THE REPUBLIC OF UGANDA

Medium Term Debt Management Strategy (MTDS)

2016/17 – 2020/21

June 2016

THE REPUBLIC OF UGANDA

Public Debt Management Strategy (PDMS) 2016

2016/17 – 2020/21

June 2016

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MINISTRY OF FINANCE, PLANNING AND ECONOMIC DEVELOPMENT

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FOREWORD

Since it's the largest portfolio in Uganda's economy,Government's external and domestic (public)debt portfolio if poorly managed has a significant impact that would cut across generations. This emphasizes the need for efficient and effective public debt management, which plays an important role in public finance and macro-economic management.

This year's Public Debt Management Strategy (PDMS2016) is built on the Public Debt Management Framework 2013 (PDF2013), which provides the costs and risk thresholds that guide borrowing and public debt management. Thestrategy examines the cost and risk trade-offs of the medium term fiscal framework and provides guidance on the operational limits within which to meet the Government's financing needs at a minimum cost, subject to a prudent degree of risk.

In principle, as the PDMS2016 describes the costs and risks characteristics associated with the current debt portfolio, it sets out cost limits, which shall guide public debt management during the medium term beginning FY2016/17. The PDMS2016 also provides a review of the MTDS2015 and how we faired against the different strategic guidelines/constraints. As we execute our financial stewardship, we believe that by adopting such an explicit and coherent Public Debt Management Strategy, Government will make informed decisions when considering different financing alternatives. In addition, this provides a platform upon which the Ministry of Finance, Planning and Economic Developmentcan be assessedand held accountable,as we execute our public debt management function.

ThisPublic Debt Management Strategyis the second publication developed using the MTDS-Analytical Tool. It has been prepared by the Ministry of Finance, Planning and Economic Developmentin collaboration with the Bank of Uganda. Governmentcommits to producing a Public Debt Strategy annually as required by the PFM Act 2015 and to provide a review of the preceding strategy to inform public debt management policy decisions and to guide Parliament while assessing any government borrowing.

For God and My Country

Keith Muhakanizi

PERMANENT SECRETARY / SECRETARY TO THE TREASURY

LIST OF ABBREVIATIONS

AfDB	African Development Bank
ADF	Africa Development Fund
ATM	Average Time to Maturity
ATR	Average Time to Re-fixing
BADEA	Arab Bank for Economic Developed in Africa
BoU	Bank of Uganda
DSA	Debt Sustainability Analysis
EIB	European Investment Bank
GDP	Gross Domestic Product
GoU	Government of Uganda
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IDB	Islamic Development Bank
IFRS	International Financial Reporting Standard
IFMS	Integrated Financial Management System
IMF	International Monetary Fund
IR	Interest Rate
MDRI	Multi-lateral Debt Relief Initiative
MEPD	Macroeconomic Policy Department
MoFPED	Ministry of Finance, Planning and Economic Development
MTDS	Medium-Term Debt Management Strategy
MTEF	Medium Term Expenditure Framework
PDF2013	Public Debt Management Framework 2013
PFMA	Public Finance Management Act
PSC	Private Sector Credit
PV	Present Value
ST	Short Term

Purpose of this Publication

Pursuant to Sections 13(10)(a)(iv) and 42(3) of the Public Finance Act, the Minister of Finance is required, while presenting the National Budget, to table a plan on the public debt and any other financial liabilities for the financial year to which the annual budget relates. The Public Debt Management Strategy 2016 presents the strategy for managing public debt over the medium term, by presenting the cost and risk implications of financing the proposed budget deficit using debt. It also describes the debt portfolio's characteristics of i.e. the composition of debt, cost and risk trade-offs, and changes in the public debt during the year.

This publication focuses on three main areas:

(i) An assessment of the cost and risk characteristics of the current debt portfolio

(ii) The implications of the cost and risk trade-offs of the medium term fiscal financing framework against the previous Medium Term Debt Strategy constraints and

(iii) The cost and risk strategic guidelines / constraints to be adopted while managing public debt during the medium term beginning FY2016/17.

Summary of the PDMS 2016

The Public Debt Management Strategy 2016 has been prepared to inform debt management policy decisions and to guide the medium term borrowing negotiations. While providing the strategic guidelines for debt management, the strategy also examines the cost and risk implications of the medium term fiscal framework's financing assumption.

Table 1: Strategic Debt Management Benchmarks

Cost & Risk Exposure	Cost & Risk Indicators	Indicative Constraint
Solvency	Present value debt as % of GDP	less than 50%
	o/w PV of External debt as % of GDP	less than 30%
	o/w PV of Domestic debt as % of GDP	less than 20%
Refinancing risk	Debt maturing in 1yr (% of total)	max. 15%
	ATM External Portfolio (years)	min. 15-years
	ATM Domestic Portfolio (years)	min. 3-years
	ATM Total Portfolio (years)	min. 3-years
Interest rate risk	Portfolio's WAIR (%)	max. 6%
	o/w External debt WAIR (%)	max. 2%
	o/w Domestic debt WAIR (%)	max.16%
	Interest payment as % of GDP	less than 2%
	ATR (years)	min. 10-years
FX risk	FX debt as % of total	less than 80%

Source: Ministry of Finance planning and Economic Development

The strategic guidelines summarized above will be monitored closely during the financial year. While being mindful of the limited availability of concessional financing, the financing strategies as outlined in section 4.2 of this publication and the timing of domestic debt issuance shall be maintained while taking into account the macroeconomic and financial markets environment.

1 Introduction

1.1 What is a Public Debt Management Strategy?

The public debt management strategy is a plan that the government intends to implement over the medium term in order to achieve a composition of the government debt portfolio that captures the government's preferences with regard to the cost-risk trade-offs. The strategy focuses on managing the risk exposure embedded in the debt portfolio, particularly, the potential variations in the cost of debt servicing and its impact on the budget and the size of the debt.

The Public Debt Management Strategy (PDMS 2016) operationalizes Uganda's debt management objectives as enshrined in the Public Debt Management Framework 2013 (PDF 2013), by guiding the contracting and management of government's debt portfolio for the five year period from Financial Year (FY) 2016/17 to FY 2019/20. The PDMS focuses explicitly on the characteristics of the debt portfolio, by outlining the government's preferred composition of the debt portfolio taking into account the cost-risk trade-offs inherent in debt management and the broad financing plan it intends to implement to achieve the preferred portfolio composition.

The debt management strategy further provides a framework within which the MoFPED will make informed choices on how the government's financing requirement shall be met, while taking account of constraints and potential risks. The Strategy comprises of the FY 2016/17 strategic debt management objectives, various benchmarks and portfolio indicators. Its articulation imparts information, transparency, and certainty and enables investors to plan their investments efficiently.

1.2 The Debt Management Strategy Objectives

The objectives in the Public Debt Management Framework form the foundation for the Public Debt Management Strategy (PDMS) for FY2016/17 - 2019/20. The priority of the policy framework remains to support debt sustainability. The framework also requires that, for all borrowing considerations, an evaluation of costs and risk trade-offs should be done to arrive at the most optimal financing strategy for each financial year. The Framework considers domestic borrowing not only as an alternative source of Government financing but also as a means to deepen the domestic financial markets. The PDF2013 objectives are repeated here:

1. To meet the Government's financing requirements at the minimum cost, subject to a prudent degree of risk;

2. To ensure that the level of public debt remains sustainable, over the medium and long term horizon while being mindful of the future generations and
3. To promote the development of the domestic financial markets.

The Government shall continue to pursue the same objectives over the medium term. The debt management strategy, therefore, shall guide the Government's debt management operations in 2016/17 and over the medium term within the context of the medium term fiscal framework while being mindful of the associated cost and risk trade-offs of the public debt as we consider new financing options; support macroeconomic stability and supporting debt sustainability.

1.3 The Scope of the PDMS 2016

The PDMS 2016 focuses on external public debt including arrears to external creditors who are yet to offer debt relief and domestic debt resulting from the issuance of government securities. Domestic arrears have not been included in this debt management strategy nor contingent liabilities.

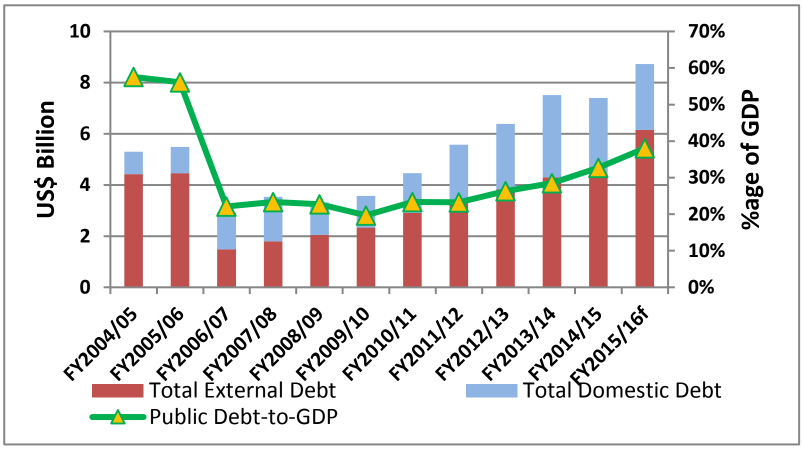
The contraction of external and domestic debt is influenced by the fiscal financing need and described by loan agreements that state the maturity profiles and interest rates. Secondly, such contraction of loans complies with the statutory requirements for parliamentary approval.

2 Characteristics of the Existing Debt Portfolio

2.1 Structure of the Uganda's Public Debt

As at 30th June 2015, public debt had increased to UGX 24.43 trillion (32.8 percent of GDP) compared to the 30th June 2014 position of UGX 19.59 trillion1 (28.5 percent of GDP) of which, external debt accounted for 19.4 percent and domestic debt 13.4 percent of GDP2. As illustrated in Figure 1 below, public debt is projected to increase to UGX 30.87 trillion by the end of June 2016 (38.1 percent of GDP), largely on account of large disbursements resulting from increased borrowing to finance a number of key infrastructure projects over the medium term.

Figure 1: Evolution of Public Debt



Source: Ministry of Finance Planning and Economic Development

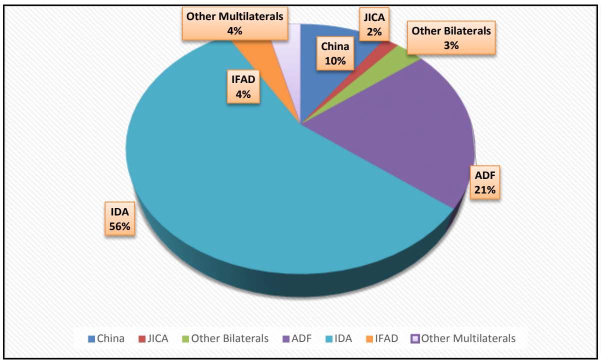
The stock of domestic debt almost tripled from UGX 2.29 trillion (10.89 percent of GDP) at the end of June 2007 to UGX 9.97 trillion (13.4 percent of GDP) as of end June 2015, of which Treasury Bills account for UGX 3.42 trillion *(34 percent of the domestic debt stock)* while Treasury Bonds accounted for UGX 6.55 trillion *(66 percent of the domestic debt stock)*. During the FY2015/16, a number of auctions in the first quarter were highly undersubscribed, forcing Government to borrow cautiously from the domestic market.

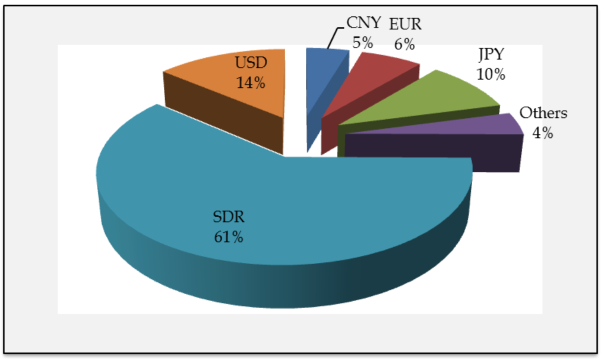
The current external debt remains largely concessional and mainly from the World Bank (IDA), the African Development Bank (ADB) and the International Fund for Agricultural Development (IFAD), who together account for 82.4 percent of the total external debt stock. China is the major bilateral creditor, with 9.8 percent of total external debt as at 30th June 2015 as shown in Figure 2 below.

[1] The change of total debt in US$ from US$7.53 trillion in June 2014 to US$7.10 trillion in June 2015 is a result of exchange rate appreciation for the period ended June 2015.

[2] Domestic Debt stock figures are evaluated at face value.

Figure 2: Creditor and Currency Distribution of External Debt as of End of June 2015





External Debt Distribution June 2015

External Debt Currency Distribution June 2015

2.2 Debt Portfolio's Cost and Risk Characteristics

It is important to assess the risks associated with debt portfolio to enable Government's debt managers to design forward looking strategies for the optimal debt structure in terms of maturity, interest rates & exchange rates. Hence GoU exposure is analysed in terms of interest rate, refinancing / roll over & exchange rate risk.

The current debt portfolio is dominated by external debt, characterized by long repayment periods with relatively low fixed rate interest rates. These features have a strong influence on the overall cost and risk exposure of Uganda's existing debt portfolio as of end June 2015 and the estimates for end June 2016, as described below.

Table 2: Cost & Risk Indicators for Existing Debt at end-June 2015 and 2016 Estimates

Cost and Risk Indicators		End June 2015			End June 2016 Estimates		
		External debt	Domestic debt	Total debt	External debt	Domestic debt	Total debt
Amount (in millions of UGX)		14,461,827.9	9,968,927.0	24,430,754.9	21,998,648.0	8,873,966.0	30,872,614.0
Amount (in millions of USD)		4,380.0	3,019.2	7,399.2	5,627.4	2,270.0	7,897.5
Nominal debt as % GDP		19.4	13.4	32.8	27.1	10.9	38.1
PV as % of GDP		10.3	13.4	23.6	16.3	10.9	27.2
Cost of debt	*Interest payment as % GDP*	0.2	1.1	1.3	0.2	1.0	1.2
	Weighted Av. IR (%)	1.0	8.3	4.0	1.0	8.3	4.0
Refinancing risk	*ATM (years)*	18.7	2.8	12.2	16.8	3.9	11.9
	Debt maturing in 1yr (% of total)	1.0	53.3	22.4	0.8	47.0	14.1
	Debt maturing in 1yr (% of GDP)	0.2	7.1	7.3	0.2	6.6	6.8
Interest rate risk	*ATR (years)*	18.7	2.8	12.2	16.2	3.9	11.6
	Debt refixing in 1yr (% of total)	1.0	53.3	22.4	9.2	15.2	11.5
	Fixed rate debt (% of total)	100.0	100.0	100.0	91.2	100.0	94.6
FX risk	*FX debt (% of total debt)*			59.2			62.1
	ST FX debt (% of reserves)			1.5			1.7

Source: MTDS-AT

2.2.1 Interest rate risks

Until the end of June 2015, exposure of GOU's portfolio to changes in the market interest rates was very minimal since the debt portfolio was on fixed rate interest rates. The status has however changed from financial year 2015/16 onwards as Uganda contracts debt on variable interest rates and disbursements thereof begin to flow in. Accordingly, the overall **Average Time to Re-fixing (ATR)**[3] of the portfolio is expected to reduce from 12.2 years as of end June 2015 to 11.6 years by end June 2016. This is primarily a result of external debt being contracted on variable interest rates, which is projected to worsen the ATR for external debt from 18.7 years as of end June 2015 to 16.2 years by the end of June 2016. Notwithstanding, the indicator suggests that Uganda's public debt is not vulnerable to interest rate risk.

The portfolio is predominantly at fixed interest rates, which are relatively low coupled with long maturity periods. This is not surprising as the debt portfolio still holds a large volume of highly concessional loans, which is characterized by long repayment periods of over 40 years at fixed interest rates of less than one percentage point. The likely improvement for domestic debt ATR from 2.8 years for end June 2015 to 3.9 years by the end of June 2016 will further improve Uganda's interest rate risk exposure. This is as a result of a deliberate effort to reduce the issuance of T/Bills in favour of T/bonds in the portfolio in compliance with the PDF 2013 requirement.

The **weighted average interest rate (WAIR)** of 4 percent for the entire portfolio is another indicator of low cost exposure despite the contraction of new debt in FY2015/16 on variable interest rates, which is unlikely to impair the WAIR by the end of June 2016.

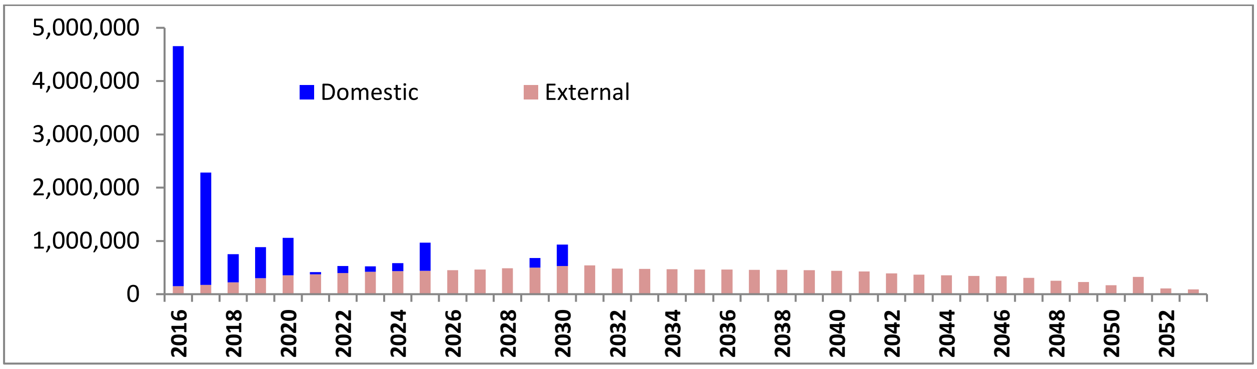
2.2.2 Refinancing/Rollover Risks

GoU is concerned about the possibility of rolling over its debt at higher interest rates and hence must monitor the redemption /maturity profile and the ATM of its debt stock. By the end of June 2016, the portfolio's average time to maturity (ATM) is estimated to reduce to 11.9 year from 12.2 years as of end June 2015. This is mainly on the account of the external debt ATM that is estimated to reduce by 2 percentage points to 16.8 years as of end June 2016. Notwithstanding, the domestic debt ATM is projected to improve from 2.8 years to 3.9 years by the end of June 2016. As mentioned earlier, this is due to strategic decisions adopted during the FY2015/16 to reduce the volume of total domestic issuance, particularly for T-Bill issuances.

[3] The average time to refixing (ATR) is a measure of weighted average time until when all the principal payments in the debt portfolio become subject to a new interest rate. If all instruments in the portfolio are contracted under fixed interest terms, the ATR will be the same as the average time to maturity.

The wide disparity in the ATM between the domestic and external debt numbers is explained by maturity characteristics of the portfolio, i.e. external debt holds a large size of concessional debt with long maturities while close to half of the domestic debt, 53.3 percent, is maturing within one year. As a result, the redemption profile (figure 3) shows a peak of principal payment in the next year due to short-term securities. The redemption profile for external debt over the long term is relatively smooth.

Figure 3: Uganda: Redemption profile as of end of June 2015, UGX million



Source: MoFPED, BoU, MTDS-AT

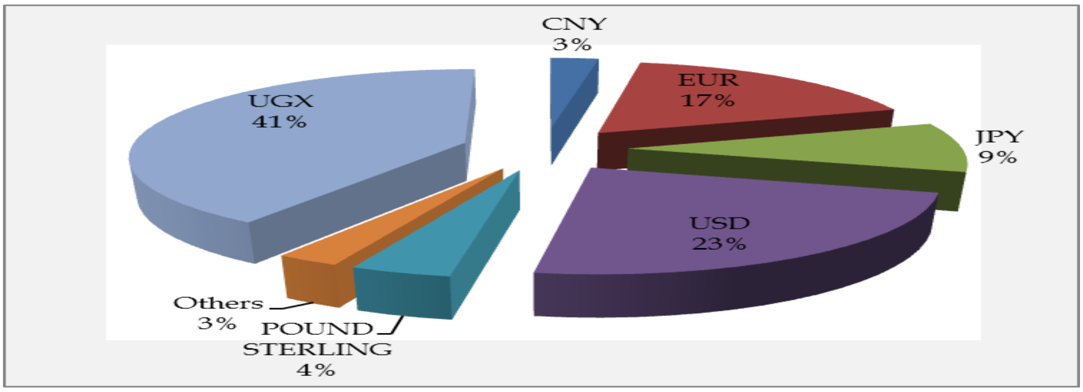
Overall, both the ATM and the proportions of debt maturing in 1 and 2 years suggest low refinancing risk exposure for Uganda's public debt portfolio. The proportion of debt maturing in 1 year is estimated to reduce to 14.1 percent by the end of June 2016 from 22.4 percent.

2.2.3 Exchange Rate Risk

The exposure to exchange rate risk remains significant given the high share of external debt in the portfolio. By the end of June 2015, foreign currency denominated debt constituted 59.2 percent and is projected to increase to 62.1 percent by the end of June 2016. Disaggregation of the SDR[4], which is the most significant currency in the portfolio, indicates that the portfolio is largely exposed to the US dollar (23 percent of total debt), followed by the Euro (17 percent) and the British pound (4 percent). The Japanese yen and the Chinese Yuan accounted for 9 percent and 3 percent of the total external debt, respectively. These 5 currencies account for 97 percent of the total external debt portfolio.

[4] The Special Drawing Rights (SDR) is a composition of different currencies i.e. US dollar, British pounds, Euro and Japanese yen each accounting for different weight.

Figure 4: Currency Distribution of the Public Debt, end of June 2015



Source: MTDS-AT 2015

3 Review of the 2015 Medium Term Debt Management Strategy

3.1 Overview of the MTDS 2015

The MTDS 2015 was anchored on the Public Debt Management Framework (PDF2013), which defines cost and risk benchmarks/thresholds. The key aim for the MTDS 2015 was to ascertain the cost and risk trade-off of financing the medium term fiscal deficit through borrowing while being mindful of debt sustainability. The strategy, similar to this year's debt management strategy, was intended to inform the Government's financing plan by setting out, inter alia, the least cost borrowing instruments subject to the most prudent degree of risk through which to raise the financing requirements over the medium term. This was to be achieved by determining the most realistic overall composition of the public debt portfolio, taking into account macroeconomic indicators and the market environment.

The MTDS 2015 preferred strategy assumed a bias towards non-concessional borrowing on terms similar to those from our most recent bilateral and commercial creditors' negotiations. This was in recognition of the limited availability of highly concessional financing for Uganda's large infrastructure projects. Accordingly, the medium term fiscal framework assumed quite a substantial amount from non-concessional financing sources. The financing distribution, which was based on the medium term fiscal framework, accounted for 60 percent of new external borrowing, limiting 15 percent and 36 percent of the entire financing requirement to non-concessional and commercial borrowing respectively. This was as a result of limited availability of concessional financing to finance the large volumes of infrastructure projects.

Consistent with the PDF2013 primary objectives of (i) meeting the Government's financing requirements at the minimum cost, subject to a prudent degree of risk; (ii) ensuring that the level of public debt remains sustainable; and (iii) promoting the development of the domestic financial markets; the following medium term strategic guidelines were implicit.

1) Ensuring that the size of external debt as a share of total debt is constrained to less than 80 percent.
2) Extending the yield curve over the medium term by;
    a) Lengthening the average time to maturity (ATM) for domestic debt to more than 3-years;
    b) Reducing the ratio of T-Bills-to-T-Bonds to 40:60; and
    c) Issuing more long term dated domestic bonds.
3) Constraining the portfolio's weighted average interest rate to less than 6% over the medium term.
4) Fiscal constraints were as follows:

a) Constraining the Present Value of Debt to GDP to less than 50 percent, consistent with the EAC convergence criteria. (PV External debt-to-GDP < 30 percent; and PV Domestic debt-to-GDP < 20 percent)

b) Constraining the interest payment as percentage to GDP to less than 2 percent

c) Constraining the interest payment-to-Domestic Revenue to less than 15 percent

Table 3: Cost and Risk Indicators as at End June 2020

Cost & Risk Indicators			End
		2014	2020
Nominal debt as % of GDP		28.6	45.6
PV as % of GDP		20.8	38.3
Weighted Ave. IR (%)		5.9	5.9
Refinancing risk	ATM External Portfolio (years)	18.9	11.0
	ATM Domestic Portfolio (years)	2.3	5.7
	ATM Total Portfolio (years)	11.8	9.9
Interest rate risk	ATR (years)	11.8	8.8
	Debt refixing in 1yr (% of total)	23.2	31.4
	Fixed rate debt (% of total)	100.0	73.1
FX risk	FX debt as % of total	57.1	74.3
	ST FX debt as % of reserves	4.6	11.1

Source: MoFPED

Applying the financing distribution of 60 percent of external new borrowing over the medium term while limiting 15 percent and 36 percent of the entire financing requirement to non-concessional and commercial borrowing respectively, the cost and risk characteristics in the table 3 were projected by end June 2020.

The MTDS 2015 indicated that the total public debt was to rise substantially on the account of large infrastructure financing projected in the medium term fiscal framework. The PV-Debt-to GDP was projected to double over the medium term from 20.8 percent as of end June 2014 to 38.3 percent by the end of June 2020. This was on the assumption that the real growth projections over the medium term shall be sustained.

The MTDS 2015 preferred strategy implied a number of actions, in particular lowering interest rate risk, lowering the ATR while increasing the amount of debt maturing after year one. As a result, it was recommended that non-concessional and commercial financing needed to be cautiously negotiated without impairing the borrowing term limits in our PDM 2013 that were largely applied. Accordingly, the terms of the different financing instrument applied in the MTDS 2015 were used as a limit i.e. as a ceiling for interest rates and as a minimum for maturity terms.

On the account of high interest rate risk exposure, the MTDS 2015 aimed at ensuring that variable interest rates should be fixed upon concluding the loan agreement or have a provision in the agreement that allows the Government to fix the interest rates at least once during the loan life.

The MTDS 2015 had also anticipated high interest rates on domestic debt instruments and aimed at reducing the large issuances of long term dated bonds of 10-year and 15-year. This was intended to avoid locking in high interest rates for a long period. The debt re-organisation from T-Bills to T-Bonds was therefore concentrated under 5-year instruments during the first two years of the strategy.

3.2 Implementation and Impact of the MTDS 2015

The Government adopted the MTDS 2015 Strategy risk and cost indicators as benchmarks rather than as targets. Because of this cautious approach, the implementation of the MTDS 2015 yielded improvements in our debt portfolio characteristics. The following were some of the actions taken to attain the set strategic objectives

a) Government well blended between long dated and short dated instruments. Where commercial loans were assumed, non-concessional financing was also included to smoothen out the maturity profile given the short term nature of commercial debt.

b) Concessional borrowing was pursued where it was available and directed to social service development projects as guided by the PDM2013.

c) Where terms were found to be in contradiction with the PDF2013 guidelines, the proposed financing was rejected.

d) Cautiously borrowed from the domestic financial market. Where yields were found to be high, Government rejected the bids. Therefore while the timing of the preferred domestic financing flows was greatly impaired, the yields and the preferred distribution between T-Bills and T-Bonds was attained.

e) Published the domestic debt issuance calendar on the MoFPED website

As a result, the implicit strategic objective to maintain the size of external debt as a share of total debt to less than 80 percent was not impaired. By the end of June 2016, the share of foreign to domestic debt is estimated to only reach 62.1 percent. Issuance of Treasury Bills and Treasury Bonds for both fiscal financing and the development of the domestic market were also implemented and the envisaged ratio of T-Bills to T-Bonds of 30:70 is consistent with the PDF 2013.

As anticipated, total debt increased from UGX 19.59 trillion as of end June 2014 to UGX 24.43 trillion[5] as at end June 2015 and is projected to increase to UGX 30.8 trillion by end June 2016,

[5] The change of total in US$ from US$7.53 trillion in June 2014 to US$7.10 trillion in June 2015 is a result of exchange rate appreciation for the period ended June 2015.

on the account of increased borrowing to finance key infrastructure projects in 2016 and over the medium term.

Table 4: Cost and Risk Indicators at End June 2014 and 2015, and End June 2016 Estimates

Cost and Risk Indicators		2014	2015	2016
		Outturn	Current	Estimates
Nominal debt as % GDP		28.6	32.8	38.1
PV as % of GDP		20.8	23.6	27.2
Cost of debt	*Interest payment as % GDP*	1.4	1.3	1.2
	Weighted Av. IR (%)	5.9	4.0	4.0
Refinancing risk	*ATM (years)*	11.8	12.2	11.9
	Debt maturing in 1yr (% of total)	22.4	22.4	14.1
	Debt maturing in 1yr (% of GDP)	7.3	7.3	6.8
Interest rate risk	*ATR (years)*	11.8	12.2	11.6
	Debt refixing in 1yr (% of total)	23.2	22.4	11.5
	Fixed rate debt (% of total)	100.0	100.0	94.6
FX risk	*FX debt (% of total debt)*	57.1	59.2	62.1
	ST FX debt (% of reserves)	4.6	1.5	1.7

Source: Ministry of Finance, Planning and Economic Development

Notwithstanding the increase in debt volumes, the key ratio of Present Value (PV) of debt to GDP has remained below the debt thresholds. The PV of debt to GDP of 23.6 percent (external 10.3 percent and domestic 13.3 percent) as of end June 2015 and the estimates of 27.2 percent of GDP for end June 2016 remains well below the PDM 2013 and EAC convergence threshold of 50 percent and also projected to remain below over the medium term.

- **PV-debt-GDP** has increased from 20.8 percent as of end June 2014 to 23.6 percent as of end June 2015 and is projected to increase to 27.2 percent by end June 2016. This is an improvement from the MTDS 2015 (on the account better financing terms concluded), which had estimated a PV-debt-GDP of 28.6 percent by the end of June 2016.

- The liquidity cost indicator of **interest payments to GDP** improved from 1.4 percent as of end June 2014 to 1.3 percent for end June 2015 but projected to improve further by the end of June 2016 to just 1.2 percent. This is consistent with the MTDS 2015 constraint of interest payment as percentage to GDP of less than 2 percent

- The **interest-payment-to-domestic-revenue** estimates for end 2016 of 6.8 percent is an improvement from 9.3 percent of end June 2015. The recent strong depreciation of the UGX did not significantly increase the interest cost in the budget given the nature of our external debt which is highly concessional and at very low interest rates. A better revenue performance during the FY2015/16 to-date than was estimated under the MTDS2015 also contributed to this improvement. The MTDS2015 interest payment-to-domestic revenue constraint of less than 15 percent was not violated.

- **Interest rate risk:** Despite the large volume of non-concessional and commercial borrowing during the period under review, the portfolios' weighted average interest rate (WAIR) was 4 percent as of end June 2015. The WAIR is estimated to remain at 4 percent for the financial year ending June 2016, which is well below the 6 percent cap set under the MTDS 2015.

- The MTDS 2015 had projected the domestic debt **ATM** to improve from 2.3 years for end June 2014 to 3.0 years by end June 2015. Through implementation of the strategy, Government was marginally short of meeting the target for end June 2015 and estimates of 3.9 years for end June 2016 are above the target. While Government has been cautious to issuing large volumes of long term dated instruments of 10-year and 15-year for fear of locking in high interest rates, the improvement in the ATM is mainly attributed to reduced T-Bills issuance over the period.

- Consistent with the improvements in the domestic debt ATM, the **T-Bills-to-T-Bonds ratio** is estimated to improve from 42:58 as of period ended June 2015 to 35:65 by end June 2016, tending towards our medium term T-Bills-to-T-Bonds targeted ratio of 30:70.

- The MTDS 2015 estimated the external debt **ATM** to be greatly impaired from 18.9 years as of end June 2014 to 11 years by end June 2020 mainly on the account of substantial volumes of non-concessional and commercial borrowing. However, our cautious implementation of the strategy has seen the external debt ATM being maintained at 18.7 years as of end June 2015 and it is estimated to only decline to 16.8 years by the end of June 2016. Generally the portfolio's ATM is estimated to remain at 11.9 years by the end of June 2016. The Government has cautiously contracted debt on terms below those estimated under the MTDS 2015.

4 Public Debt Management Strategy 2016 (PDMS 2016)

4.1 Key macroeconomic assumptions

The macroeconomic assumptions underpinning the PDMS 2016 are consistent with the medium term macroeconomic and fiscal framework for financial years 2015/16 – 2019/20. During the medium term, the Government shall pursue an expansionary fiscal policy to accommodate the large size of infrastructure projects.

- The medium term economic outlook assumes the economy to grow from 5.0 percent in FY 2015/16 to a medium term average of 5.7 percent. This growth will be driven by increased productive capacity in the economy, supported by improved infrastructure development, particularly in the energy and transport sectors towards which most of the borrowing is directed.

- The nominal exchange rate is projected to depreciate at an annual average of 4.8% over the medium term.

Table 5: Selected Medium Term Macroeconomic and Fiscal Assumptions

	2015/16	2016/17	2017/18	2018/19	2019/20
	Estimates	*Projections*	*Projections*	*Projections*	*Projections*
Fiscal Projections					
Revenue and grants (Shs. Bn)	13 306	14 811	16 170	18 132	20 602
Total expenditure and net lending (Shs. Bn)	18 943	20 942	22 514	24 780	26 439
Total Budget deficit (Shs. Bn)	-5 637	-6 131	-6 344	-6 648	-5 837
Public Sector interest expenditure	1 804	2 062	2 480	2 905	3 272
Public Sector Primary expenditure	17 139	18 880	20 034	21 875	23 167
Primary deficit (Shs. Bn)	-3 833	-4 069	-3 864	-3 743	-2 565
Grants					
As %ages of GDP					
Revenue and grants (%age of GDP)	15.7%	15.8%	15.8%	16.0%	16.5%
Total expenditure and net lending (%age of GDP)	22.3%	22.4%	22.0%	21.9%	21.1%
Total Budget deficit (%age of GDP)	-6.6%	-6.6%	-6.2%	-5.9%	-4.7%
Primary deficit (%age of GDP)	-4.5%	-4.4%	-3.8%	-3.3%	-2.0%
Memorandum Items					
Real MP GDP growth	5.0%	5.8%	6.1%	6.3%	6.5%
Nominal GDP (Shs. Bn)	84 984	93 473	102 407	113 001	125 168

Source: MoFPED-Macroeconomic Policy Department

- Government revenue, excluding grants, as a percentage of GDP is projected to grow by half a percentage point annually during the medium term from 13.0 percent of GDP in FY2014/15 and 13.5 percent of GDP in FY2015/16 to an average of 14.5 percent during the PDMS 2016 projection period.

- Consistent with Uganda's aspiration to transform from a peasant country to a modern and prosperous country in 30 years, as set out in the Vision 2040, Government expenditure is forecasted to increase from an outturn of 19.4% of GDP in 2014/15 to an average of 22% during the medium term.

- The fiscal deficit (including grants) is projected to expand from 4.6% of GDP in 2014/15 to peak at 6.6 percent for period ending June 2016. Thereafter, as revenues improve, the deficit will contract to an average of 6.0 percent of GDP over the medium term settling at 4.7 percent by the end of June 2020.

- The primary deficit is projected to rise from 3.9 percent of GDP in FY2014/15 to 4.5 percent by the end of FY2015/16 and to an average of 3.6 percent over the medium term projection period. To reduce the pressures on debt management, fiscal consolidation is projected towards the end of the medium term with a decreasing primary deficit of 2.0 percent of GDP by the end of FY2019/20, just below the EAC convergence threshold of 3 percent.

- Annual headline inflation is projected to fall to 6.3% in 2016/17, after which it will reduce to an average of 5% over the medium term, well within the EAMU convergence criterion of 8%.

4.2 Financing Strategy

The financing assumptions adopted for PDMS 2016 are consistent with the PDMF 2013. Accordingly, GoU will seek to achieve the most beneficial and cost-effective terms and conditions for external financing.

- Given the size of infrastructure projects with a large external content, the deficit will be largely financed using external borrowing. Domestic borrowing will only be used conservatively and as such, Government will scale back on domestic financing in the medium term.

- The Government shall continue to prioritize concessional financing as the preferred means of meeting external financing requirements. However, given the constraints to access large volumes of concessional[6] financing to meet Uganda's funding needs for large infrastructure projects, non-concessional borrowing will largely be considered over the medium term. Non-concessional borrowing shall nonetheless only be limited to projects that are financially and economically viable, and with rates of return much higher than

[6] Concessional loans are those whose grant element is not less than 35%. These typically come from multilateral creditors such as the IDA and the ADF/B.

the finance cost of the loan (an economic rate of return greater than the interest rate charged).

- Accordingly, during the medium term, non-concessional loans will be used to finance the following priority infrastructure projects: the Karuma, Ayago and Isimba hydropower dams, a number of transmission lines and industrial substations, rehabilitation of Entebbe international Airport, construction of the Albertine Region Airport, the first phase of the standard gauge railway, oil pipeline and a number of roads to support the oil and gas sector.

- The following terms as provided for under the PDMF 2013, have been assumed for all new external borrowing under this Public Debt Management Strategy:

  (i) Loans for social service delivery and development must be contracted on highly concessional terms. Highly concessional terms have been qualified to mean "IDA comparable or better terms" with a grant element[7] of not less than 50 percent.

  (ii) Loans for projects intended to enhance productivity but on less concessional terms than those in (i) above shall be on terms with a grant element of not less than 35 percent.

  (iii) Finally, non-concessional loans have been limited to only those with terms that would provide a grant element of not less than 25 percent in addition to providing an economic rate of return. The grant element of not less than 25 percent also applies to any commercial borrowing during the medium term.

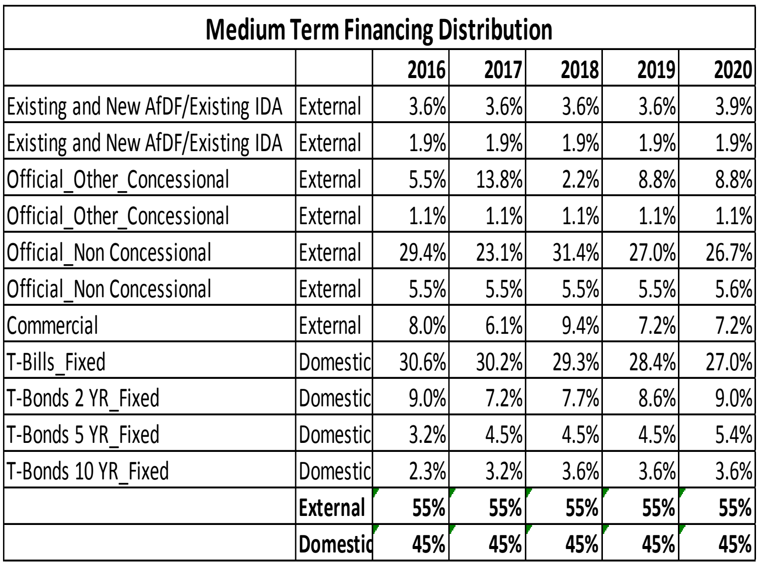
4.2.1 Analytical Foundation of PDMS 2016

Recognising the fact that concessional borrowing will be limited and not suffice to meet Government's planned infrastructure projects, alternative financing options were examined to identify a strategy that will provide the minimum cost and risk exposure to our debt portfolio i.e. Euro Bond Issuance, large concentration of domestic borrowing, Pure Commercial Borrowing, and a blend between concessional and non-concessional financing.
Issuance of an International Sovereign Bond (Euro Bond) and a large concentration of domestic borrowing were found to be with the highest cost and significant risk exposure. As

[7] *The grant element measures the concessionality (softness) of a loan and reflects the financial terms of a transaction: interest rate, maturity (interval to final repayment) and grace period (interval to first repayment of capital). It is calculated as the difference between the face value of a loan and the discounted present value of the debt service payments the borrower will make over the lifetime of the loan, expressed as a percentage of the face value.*

a result, also recognizing the limitations to access highly concessional financing, the adopted financing strategy is a blend between concessional and non-concessional external financing, and a limited size of domestic debt financing

Table 6: Distribution of Financing Options



Medium Term Financing Distribution						
		2016	2017	2018	2019	2020
Existing and New AfDF/Existing IDA	External	3.6%	3.6%	3.6%	3.6%	3.9%
Existing and New AfDF/Existing IDA	External	1.9%	1.9%	1.9%	1.9%	1.9%
Official_Other_Concessional	External	5.5%	13.8%	2.2%	8.8%	8.8%
Official_Other_Concessional	External	1.1%	1.1%	1.1%	1.1%	1.1%
Official_Non Concessional	External	29.4%	23.1%	31.4%	27.0%	26.7%
Official_Non Concessional	External	5.5%	5.5%	5.5%	5.5%	5.6%
Commercial	External	8.0%	6.1%	9.4%	7.2%	7.2%
T-Bills_Fixed	Domestic	30.6%	30.2%	29.3%	28.4%	27.0%
T-Bonds 2 YR_Fixed	Domestic	9.0%	7.2%	7.7%	8.6%	9.0%
T-Bonds 5 YR_Fixed	Domestic	3.2%	4.5%	4.5%	4.5%	5.4%
T-Bonds 10 YR_Fixed	Domestic	2.3%	3.2%	3.6%	3.6%	3.6%
	External	**55%**	**55%**	**55%**	**55%**	**55%**
	Domestic	**45%**	**45%**	**45%**	**45%**	**45%**

Source: 2016 MTDS Analytical Tool

The Strategy assumes the financing distribution as detailed in the medium term fiscal framework, between external and domestic with a large bias towards non-concessional external financing.

An average of 55 percent of external new borrowing over the medium term fiscal framework is assumed, of which over 27.5 percent and 7.5 percent of the annual financing requirement is from non-concessional and commercial financing sources respectively, table 6 refers.

In order to establish the risk and cost benchmarks to be adopted during the implementation of the Public Debt Strategy, the Medium Term Debt Management Strategy Analytical tool (MTDS-AT) was used. The tool provides the analytical foundation for a debt management strategy to steer the Government's debt portfolio's towards a set of preferred cost and risk characteristics. Particularly by outlining the government's preferred composition of the debt portfolio, taking into account the cost-risk trade-offs inherent in debt management. The choice of the financing strategy to be adopted during the medium term is informed by considering different financing options.

Adopting the medium term macro and fiscal financing assumption, a set of cost and risk ratios have been generated by the MTDS-AT. The identified cost and risk ratios will be applied as constraints while implementing the Public Debt Strategy during the FY2016/17 and shall inform the debt management decisions over the medium term framework.

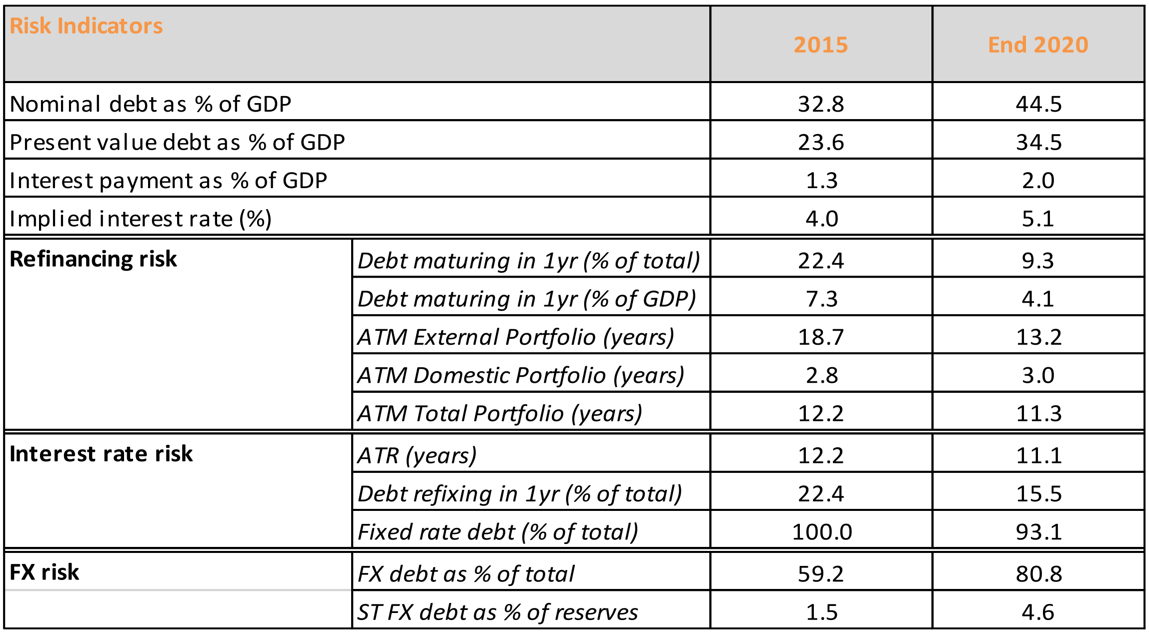
4.2.2 Cost/Risk Analysis and Strategic Guidelines

On the account of the medium term fiscal framework, which largely accommodates a large size of increased borrowing to finance the greatly needed infrastructure development, the total nominal debt is estimated to more than double over the coming 5 years, rising from UGX 24.43 trillion (32.8 percent of GDP) as of end June 2015 to UGX 53.2 trillion (44.5 percent of GDP).

Notwithstanding the increase in debt volumes, the key ratio of **Present Value (PV) of debt to GDP** (PV-debt-GDP) shall remain below the debt strategy thresholds and EAC convergence threshold of 50 percent and is also projected to remain below these thresholds over the medium term.

- **PV-debt-GDP** is estimated to increase from 23.6 percent for end June 2015 to 34.5 percent by end June 2020 mainly on the account of prudent debt management and improvement GDP growth assumptions. The impact is largely on the PV of external debt to GDP, which is estimated to rise from the current 10.3 percent as of end June 2015 to 26.0 percent. Our domestic debt exposure is projected to reduce mainly on the account of reduced Government appetite for domestic debt as the yields remain high.

Table 7: Cost and Risk Indicators at End 2020, 2016 PDMS



Risk Indicators		2015	End 2020
Nominal debt as % of GDP		32.8	44.5
Present value debt as % of GDP		23.6	34.5
Interest payment as % of GDP		1.3	2.0
Implied interest rate (%)		4.0	5.1
Refinancing risk	*Debt maturing in 1yr (% of total)*	22.4	9.3
	Debt maturing in 1yr (% of GDP)	7.3	4.1
	ATM External Portfolio (years)	18.7	13.2
	ATM Domestic Portfolio (years)	2.8	3.0
	ATM Total Portfolio (years)	12.2	11.3
Interest rate risk	*ATR (years)*	12.2	11.1
	Debt refixing in 1yr (% of total)	22.4	15.5
	Fixed rate debt (% of total)	100.0	93.1
FX risk	*FX debt as % of total*	59.2	80.8
	ST FX debt as % of reserves	1.5	4.6

Source: MTDS- 2016 Analytical Tool

- The liquidity cost indicator of **interest payments to GDP** is estimated to rise from 1.3 percent for end June 2015 to reach 2.0 percent by end June 2020, which is the set under this year's debt strategic objectives. External debt, which the largest driver of this cost indicator must therefore be contracted at less than the anticipated interest rates during the MTDS 2016.

The **interest-payment-to-domestic-revenue:** The PDMS 2016 estimates interest payment as percentage of domestic revenue to reach only 11.9 percent by end June 2020, which shall be within the Public Debt Management Framework benchmark.

- During the implementation of the 2016 Strategy, the **ATM** for domestic debt is estimated to reach 3.9 years, which is consistent with the PDF 2013 target of not less than 3.0 years. This shall mainly be on the account of the Government's cautious approach to issuing large volumes of new domestic debt while re-aligning the T-Billls towards T-Bonds.

- While the end June 2016 estimates of external debt ATM indicate a deterioration to 16.8 years from 18.7 years, the end June 2020 ATM is estimated to deteriorate further to 13.2 years. This shall be on the account of substantial amounts of non-concessional and commercial borrowing during the medium term. Government shall therefore continue its cautious approach during the FY 2016/17 to contract external debt on better terms to ensure that the ATM for external debt does not degenerate to less than 15 years.

- **Interest rate Risk:** The portfolios' weighted average interest rate (WAIR) under the MTDS2015 was estimated to remain at 5.9 percent. The portfolio's new estimates are now projected to improve to 5.1 percent by end June 2020, which is well below the cap of 6 percent, largely on the account of relatively better external debt terms despite the high domestic interest rates.

- The **T-Bills-to-T-Bonds ratio** is projected to continuously improve throughout the medium term from the 42:58 as of end June 2015 to 28:72 by the end June 2020, surpassing the PDF 2013 target of 30:70.

- The large volume of external financing projected during the medium term to address the large size of infrastructure needs is likely to impair the **share of external debt to the total portfolio**. While external debt currently accounts for 59.2 percent of the total debt portfolio, the position is estimated to reach 80.8 percent by end June 2020, which is marginally short of the maximum level of 80 percent. During the implementation of the PDMS 2016, Government shall ensure that the PDF2013 set level of 80 percent is not breached.

4.2.2.1 The PDMS2016 Strategic Guidelines

Consistent with the Public Debt Management Framework (PDF) of 2013 primary objectives and upon examination of the MTDS-AT's alternative financing options estimates of the various debt portfolios' cost and risk indicators over the medium term, the following are the PDMS 2016 strategic guidelines. As applied, in the just concluded Debt Strategy implementation, these strategic objectives shall be used as constraints within which to operate and not as targets.

1) Uphold the EAC convergence criteria for public debt management of PV of Debt-to-GDP of less than 50 percent;
    a) PV of external debt as a percentage of GDP of less than 30 percent
    b) PV of domestic debt as a percentage of GDP of less than 20 percent

2) Constrain the portfolio's weighted average interest rate to less than 6% over the medium term.
    a) External debt portfolio's WAIR of less than 1.5 percent
    b) Domestic debt portfolio's WAIR of less than 15.5 percent

3) Lengthening the portfolio's ATM by reducing the ratio of T-Bills-to-T-Bonds to 30:70.

4) Limit the interest payment as percentage to GDP to less than 2 percent

5) Limit the interest payment-to-domestic revenue to less than 15 percent

6) Despite the large volumes of external financing projections, cap the share of external debt to 80 percent of the total portfolio.

4.2.2.2 The PDMS 2016 Strategic Action to meet the set Guidelines

a) Contract external debt on better terms to ensure that the ATM for external debt does not degenerate to less than 15 years;

    (i) Limit non-concessional and commercial borrowing to only those with terms that would provide a grant element of not less than 25 percent.

b) Appropriately issue more longer term domestic debt instruments over T-Bills in times of favourable domestic financial market conditions

c) Publish the domestic debt issuance calendar by 30th June 2016

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