediment.

Open Market Operations

The domestic dealing room continued to implement open market operations (OMO) instructions via REPOs. During the year, REPO instruments largely performed the role of fine-tuning liquidity management. In order to effectively carry out OMO, BOU's stock of Treasury bills for REPO was increased by Shs 100 billion. The REPO securities were issued at no cost to the BOU. However, Treasury had the obligation of paying interest on REPOs to the commercial banks.

The Central Depository System (CDS)

The number of investors opening up accounts on the CDS continued to grow. Over one thousand individuals are active on the CDS although volumes held by individuals are still low (under 1 per cent).

Secondary Market Activity

Activity in Treasury bills in the secondary market continued to be dominated by lien transactions and rediscounts by commercial banks. There were no significant volumes in other secondary market transactions.

Market Development

A significant amount of work has been done to develop the market through introduction of primary dealers, horizontal REPOs and issuance of long-term government bonds. It is expected that the work will be completed in the next reporting period.

FOREIGN RESERVE MANAGEMENT

During the financial year 2001/02, the Board approved the new Reserve Management Policy document. The document spells out the policy framework, which guides reserve management. It specifies parameters for key risks including currency, liquidity, interest rate, credit and counter-parties. Implementation of the policy document commenced. The focus is on capacity enhancement in the areas of market information and application systems (information technology) training and effective oversight. The Board approved expansion of the external management programme through appointment of two additional managers and commitment of USD 100 million to external management.

Reuters – Uganda Investment Services (UIS)

In order to improve information flow in the market and aid price discovery, all authorized dealer banks were required to secure Reuters – UIS services. The new system became operational on 22nd October 2001. The effect of the system was an increase in market efficiency, thus a substantial reduction in margins. The Reuters system has also greatly enhanced transparency in BOU market operations, which are currently based on the rates posted and displayed on the Reuters screen.

Effective 2nd April 2002, new guidelines and procedures were issued to all IFEM participants on intervention and sterlisation operations. With regard to intervention, BOU ceased to announce its purchase or sale amounts. BOU also introduced sterilisation transactions whose objective is to mop up excess shilling liquidity in the market and maintain monetary aggregates within the desired/programmed path.

Exchange Rate Movements

Maintenance of exchange rate and market stability continued to be the key objective of BOU operations. At the beginning of the period, the mid rate was 1726.81 (02/07/2001) and by close of the year, it was 1797.15 (28/06/2002). Due to high demand pressures and supply constraints, the shilling depreciated to a level above 1800 per US dollar in the month of April 2002. The introduction of sterilisation market operations in the same month kept the depreciation in check and generally brought about relative market stability for the remainder of the period under review.

An increase in the use of forward contracts and cross currency trades was also reported in the market. This is an indication of increased sophistication in the market. Increased market competition and the desire to effectively deal with market uncertainties underpin the quest for new products and improved service delivery.

SUPERVISION OF FINANCIAL INSTITUTIONS

The supervisory capacity of BOU continued to grow through conducting in-house and external tailor made training programmes for staff development. Updating of the bank supervision manual has commenced through acquisition of external technical assistance from the United States Department of Treasury. Additional technical assistance has been secured to formulate robust policy and procedures for resolving problem banks. During the financial year under review, BOU continued with its rigorous on-site surveillance programme of inspecting all financial institutions once a year in the case of strong ones, and more frequently for weak institutions. In addition, quarterly off-site surveillance of financial institutions has continued to be conducted on schedule.

The monitoring of financial institution soundness is an ongoing process and is conducted through review of statutory weekly, monthly and quarterly returns. Most of the financial institutions performed well as evidenced by positive developments in capital adequacy compliance, growth in deposits and total asset holdings as at June 30, 2002.

The liquidation of closed banks has progressed with notable success being recorded in the recoveries of bad debts through foreclosure of collateral securities. BOU has continued to execute the liquidation process as a measure of minimizing costs of the exercise. However, whenever it was found necessary, legal experts, valuers and auctioneers were contracted to execute special assignments.

Following the recommendations of the Judicial Commission of Inquiry into the failure of four banks in 1998/99, BOU took appropriate measures to strengthen its regulatory and supervisory capacity over the financial sector. The measures taken involved drafting a new Financial Institutions Bill 2002 (FIB, 2002). The Bill, which was gazetted in May 2002, is due to be tabled in parliament. The objective of the Bill is to rectify the existing weaknesses in the current legislation FIS (1993) by strengthening corporate governance practices through emphasis on the responsibilities of the Board of Directors, external and internal auditors and management of financial institutions.

The FIB (2002) also proposes strict restrictions on insider lending, imposes limits on large exposures and ownership concentration to prevent financial institutions from being owned and controlled by one person or family. In addition, the Bill stipulates mandatory prompt corrective actions to be implemented upon distressed financial institutions by the regulatory authority. Furthermore, the Bills seeks to enhance market discipline by enforcement of transparency and disclosures through information published by financial institutions.

The Government and BOU have jointly developed a legal framework for micro deposit taking institutions, namely the Micro Deposit Taking Bill (MDI, 2002), which provides for the regulation and supervision of only those institutions defined as MDIs, which take deposits from the public. The Bill has already been gazetted and will be tabled in parliament soon.

A policy paper for reforming the Deposit Protection Fund was concluded. It aims at transforming the Fund into a legal entity (corporate body) with its own board of directors and expanding its mandate to include the key agency role of resolving problem/closed financial institutions, in particular serving as a receiver or liquidator. A total of 17 commercial banks and 7 credit institutions subscribed to the Deposit Protection Fund during the financial year

2001/02. The annual premium of the Fund is a flat rate of 0.2 per cent of each financial institution's average monthly deposit liabilities for the preceding year

Resolution of Uganda Commercial Bank Limited. (UCBL) has been concluded with a sale of 80 per cent of its shares to Standard Bank Investment Corporation (Stanbic) of South Africa, while Government retained a 20 per cent stake in the bank. In addition, the process of merging the two institutions into one commercial bank is expected to be completed in the first quarter of the new financial year. Upon merger, the Government's 20 per cent stake will convert to 10 per cent stake in the merged bank.

PUBLIC RELATIONS

During the year under review, considerable work was done on developing the information policy of the BOU. A draft information policy paper was prepared for discussion. The BOU had a good rapporteur with the mass media and this facilitated the implementation of monetary policy. The BOU held monthly media discourse and on a number of occasions disseminated information through press statements. This was meant to improve public awareness. In an effort to further improve on the communications, a review of the BOU website was undertaken and proposals for improvement submitted for discussion.

On a number of occasions the BOU organised regional and local workshops and seminars on various economic issues. In addition, the BOU continued to receive guests from various parts of the world, and on different missions including, study tours, conferences, attachments and consultations.

The BOU organised the 10th Joseph Mubiru Memorial Lecture, which took place on 14th December 2001 at the International Conference Centre. The lecture was well attended. The guest speaker was Dr. Chiedu Osakawe, Director, Technical Co-operation Division at the Secretariat of the World Trade Organisation. The theme of his talk was 'Poverty Reduction and Development: The Contribution of Trade, Macroeconomic and Regulatory Policies.'

In addition to doing its traditional role, BOU continued to effectively participate in community relations to improve its corporate image through contributions to charity activities.