

Bank Of Uganda

FINANCIAL STABILITY REPORT

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GLOSSARY

ALSI	All Shares Index
BCBS	Basel Committee on Banking Supervision
CAR	Capital adequacy ratio
CCB	Countercyclical capital buffer
CI	Credit institution
D-SIB	Domestic systemically important bank
EAC	East African Community
ECB	European Central Bank
EMEs	Emerging market economies
EU	European Union
FSB	Financial Stability Board
FSR	Financial stability report
GDP	Gross domestic product
GFSR	Global financial stability report
G-SIB	Global systemically important bank
IMF	International Monetary Fund
LCR	Liquidity coverage ratio
MDI	Microfinance deposit-taking institution
MFPED	Ministry of finance, planning and economic development
NPLs	Non-performing loans
NSE	Nairobi stock exchange
RHS	Right hand side
ROA	Return on assets
ROE	Return on equity
RWA	Risk-weighted asset
SI	Statutory instrument
SIFI	Systemically important financial institution
UBOS	Uganda Bureau of Statistics
UGX	Uganda shilling
URA	Uganda Revenue Authority
USE	Uganda Securities Exchange
USD	US dollar
WEO	World Economic Outlook

A NOTE ON FINANCIAL STABILITY

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

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

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

FOREWORD AND ASSESSMENT OF FINANCIAL STABILITY

The *Financial Stability Report* of the Bank of Uganda (BOU) analyses the performance and condition of the Ugandan banking system and assesses threats to systemic stability.

The Ugandan economy improved during 2012/13, with real GDP growth accelerating to 5.8 percent, from 3.4 percent in the previous year and core inflation falling to 5.8 percent in June 2013 from 19.6 percent in June 2012. The recovery of the economy contributed to a strengthening of the financial position of the Ugandan banking system. Non-performing loans as a share of total loans fell to 4 percent in June 2013 from 4.7 percent in September 2013. Strong profitability, combined with capital injections to meet the new statutory minimum paid-up capital of Ushs. 25 billion, which came into force in March 2013, raised the tier one capital adequacy ratio of the banking system to 21.3 percent in June 2013, which is more than double the statutory minimum of 8 percent.

The Government and the BOU have taken several steps to strengthen the regulatory framework in order to enhance the resilience of the banking system. The Honourable Minister of Finance, Planning and Economic Development issued a statutory instrument (SI) in May 2013 to introduce Basel III capital measures, including a capital conservation buffer of 2.5 percent of risk-weighted assets. The SI will also allow the BOU to impose a countercyclical capital charge in periods of excess credit growth, to dampen volatility in the credit cycle, and to impose additional capital charges on domestic systemically important banks (D-SIBs). This Report contains a chapter which outlines how the capital surcharge for D-SIBs will be applied.

The BOU has also strengthened its monitoring and surveillance of factors which might pose potential risks to the banking system. All commercial banks have begun providing data on their non-performing loans broken down by the currency denomination of the loan. In addition, the property price indices that are compiled in collaboration with the Uganda Bureau of Statistics will be published by the BOU on its website and in other publications to improve the availability of financial information for banks and borrowers.

Our overall assessment of financial stability is that there are currently no major threats to the systemic stability of the Ugandan banking sector, given the strong financial condition of the banks and the prevailing financial and economic circumstances. Nevertheless, the BOU will continue to monitor closely the condition of the financial system and tackle any threats to its stability which might emerge in the future.



Emmanuel Tumusiime-Mutebile

GOVERNOR

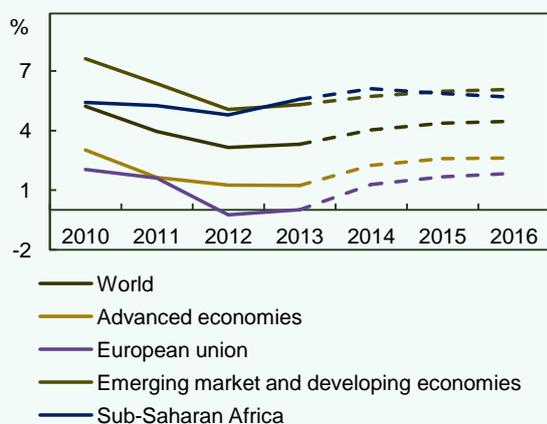
1. THE MACROECONOMIC ENVIRONMENT AND FINANCIAL DEVELOPMENTS

Global and national economic and financial market sentiment improved over the last year to June 2013. In the East African region, inflation pressures eased and there was increased economic growth. However, there are several key risks stemming from the macroeconomic environment that could lead to financial stress for domestic banks. The first is that any renewed economic weakness in Europe could trigger further weakening of export performance, as well as a decline in financial flows. Secondly, any disorderly adjustment to the credit and property market upswings being experienced in most emerging markets could lead to capital outflows from the region and increase exchange rate depreciation.

1.1. Global economic conditions

Global financial and market conditions improved substantially in the first half of 2013. This was due to a combination of renewed monetary stimulus and continued liquidity support which enhanced confidence, and strengthened the economic outlook (IMF WEO April 2013). However, the acceleration of economic growth is still constrained by weak domestic demand, continued fiscal consolidation by European governments, and the protracted recession in the Euro area. The downside risks to global growth also include the possibility of a growth slowdown in emerging market economies, especially given slowing credit and possibly tighter financial conditions if the anticipated unwinding of monetary policy stimulus in the United States leads to sustained capital flow reversals (IMF WEO Update July 2013). In addition, a deeper recession in advanced economies may lead to FDI outflows, with negative implications for Uganda's balance of payments.

Chart 1: Projected annual GDP growth for major regions



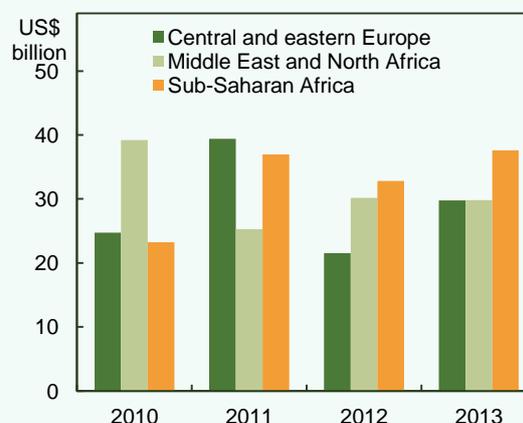
Source: IMF World Economic Outlook Update, April 2013

Notes: 2014, 2015 and 2016 figures are forecasts.

1.2. Developments in the Euro area

Despite recent optimistic sentiments that growth in the Euro area is recovering, economic performance remains a concern for global financial stability. Growth for 2013 in the Euro area is still forecast to be negative despite the strong policy action that has led to a reduction in acute short-term stability risks. While price and liquidity conditions in sovereign, bank, and corporate debt markets have improved dramatically, growth is likely to be constrained by the ongoing fiscal adjustments, and high unemployment. The European Central Bank (ECB) has also pointed out the need for Euro banks to raise further capital.

Chart 2: FDI flows and aid to different regions (US\$ billion)



Source: IMF World Economic Outlook Update, April 2013

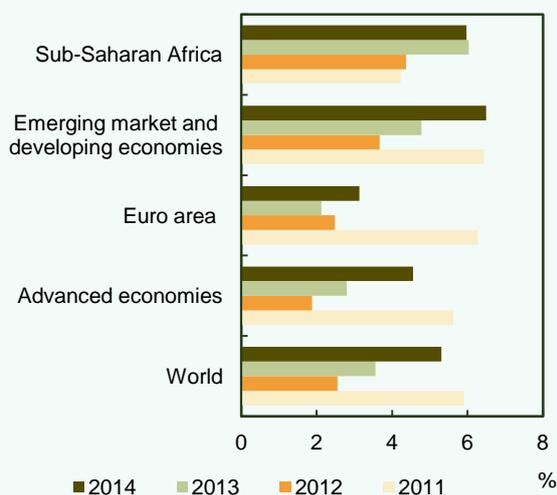
The continued weakness in the Euro area could have a negative impact on Uganda's export industry for which the European Union (EU) is the second largest trading partner with a share of 21 percent of exports in 2012/13. The value of Ugandan exports to the EU dropped by 2 percent to US\$539.2 million in 2012/13. On a similar note, the value of foreign direct investment inflows from Europe reduced by 5 percent from US\$201.8 million in 2010 to US\$193 million in

2012. The growing unemployment situation in the euro area has led to a decline in the value of remittances sent to Uganda. In 2012, the value of remittances from Europe fell significantly by US\$38.2 million to US\$187 million in 2011 from highs of US\$225.5 million in 2010. Therefore, a downturn or slow recovery in the Euro zone could negatively affect Uganda's financial flows.

1.3. Emerging and developing countries

The IMF, in the WEO of April 2013, noted that growth in emerging and developing economies during 2012 was impacted by the sharp deceleration in demand from key advanced economies, domestic policy tightening, and the end of investment booms in some of the major emerging market economies. However, with improved consumer demand and exports reviving, most emerging economies in Asia and sub-Saharan Africa are forecast to witness higher growth as demand from some advanced economies begins to pick up. Growth in sub-Saharan Africa is projected to reach 5.5 percent and 6 percent in 2013 and 2014 respectively (GFSR, 2013).

Chart 3: Export of goods and services across regions

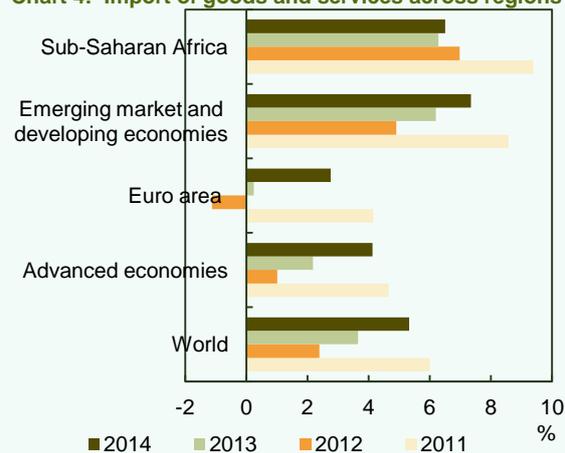


Source: IMF World Economic Outlook Update, April 2013

However, the main risks to the above growth projections for emerging markets are increasingly local rather than external in nature. The recent easing in international commodity prices may possibly intensify, and any such easing is likely to affect the

value of Uganda's exports and thus the trade account. More pronounced risks in the sub-Saharan region include the potential for reversal of capital flows and possibility adverse weather shocks (IMF 2013). Many emerging market and developing economies face a trade-off between macroeconomic policies to support weak activity and those to prevent capital outflows. Nonetheless, macroprudential and structural reforms can help make this trade-off less severe.

Chart 4: Import of goods and services across regions



Source: IMF World Economic Outlook Update, April 2013

1.4. Developments in the East Africa region

Economic growth during 2012/13 in the East African region rebounded owing to prudent fiscal and monetary policies, with Rwanda registering the highest growth rate of 7.6 percent. Regional growth rates averaged 5.9 percent in 2012/13 and are forecast by the IMF to reach 6.4 percent in 2013/14, aided by natural resource discoveries, improved agricultural performance, and economic diversification.

Regional inflation rates slowed down significantly from highs of 11.5 percent in 2011/12 to 6.7 percent in 2012/13 due to the tight monetary stance by the respective central banks. Unlike Kenya and Uganda, Tanzania did not fight inflation as aggressively and as quickly during the inflationary spike of 2011. This resulted in a slower reduction in inflation rates for Tanzania. In general, the drop in inflation levels impacted positively on financial sector performance which reduced risks to financial stability in the region.

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

	2010	2011	2012	2013
Burundi	3.8	4.2	4.8	4.5
Kenya	5.6	5.0	5.2	5.9
Rwanda	7.5	8.8	7.6	7.6
Tanzania	6.5	6.7	6.4	7.0
Uganda	5.9	6.7	4.2	4.8

Source: IMF, WEO Database April 2013

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

	2010	2011	2012	2013
Burundi	4.1	14.9	10.3	9.0
Kenya	4.1	14.0	10.6	5.2
Rwanda	2.3	5.7	7.9	4.9
Tanzania	10.5	7.0	17.4	9.0
Uganda	9.5	6.5	23.4	5.5

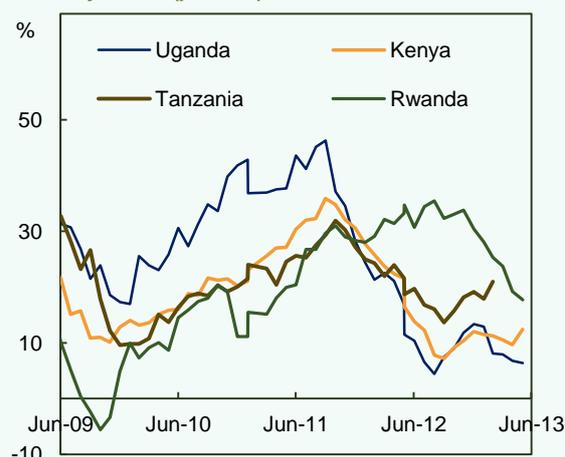
Source: IMF, WEO Database April 2013

Financial performance of banks in the region

Following the easing of inflationary pressures across the EAC region, EAC central banks reduced their policy rates during 2012/13. However, this did not translate into a similar re-pricing of lending rates by banks. Partly as a result of this, coupled with reduced aggregate demand, bank lending in all the East African countries slumped to lower levels for the period 2012/13 as compared to 2011/2012 with Uganda witnessing the least growth in private sector credit at 6 percent for the period under review. The annual growth rate of credit to the private sector in the year to June 2013 reduced to a regional average of 12 percent as compared to 19 percent recorded in June 2012. There is the risk that any continued stagnation of credit growth may translate into low corporate activity and economic growth.

In the period between June 2012 and June 2013, the ratio of non-performing loans (NPLs) to total gross loans rose for all the East African countries with Burundi registering the highest NPL ratio of close to 10 percent. As banks continue to reduce lending rates going forward, it is expected that loan performance will improve.

Chart 5: Annual growth of credit extended to the private sector by banks (percent)



Source: EAC Central Banks

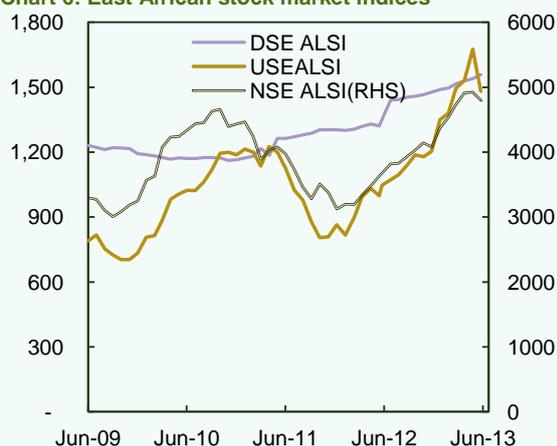
In general, banks in East Africa remained well capitalised with the tier one regulatory capital-to-risk weighted assets ratio averaging 19.9 percent at the end of June 2013. Also, banks' profitability in the region rose with return on assets rising from 2.7 percent to 3.2 percent between June 2012 and June 2013. In contrast, average return on equity dropped from 22.6 percent to 17.3 percent within the same period.

Developments in regional securities markets

Stock market activity rose significantly across the three regional exchanges during 2012/13 as compared to 2011/2012. This was on account of increased foreign investor activity coupled with the good macroeconomic conditions. The Dar es Salaam bourse witnessed relatively stable activity in the period under review and similarly in Kenya, significant activity was realised after the peaceful presidential elections. In Uganda, the listing of Umeme¹ on the Uganda Securities Exchange (USE) in the first half of 2012/13 coupled with relative stability in the macro environment increased investor activity and improved performance. The shares of the banks listed on the USE; Stanbic bank, DFCU and Bank of Baroda, were relatively stable during the year, partly reflecting very limited trading of these shares as investors preferred to hold.

¹ Umeme is an energy distribution network company in Uganda.

Chart 6: East African stock market indices

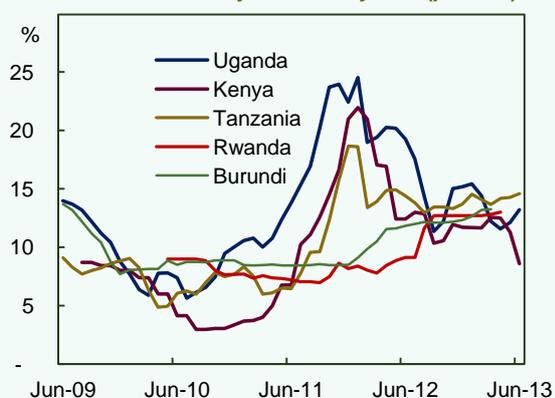


Source: EAC Central Banks

Regional Treasury securities markets

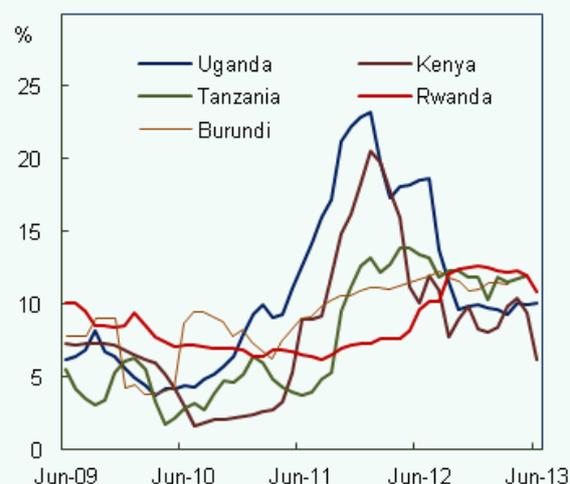
As financial market conditions continued to improve during 2012/13, Treasury bill yields for all East African countries, with the exception of Rwanda and Tanzania, dropped during the period. The 91-day and 364-day Treasury bill rates for Uganda experienced a significant fall from 18.5 and 19.2 percent in June 2012 to 10 percent and 13 percent in June 2013 respectively. In the same period, Rwanda registered the highest Treasury bill rates for 91 days while Tanzania registered the highest rate for 364 days. While the fall in Uganda’s treasury yields signals better financial sentiment for Ugandan banks, it may increase the risk of potential capital outflows by offshore yield-seeking investors. Ugandan banks, however, hold adequate funds to withstand any rapid outflows of short-term wholesale funds by offshore institutions.

Chart 7: Yields for one-year treasury bills (percent)



Source: EAC Central Banks

Chart 8: Yields for 91-day treasury bills (percent)

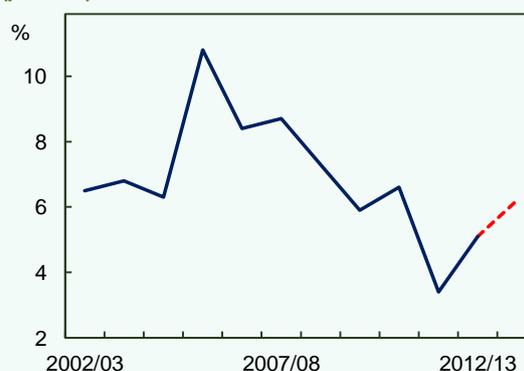


Source: EAC Central Banks

1.5. Uganda’s macro financial environment

Preliminary data shows that real GDP in Uganda grew by 5.1 percent in 2013/14, a significant increase from the 3.4 percent registered in 2012/13 (Ministry of finance, planning and economic development, Background to the Budget June 2013). The strong rebound in economic growth was mainly driven by an increase in net exports. Furthermore, growth of Uganda’s economy is expected to improve if the recovery in the advanced economies stays on course. Domestic factors are also forecast to improve including, the expected reduction in inflation to stabilise at 5 percent in the medium-term and, a possible drop in lending rates as banks re-price loans going forward. This is likely to improve business activity and contribute to achieving the forecast real GDP growth of 6.2 percent in 2013/14.

Chart 9: Annual real GDP growth rates at market prices (percent)

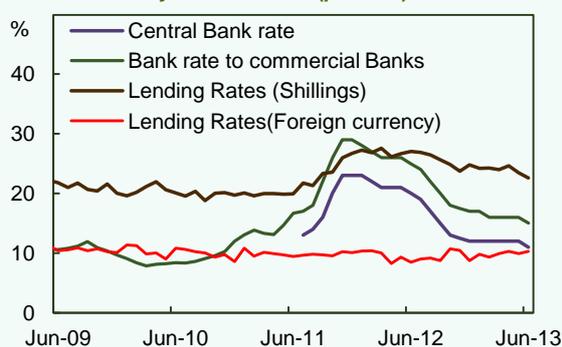


Source: Bank of Uganda

Inflation and interest rates

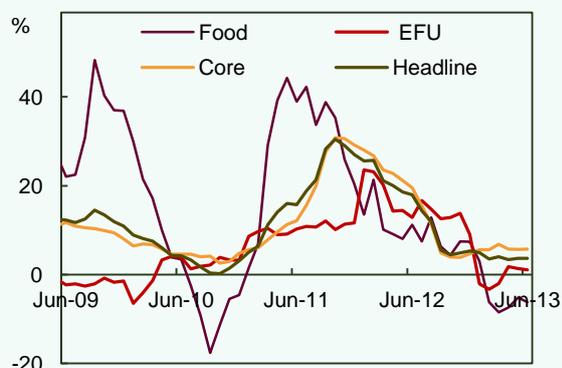
Inflation declined to 3.4 percent in June 2013 from 16 percent registered in June 2012 in response to the Bank of Uganda's tight monetary stance. As inflationary pressures eased, the central bank rate (CBR), reduced from 19 percent in June 2012 to 11 percent in June 2013. Although the reduction in the CBR was not fully reflected to the same magnitude in bank lending rates, lending rates for shilling loans fell from 27 percent in June 2012 to 23 percent in June 2013. This is expected to lead to an improvement in credit demand moving forward.

Chart 10: Monthly interest rates (percent)



Source: Bank of Uganda

Chart 11: Domestic annual inflation (percent)



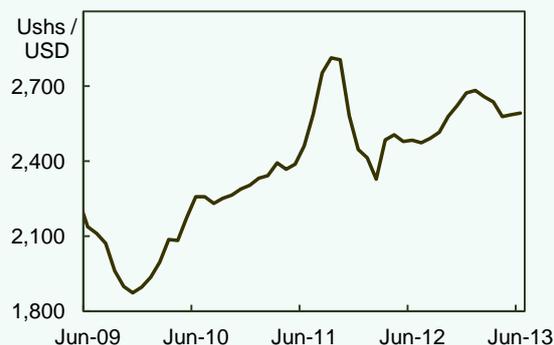
Source: Bank of Uganda

Foreign exchange market

During 2012/13, exchange rate risks to bank performance remained minimal, aided by a very stable foreign exchange market. In the second quarter of 2012/13, the shilling experienced depreciation pressures due to the uncertainty created by the suspension of donor aid. The shilling later regained some of its losses in the last two quarters, supported by exports proceeds and remittances coupled with

reduced import demand. The shilling depreciated by 4.4 percent on a year-on-year basis in 2012/13.

Chart 12: Monthly average exchange rate for the Ugandan shilling against the US dollar

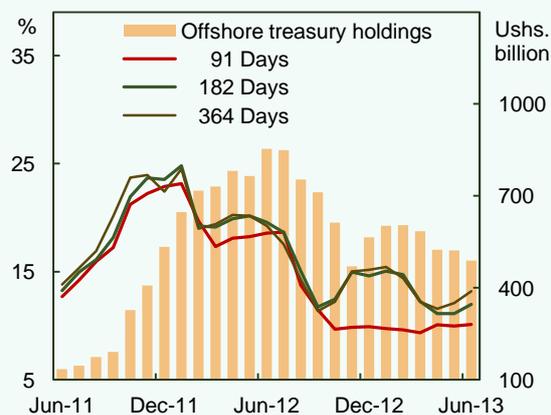


Source: Bank of Uganda

Yield on treasury securities

The reduction in policy rates over the year to June 2013 was a key factor in the drop in the average yields on government securities. This was reflected in the decline in 91-day, 182-day and 364-day Treasury bill rates from 18.6 percent, 19.6 percent and 19.2 percent in June 2012 respectively to 10.2 percent, 12.0 percent and 13.2 percent in June 2013. Nevertheless, these rates remain the highest in the EAC region.

Chart 13: Treasury bill yields and offshore holdings of treasury securities



Source: Bank of Uganda

While higher interest rates had previously encouraged yield-seeking offshore investors to switch to Ugandan securities, the drop in interest rates during 2012/13 contributed to the reduction in offshore holdings of treasury securities by 48 percent from Ushs.853 billion held at June 2012 to Ushs.489 billion held at June 2013. The increase of the CBR to 12 percent in

August 2013 to dampen inflation pressures is likely to attract increased inflows. In addition, given that banks had increased their investment in government securities, which grew by 20.8 percent in the year to June 2013, higher than 3.2 percent growth rate in June 2012, the recent rise in the CBR is likely to boost their earnings.

1.6. Uganda's real estate sector

In 2011, Bank of Uganda and UBOS started to collect real estate data and compile real estate indices (REIs). The REI program produces quarterly data on changes in the volume of real estate and prices paid by buyers for a representative basket of real estate properties and related services on a quarterly basis. The global financial crisis which began in 2007 showed how unsustainable real estate booms can lead to a build-up of financial risks and lead to bank failure. The aim of compiling REIs is to facilitate the analysis and amelioration of such risks.

Overall, 2012/13 saw a gradual resurgence in land and housing market activity, which, like in most emerging economies, has been occurring in an environment of stable exchange rate and relative decline in domestic inflation.

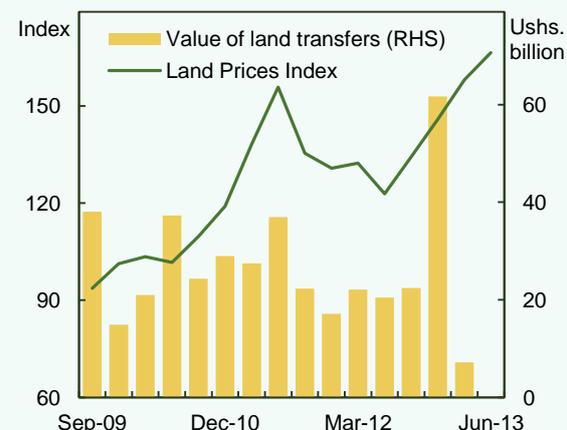
Land prices

The land price index (LPI) is a measure of the percentage change of the average price of buying a unit of land for commercial or residential purposes. Recent trends in the aggregate LPI² showed that the unit cost of land in the greater Kampala area increased by 25.4 percent between June 2012 and June 2013, compared to a reduction of 21.0 percent between June 2011 and June 2012. The share of bank lending for land purchase to total credit to the real estate sector also rose from 1.1 percent in June 2012 to 1.8 percent as at June 2013. This is not a

² The land price index is a weighted quarterly price index that gives a measure of the percentage change in the average price of a unit of land (one square meter). Weights were developed for the land price index with a base period of 2009/10. In the period 2009/2010, Kampala central and Wakiso were allocated the highest weights by region because Wakiso had the largest volume of land on sale while Kampala Central had the highest unit cost of land per square metre.

very significant exposure by commercial banks and represents relatively low risk.

Chart 14: Land price index and land transfer values



Source: Uganda Bureau of Statistics

Data from Uganda Revenue Authority (URA) also showed a rise in volume of land transfers. It should be noted that the low values of land transferred in the quarter to March 2013 were because of the closure of the land registry in that period and does not contradict the land price index which indicates an increase in the value of land for sale.

Commercial real estate

The commercial rental cost index³ indicated that there was a 22.1 percent decrease in the cost of commercial building rental space between the base-quarter of September 2012 and June 2013. The changes in rental cost may be partly caused by changes in exchange rate (for rent charged in foreign currency) or a drop in rental cost due to increased supply of rental space from the construction observed in the regions.

Commercial mortgages comprised 21.2 percent of bank credit extended to the building, construction and real estate sector as at June 2013. Reductions in this index reflect a risk to commercial banks arising from the ability of borrowers/builders to repay loans.

³ The commercial buildings rental price index (CBRPI) is a weighted quarterly price index that gives a measure of the percentage change in the average rental cost of a unit (one square metre) of rental space in commercial buildings. A frame of 990 commercial buildings in the greater Kampala region was used to develop the weights for the commercial buildings rental cost index.

Table 2: Commercial buildings' rental cost index

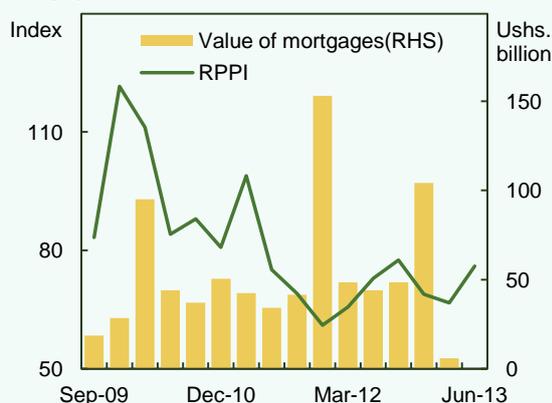
Period	Sept-12	Dec-12	Mar-13	Jun-13
Index	100.0	99.3	95.3	77.9

Source: Uganda Bureau of Statistics

Residential property

There was a 4.2 percent rise in the residential property price index (RPPI)⁴ between June 2012 and June 2013. The rise in house prices was still much lower than the highs seen before 2012 due to lower volume of listings. With economic activity expected to pick up, and banks reporting an easing of credit standards for mortgages, it is expected that house prices are likely to continue rising in the near term. At bank level, as a ratio of lending to the real estate sector, residential mortgages account for 29.3 percent of bank credit and so, banks should take into account the rise in house price inflation to avoid significant exposure.

Chart 15: Residential property price index and value of mortgages transferred



Source: Uganda Bureau of Statistics

1.7. Conclusion

During 2012/13, macro financial risks to Uganda's banking sector stability eased. The main factors behind the reduction in risks were the improvement in the macroeconomic conditions in the second half of 2012/13, better financial market sentiment and bank performance. However, the outlook could be nuanced

⁴ The Residential Properties Price index (RPPI) is a weighted quarterly price index that gives a measure of the percentage change in the average cost of purchasing a residential house in the greater Kampala area.

by risks arising from a slow recovery in the Euro zone which may affect business activity and credit, rising domestic inflationary pressures and the risks from portfolio outflows.

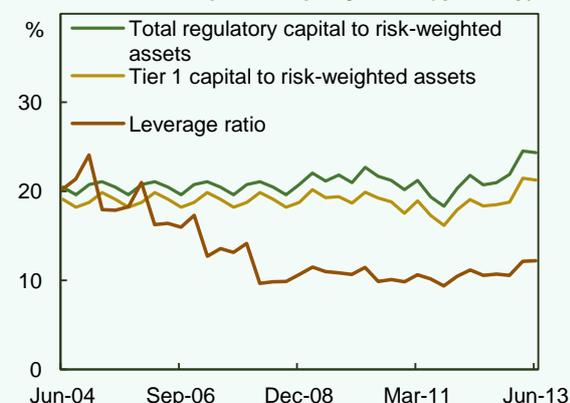
2. KEY DEVELOPMENTS IN THE BANKING SYSTEM

The Ugandan banking sector performed well in 2012/13. Capital adequacy levels remained strong, aided by high profits, and liquidity and funding conditions improved. However, bank lending growth remained lower than the previous year, with banks reducing their risk-weighted assets and switching to investing in government securities. In addition, asset quality and rapid growth in foreign currency lending remain a concern. Although bank lending has started growing, a rise in interest rates could affect marginal borrowers and bank interest income could be compressed and affect profitability going forward.

2.1. Capital adequacy

Ugandan banks remain well capitalised and have adequate capital buffers to withstand shocks. In the year to June 2013, the tier one capital adequacy ratio increased to 21.3 percent from 18.3 percent in the previous year, while the ratio of total regulatory capital to risk-weighted assets rose from 20.7 percent to 24.3 percent, aided by an increase in paid-up capital of 44.3 percent. The rise in capital also led to an improvement in the leverage ratio⁵, which is a new indicator of banks' capital adequacy, from 10.6 percent to 12.2 percent in the year to June 2013, far above the minimum of 3 percent recommended by the Basel Committee on Bank Supervision (BCBS).

Chart 16: Banks' capital adequacy ratios (quarterly)

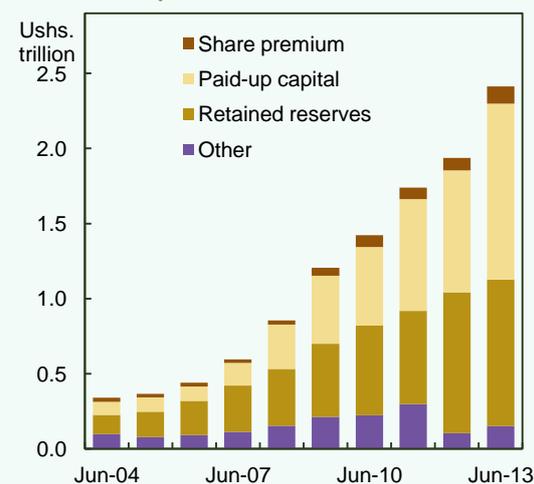


Source: Bank of Uganda

Regarding the composition of capital, banks' capital is of high quality, composed largely of equity (paid-up capital) and retained reserves. The type of capital held by banks implies that they already meet Basel III capital requirements regarding eligible types of capital.

⁵ The leverage ratio recommended in Basel III is computed as the ratio of the average three-month regulatory tier one capital to total assets plus off-balance sheet items.

Chart 17: Composition of banks' shareholders' funds



Source: Bank of Uganda

The strong rise in the overall level of capital was a result of higher regulatory capital requirements; Bank of Uganda required all banks to increase their minimum unimpaired paid-up capital from Ushs.4 billion to Ushs.25 billion effective 1st March 2013, to which all banks complied. In addition, new minimum capital requirements are due to come into effect as part of the Basel III package to improve the soundness and resilience of the banking system. This follows the signing of The Financial Institutions Enhancement of Minimum Ongoing Capital Requirements Instrument on 24th May 2013, by the Minister of Finance, which will require all banks to hold a capital conservation buffer and for domestic systemically important banks (D-SIBs), an additional loss absorbency capital buffer.

From January 2015, all banks will be required to hold an additional 2.5 percent of common equity above the minimum requirements in the form of a conservation buffer, while D-SIBs will have to hold an additional 1 percent of common equity. This will result into higher

minimum ratios; the tier 1 capital ratio will rise from 8 percent to 10.5 percent (11.5 percent for D-SIBs), and the total regulatory capital ratio will rise from 12 percent to 14.5 percent (15.5 percent for D-SIBs).

The current tier one capital adequacy ratios of banks indicate that they are well placed to meet the new regulatory requirements. This level of capital should provide banks with the scope to absorb a significant decline in asset quality without threatening the solvency of the banking system. The Instrument also provides Bank of Uganda with the powers to impose additional macroprudential requirements, including the Basel III counter-cyclical capital buffer, during periods of rising systemic risk to help build greater cyclical resilience and to assist in dampening the credit cycle.

Chart 18: Banks' ratio of risk-weighted assets to total assets (percent)



Source: Bank of Uganda

2.2. Earnings and profitability

In the year to June 2013, Ugandan banks maintained the trend of good profitability recorded in the previous year. The solid profits in the last two years enabled the banking system, via retained earnings, to increase the level of capital available to absorb future losses. The main contributing factor was net interest income, which increased from Ushs.1,262 billion in 2011/12 to Ushs.1,302 billion in 2012/13. As a share of total income, interest income on loans and advances accounted for 54.6 percent, while income on government securities accounted for 12.8 percent of total income, up from 10.1 percent in June 2012. A rise in operating costs, which resulted in the cost-to-income ratio rising from 68.1 percent to 72.4 percent in the year to June 2013, led to a small decline in

year-on-year net profit after-tax of Ushs.87 billion to Ushs.501 billion during this period. Although the average return on assets (ROA) and average return on equity (ROE) declined to 3.3 percent and 20.4 percent respectively, the two remain at levels that are higher than those in the EAC region.

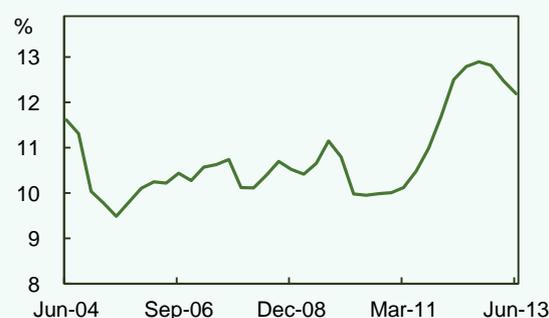
Table 3: Indicators of banking sector profitability

	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Net profit after tax (Ushs. billion)	280.8	224.0	354.7	587.0	500.7
ROA (%)	3.7	2.4	3.1	4.4	3.3
ROE (%)	25.8	16.1	22.4	29.5	20.4
Cost to income (%)	69.5	79.2	71.3	68.1	72.4

Source: Bank of Uganda

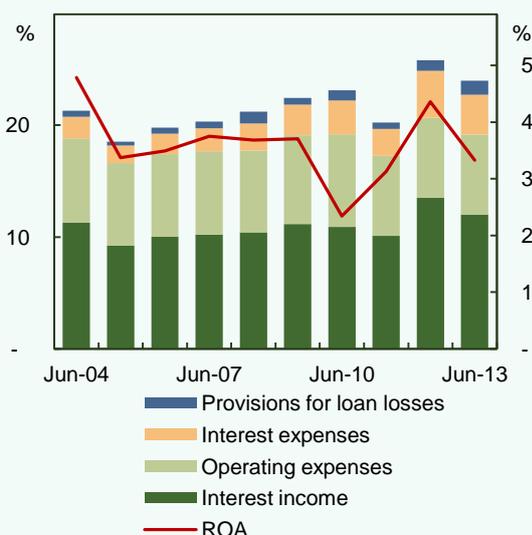
The profits made by banks since 2012 were driven by high net interest margins. While margins increased as the central bank rate (CBR) rose in 2012, banks were slow to re-price variable rate loans to reflect the fall in the CBR in the period to June 2013. At the end of June 2013, the interest spread on shilling denominated loans and deposits remained high at 11.0 percent, while that on the foreign currency denominated loans and deposits rose to 5.8 percent from 5.3 percent. Despite nascent upward inflation pressures in August 2013, it is expected that inflation expectations will remain well anchored and not increase further than 7.3 percent, thus banks should reduce the average margins over the next year.

Chart 19: Banks' net interest margin (percentage ratios, quarterly)



Source: Bank of Uganda

Chart 20: Bank income and expenses as a share of total assets



Source: Bank of Uganda

2.3. Changes in banks' assets

Strengthening of banks' capital ratios reflected the slow growth of bank assets during the period and the switching of the balance sheet away from risk-weighted assets. The total assets of the banking sector increased by 8.9 percent to reach Ushs.15.7 trillion in June 2013, compared to growth of 15.1 percent in the previous year, largely on account of subdued performance of bank loans and advances, normally the strongest driver of banks' assets. The growth of off-balance sheet items, which usually reflect changes in bank business contracts including letters of credit and guarantees, also fell, recording a reduction of 28 percent compared to an increase of 51.3 percent in June 2013. In particular forward/futures contracts declined from Ushs.1,016 billion in June 2012 to Ushs.78 billion in June 2013.

Table 4: Changes in banks' assets

	Jun - 09	Jun - 10	Jun - 11	Jun -12	Jun- 13
Assets					
Volumes (Ushs. trillion)	8.3	10.2	12.5	14.4	15.7
Annual growth (%)	27.2	22.7	23.3	15.1	8.9
Loans					
Volumes (Ushs. trillion)	3.6	4.5	6.5	7.2	7.7
Annual growth	31.2	25.2	43.6	10.8	6.4

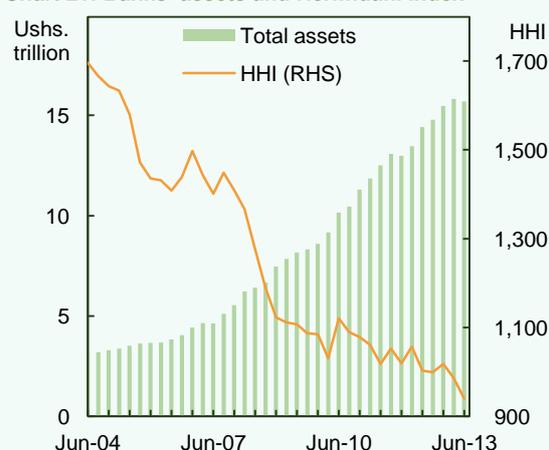
	Jun - 09	Jun - 10	Jun - 11	Jun -12	Jun- 13
(%)					
Off-Balance Sheet Items					
Volumes (Ushs. trillion)	1.8	2.1	2.2	3.3	2.4
Annual growth (%)	-3.0	21.5	2.7	51.3	-27.7

Source: Bank of Uganda

As a share of total assets, risk-weighted assets dropped from 70.8 percent in June 2012 to 66.1 percent in June 2013. Bank investment in government securities, on the other hand, increased by 20.8 percent during the same period. The rise in holdings of securities occurred in an environment where the government had increased the volume of issuances to meet fiscal needs. Consequently, the real interest yield on government treasury bills and bonds rose, making these assets competitive relative to lending. Looking ahead, if this switching is sustained, bank lending may take longer to revert to strong growth seen before 2011.

The evolution of the Herfindahl Index (HHI)⁶ of Uganda's banking sector indicated less concentration within the sector between June 2012 and June 2013. The index declined from 1,003.3 to 939.7 during that period, indicating an increase in competition.

Chart 21: Banks' assets and Herfindahl Index



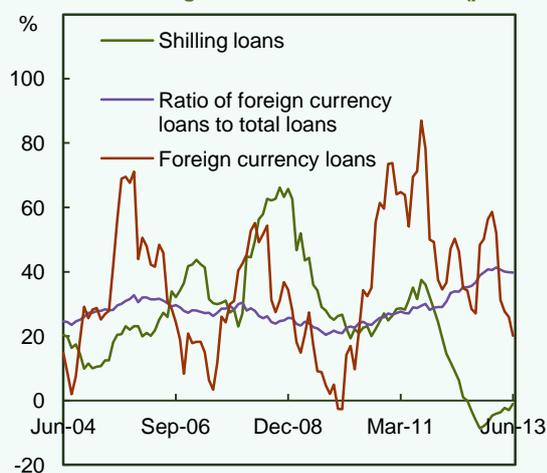
Source: Bank of Uganda

⁶ Herfindahl Index (HHI) is the sum of squares of the market shares of all firms in a sector.

2.4. Banks' lending activity

Although quarterly data shows that bank lending started to pick up in March 2013, overall lending remained subdued over the year to June 2013, and was far below the rates of growth seen before the economic downturn in 2011/12. Total bank loans grew by 6.4 percent during the year to June 2013 compared to 11.6 percent in the year to June 2012. The banking sector is the primary conduit for intermediating credit to households and businesses and the indications that credit growth is starting to pick up will support economic output in the year to June 2014, projected at 6.0 percent, and enhance bank financial performance.

Chart 22: Annual growth rates of bank credit (percent)



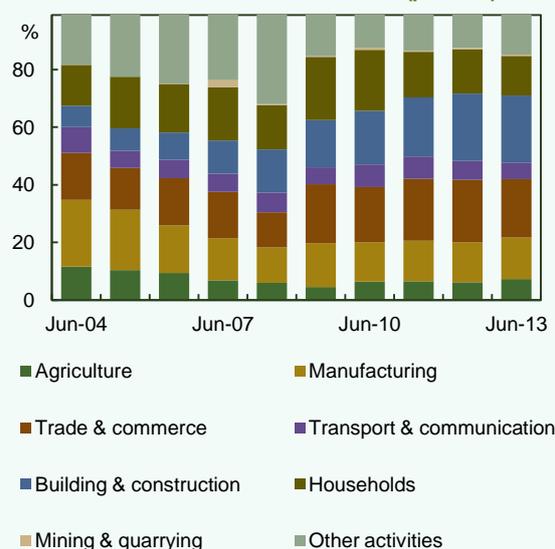
Source: Bank of Uganda

Annual growth in lending was driven almost entirely by growth in the foreign currency denominated loans, which rose by 20.1 percent in June 2013 although this was lower than 34.9 percent in June 2012. On the contrary, shilling loans have recorded zero growth over the last two years.

In terms of sectoral lending, the annual growth of loans to businesses remained subdued, while lending to households and agriculture picked up. As a share of total loans, bank credit as at end-June 2013 was mainly to the building and real estate sector (23.3 percent) and the trade and commerce sector (20.3 percent). The sector with the highest annual loan growth rate was the agriculture sector at 26.1 percent, followed by the manufacturing sector with 10.0 percent. Most of the increase in foreign currency

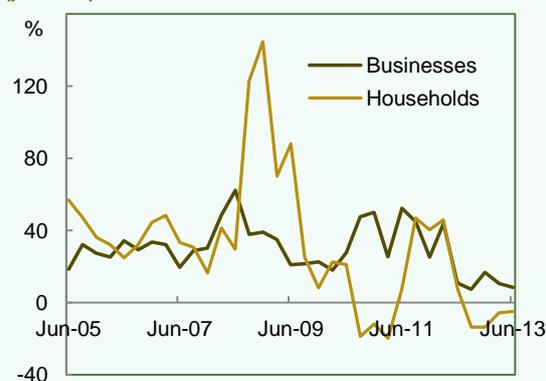
loans was directed towards the building and construction and manufacturing sectors, which accounted for 31.0 percent and 21.4 percent of the rise in foreign currency loans respectively. Banks also increased lending to agriculture which accounted for 20.3 percent of the rise in foreign currency loans, after low performance for the previous two years.

Chart 23: Sectoral distribution of loans (percent)



Source: Bank of Uganda

Chart 24: Annual growth of bank loans by sector (percent)



Source: Bank of Uganda

Underlying the performance of bank shilling loans was the relative tight bank lending standards, especially for enterprises. The findings of the Bank of Uganda *Bank Lending Survey* for June 2013 indicate that 46.8 percent of banks reported tightening of credit standards in the three quarters to June 2013. On a net basis, they reported tightened credit standards for the building and real estate and trade sectors. The key factors cited for the tightening of credit standards

were: low credit turnover, low demand, reduction in real estate market valuations, high default rate and slow resumption of operations at the land offices. On the other hand, most banks reported credit easing in the agricultural sector citing the rolling out of the agricultural credit facility by Bank of Uganda.

Chart 25: Bank lending policy for enterprises



Source: Bank of Uganda

Notes:

(a) Net percentage balances are calculated by obtaining the difference between the percentages of lenders reporting that a factor has tightened/increased and those reporting that it has eased/decreased. A negative balance indicates that more credit is available.

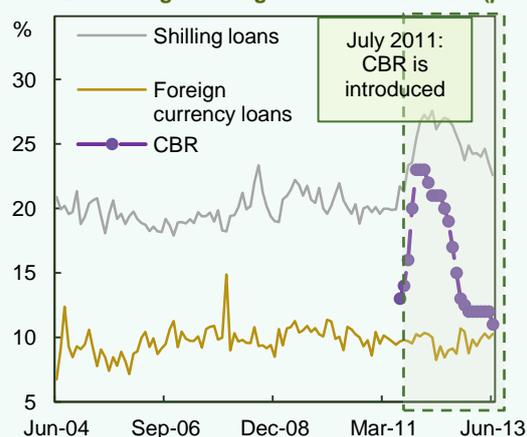
(b) The graphs show the net percentages over the previous three months and the expectation over the next three months.

(c) Expectations have been moved forward one quarter so that they can be compared with the actual outcome in the following quarter.

Looking forward, most banks expect to ease credit standards on a net basis in the year to June 2014, with a focus on short-term loans rather than long-term loans and, most banks (70.7 per cent) expect the margins on loans to remain broadly unchanged.

The rise in foreign currency loans was also aided by lower and relatively stable interest rates on foreign currency loans at 8.4 percent in June 2012 and 10.3 percent in June 2013. Bank lending rates on shilling loans fell from 27 percent in June 2012 to 22.7 percent in June 2013 following the reduction in the CBR from 19 percent in June 2012 to 11 percent in June 2013.

Chart 26: Average lending rates for bank loans (percent)



Source: Bank of Uganda

2.5. Bank asset quality

Non-performing loans and provisioning

System-wide non-performing loans as a ratio of total lending fell to 3.9 percent in June 2013 from a peak of 4.7 percent in March 2013. The improvement in the NPL ratio can be observed in the volume of NPLs which grew by only Ushs.21.8 billion between June 2012 and June 2013 after having increased by Ushs.178.5 billion in the previous year. This was partly on account of commercial bank charge-offs and write-offs of Ushs.766.5 billion between July 2012 to June 2013.

Table 5: Sectoral NPL ratios (percent)

	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Agriculture	19.0	9.2	1.7	3.9	3.5
Manufacturing	1.0	2.5	0.2	0.6	1.5
Trade	5.7	4.1	1.1	5.5	5.3
Transport & communication	1.9	2.0	0.7	1.7	3.2
Building & construction	5.7	2.2	1.3	5.3	3.8
Personal loans	-	1.4	1.5	2.1	3.3
Other activities	2.3	5.5	4.9	5.9	6.1
Overall ratio of NPLs to total loans	4.0	3.4	1.6	3.9	3.9

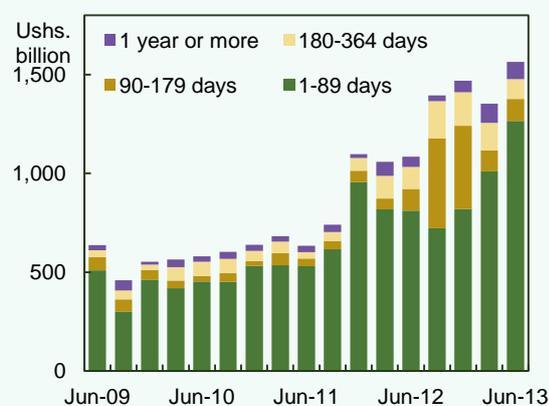
Source: Bank of Uganda

The improvement in asset quality has been particularly pronounced in the building and construction sector whose NPLs ratio reduced by 1.5 percent in the year to June 2013. Sectors that recorded notable growth in NPLs were the manufacturing sector by 160.4 percent and the

transport and communications sector by 74.9 percent. However, manufacturing, which makes up a large share of total bank lending, still has the lowest share of NPLs as a proportion of sectoral lending.

Asset quality is expected to continue to recover on the back of improving economic growth. Despite this positive outturn, going forward, risks remain that could affect asset quality. First, ‘watch’ loans (loans past due by 1-89 days) – an indicator of banks’ expectation of future deterioration in asset quality – increased over the year to June 2013. Banks increased loan-loss reserves from Ushs.89.5 billion to Ushs.144.8 billion between June 2012 and June 2013. Moreover, loan losses among marginal borrowers could rise if interest rates go up. Nevertheless, banks remain adequately capitalised to handle potential losses and banks’ provisioning against potential credit losses remains adequate with the NPL coverage ratio (calculated as the ratio of loan loss reserves to total NPLs)⁷ increasing by 15.9 percentage points from 31.6 percent to 47.5 percent at the end of June 2013.

Chart 27: Ageing analysis of banks’ loans and overdrafts



Source: Bank of Uganda

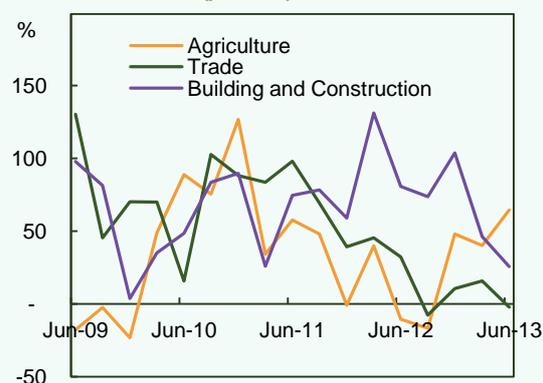
Quality of foreign currency loans

The rapid growth in foreign currency lending mentioned earlier, brought concerns about the quality of such lending. Bank of Uganda has taken two steps to improve the analysis of foreign currency loans; all banks will start reporting foreign currency non-performing loans by sector starting September 2013. Also, a survey was conducted amongst banks to

⁷ The NPL coverage ratio is a measure of a bank’s ability to absorb potential losses from its non-performing loans.

obtain information on foreign currency denominated bad loans by sector between 2006 and 2013. The results showed that credit risk from foreign currency loans remains very low. The ratio of foreign currency NPLs to foreign currency loans was only 0.8 percent at June 2013. The trade and commerce and mining and quarrying sectors contributed the highest percentage to the foreign currency NPLs. However, risks remain that a real depreciation of the exchange rate may increase the debt burden of borrowers in foreign currency and increase bad loans.

Chart 28: Annual growth rate of foreign currency loans to selected sectors (percent)



Source: Bank of Uganda

2.6. Bank funding and liquidity

Funding

Ugandan banks fund loans and other assets through equity, retail deposits and wholesale market funds (both short and long term). Over the period between June 2012 to June 2013, banks’ funding base from both wholesale and retail funding remained unchanged. The banking system’s level of funding from customer deposits remained stable in the year to June 2013, rising at 6.7 percent, similar to the rate of growth in the previous year to June 2012. This is also a marked improvement from the 17.5 percent drop registered in the same period to June 2011. The growth of foreign currency deposits dropped to 8.3 percent from 37.8 percent in the same period.

The continued stability of retail funding was driven by higher growth in savings and time deposits between June 2012 and June 2013, which grew by 14.4 percent to reach Ushs.1.7 trillion, and 15 percent to Ushs.2.3 trillion respectively. This increase in savings

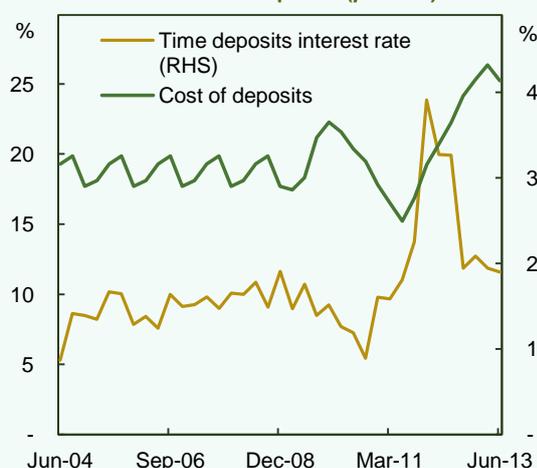
and time deposits reflects aggressive deposit mobilisation by banks during this period. The robust deposit mobilisation has, however, contributed to a rise in retail funding costs over the two years to June 2013, with the cost of deposits almost doubling from 2.4 percent in June 2011 to 4.2 percent in June 2013. Banks have continued to bear this high cost of deposits because most of it constitutes contracts on fixed deposits that were taken on in early 2012 when the CBR was at a high of 19 percent.

Table 6: Sources of bank funding as share of total liabilities (percent)

	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Balance sheet					
Deposits	76	84	85	80	80
Resident banks	6	2	2	4	3
Non-resident financial institutions	3	3	1	2	2
Others	15	12	13	15	16
Off-balance sheet					
Foreign exchange swaps	N/A	N/A	3	4	2

Source: Bank of Uganda

Chart 29: Banks' cost of deposits (percent)

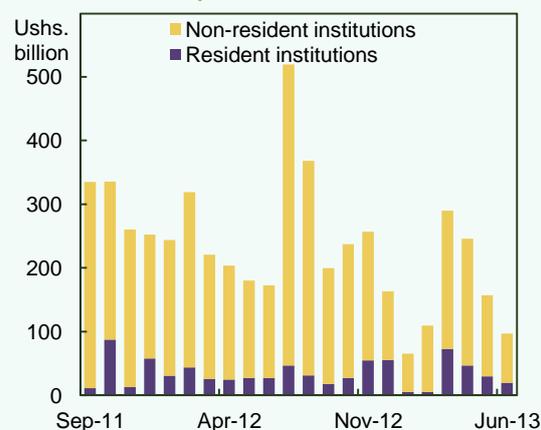


Source: Bank of Uganda

If the volume of these deposits reduces or they are re-priced as they mature by end 2013, as is expected, the cost of retail funding is likely to reduce. On the other hand, if inflationary pressures continue to rise, actions by the central bank to raise the CBR may likely result in a rise in the cost of funding, and these costs could be passed on to retail lending rates.

Regarding wholesale funding, during the past year, Ugandan banks' reliance on short-term wholesale funding from offshore banks did not change. This type of funding shifts the currency composition of funds available for banks. Borrowing of shillings through foreign exchange swaps from financial institutions abroad fell, with net amounts payable on swap transactions reducing to Ushs.96.7 billion and US\$58.9 million in June 2013 compared to Ushs.172.9 billion and US\$116.1 million in June 2012. In addition, loans from banks abroad reduced. In June 2011, borrowings from non-resident banks were at Ushs.263 billion, which increased by 98.2 percent to Ushs.450 billion in June 2012. By June 2013, however, they had declined by 27.6 percent to Ushs.326 billion. This decline in offshore wholesale funding reflected the stability of the retail funding and preference by Ugandan banks to borrow shillings at relatively lower rates from the domestic interbank markets, whose rates have significantly declined.

Chart 30: Outstanding amounts due to financial institutions on swaps



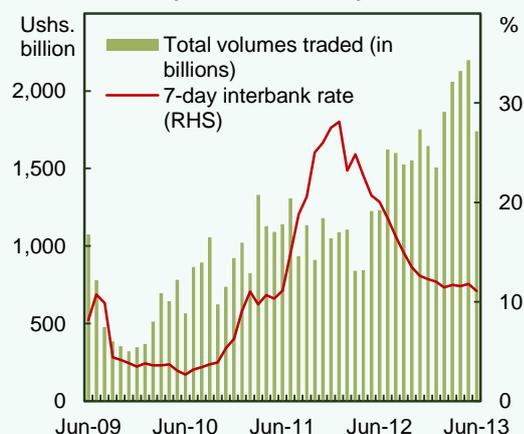
Source: Bank of Uganda

The interbank market

Over the 12 months to June 2013, an easing of financial sentiment, aided by a reduction in inflationary pressures, led to improved availability and a significant decline in cost of wholesale interbank market funding for banks. The total volume traded in the market increased to Ushs.1.7 trillion in June 2013, up from Ushs.1.2 in June 2012. There was also a decline in interbank rates within the period, with the overnight and seven-day weighted average rates dropping to 7.8 percent and 11.1 percent in June

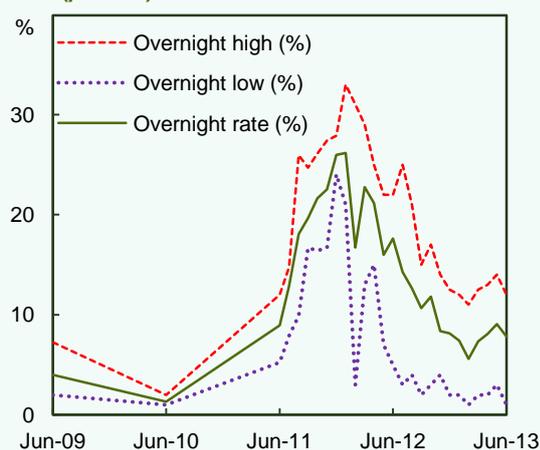
2013 from 17.6 percent and 20.0 percent in June 2012 respectively. The decrease in these rates followed the lowering of the central bank rate from 20 percent in June 2012 to 11 percent in June 2013.

Chart 31: Monthly interbank activity



Source: Bank of Uganda

Chart 32: Monthly average weighted overnight interbank rates (percent)



Source: Bank of Uganda

Indicators of liquidity

Ugandan banks' holdings of liquid assets increased in the year to June 2013, thereby enhancing their ability to withstand periods of severe liquidity stress. The ratio of liquid assets to total deposits increased from 38.9 percent in June 2012 to 41.1 percent in June 2013, far above the regulatory minimum of 20 percent. The improvement in liquidity indicators was aided by the increase in banks' investment in government securities, which grew by 20.8 percent between June 2012 and June 2013, compared to 3.2 percent in the previous year. Total loans as a share of total deposits declined from 74.2 percent in June

2012 to 73.9 percent in June 2013, due to a decline in the annual shilling loan growth.

Table 7: Banks' key indicators of liquidity (percentage ratios)

Indicator	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Total loans to total deposits	68.9	61.8	71.5	74.2	73.9
Liquid assets to total deposits	42.2	41.6	35.6	38.9	41.1
Foreign currency loans to foreign currency deposits	57.3	52.1	68.6	67.1	72.8

Source: Bank of Uganda

2.7. Exposure to exchange rate risk

In the year to June 2013, there was a marked growth in banks' foreign currency assets as a share of their total assets. This was largely aided by the high demand for foreign currency loans. As a share of total loans, foreign currency denominated loans increased from 35.2 percent in June 2012 to 39.7 percent at the end of June 2013, while the ratio of foreign currency loans to foreign currency deposits rose from 63.2 percent in June 2012 to 72.8 percent in June 2013. In March 2013, a number of banks exceeded the regulatory limit of 80 percent, with the overall ratio peaking at 82.3 percent in March 2013. Bank of Uganda responded by enforcing the Foreign Currency Business Rules (2010), and all banks complied with the limit by June 2013.

Table 8: Indicators of banks' exposure to foreign currency (percentage ratios)

	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Foreign currency deposits to total deposits	27.4	29.0	30.1	34.9	33.2
Foreign currency loans to total loans	22.8	24.5	28.9	35.2	39.7
Foreign currency assets to total assets	24.9	25.3	26.6	33.2	30.8
Foreign currency assets to foreign currency liabilities	111.3	98.4	100.1	103.4	104.9
Foreign currency loans to foreign currency deposits	57.3	52.1	64.2	63.2	72.8

	Jun-09	Jun-10	Jun-11	Jun-12	Jun-13
Foreign currency liabilities to total liabilities	26.5	29.9	30.7	35.8	36.6

Source: Bank of Uganda

In spite of the rising foreign currency exposure, overall exchange rate risk remains low, with the ratio of foreign currency assets to foreign currency liabilities standing at 104.9 percent in June 2013.

2.8. Other providers of intermediated credit

The non-bank deposit-taking and lending sector continued to grow. The sector, which is made of credit institutions (CIs) and microfinance deposit-taking institutions (MDIs) supervised by Bank of Uganda, had combined assets of Ushs.542.5 billion at end July 2013, comprising about 4 percent of banking assets,

2.9. Conclusion

Since the first half of 2013, there have been signs of an improvement in bank performance. Asset quality has picked up, bank liquidity has strengthened and banks remain well capitalised with their efforts to boost capital supported by strong profits. Despite the rise in foreign currency loans as a ratio of foreign currency deposits, foreign currency NPLs remain low and overall exchange rate risk is minimal because banks' exposure to foreign exchange denominated liabilities was closely matched by their foreign exchange denominated assets.

up from Ushs.450 billion in July 2012. MDIs' total loans stood at Ushs.199.1 billion as at June 2013, higher than Ushs.175.2 billion in June 2012, while loans by credit institutions were Ushs.123.3 billion at June 2013, an increase of 14.2 percent from Ushs.108.0 billion in June 2012.

However, asset quality remains a concern with MDIs portfolio at risk (ratio of non-performing loans to total loans) rising from 5.2 percent in June 2012 to 5.3 percent in June 2013, while that for credit institutions rose from 3.8 percent in June 2012 to 5.6 percent in June 2013, largely on account of inadequate lending practices at one institution. Three more MDIs are expected to be licensed during 2013/2014. These firms, with their country-wide reach and focus on micro lending, could help alleviate supply-side constraints to credit growth, although their impact is likely to remain small at this point.

3. THE OUTLOOK FOR FINANCIAL STABILITY

3.1. Assessment of systemic risk

Bank resilience improved in the year to June 2012

In the period leading up to our last *Report* of June 2012, banks faced a difficult macroeconomic environment which included a sharp rise in inflation, a slowdown in economic growth and substantial exchange rate volatility. These conditions continued to the end of December 2012 and led to slower deposit growth, a rise in non-performing loans and higher funding costs.

Since the first half of 2013, there have been signs of an improvement in bank performance from the downward trends observed before regarding the two main risks Ugandan banks face, that is, credit risk and liquidity risk. Regarding credit risk, asset quality has picked up and since May 2013, bank lending has started to grow again.

Chart 33: Quarterly growth of total bank loans (percent)



Source: Bank of Uganda

In addition, banks remain well capitalised. Bank liquidity has strengthened and overall exchange rate risk is minimal because banks' exposure to foreign exchange denominated liabilities is closely matched by their foreign exchange denominated assets.

The overall assessment of systemic risk in the financial sector shows that bank's resilience has improved in the year to June 2013. Going forward, the banking system is likely to face some challenges, whose triggers include the high level of non-performing loans among small and new banks, which

is likely to affect interest income and profitability. The rising exposure of banks to the building and construction sector also remains a concern given the rise in house and land prices; regarding liquidity risk, there is rising exposure to parent/group banks.

a) Credit risk

High non-performing loans among small banks

While loan quality among commercial banks has generally started to improve, with the ratio of non-performing loans to total loans reducing to 4.0 percent in June 2013 compared to 4.2 percent in March 2013, BOU policy actions may reduce the ability of marginal borrowers to service their loans. This is likely to reduce banks' profitability moving forward. Risks from the rise in foreign currency lending that we highlighted in our last *Report* also remain pertinent.

The performance of new banks licensed since 2007 continues to be mixed. Many of the small and new banks, in a bid to increase market share, have increased their lending, but loan quality among these banks remains a concern. Overall, most of the new banks are still loss-making, and their NPL ratios have increased as they strive to attain market share. The rise in NPLs poses a challenge in maintaining adequate capital at new banks, whose collective losses may give rise to systemic risk.

Table 9: Selected FSIs for new banks (percent)

Indicator	Jun-10	Jun-11	Jun-12	Jun-13
Core capital ratio	33.4	41.3	30.8	41.9
NPLs to total gross loans	5.8	1.7	6.3	10.0
Return on assets	-19.1	-3.4	-0.7	-3.8
Liquid assets to total deposits	61.2	42.2	51.4	58.3
Year-on-year profit after tax (Ushs. billion)	-77.6	-25.9	-6.5	-29.3
Total assets as a ratio of total bank assets	5.4	7.7	8.1	9.7

Source: Bank of Uganda

Performance of the real estate sector

Commercial banks' lending exposure to the building and construction sector has continued to rise, and the

sector had the largest share of total bank loans at 23 percent and 25 percent of foreign currency loans in June 2013. This exposure makes the banking system susceptible to changes in the value of house prices and land prices as the 2007 global crisis showed. Indicators show that property prices have started showing significant growth, especially land prices as shown in the land price index.

Chart 34: Land price index



Source: Uganda Bureau of Statistics

The rise in the land price index of 25.4 percent in the year to June 2013, combined with a greater willingness on the part of banks to lend for mortgages and land purchase relative to the same period last year, suggests that many new borrowers will be acquiring homes and land with higher values. However, the increase in the underlying indebtedness of households is likely to increase their vulnerability to a rise in interest rates. Given the rise in the central bank policy rate in August 2013, lenders should ensure borrowers will be able to service loans even if interest rates rise substantially. Rapid increases in house prices should also make banks more careful about high loan-to-value ratio (LVR) lending. High-LVR lending would increase losses to the banking system and the wider economy in the event of significant reversal in house prices.

b) Liquidity risk

Overall liquidity in the banking sector improved as shown by the ratio of liquid assets to total deposits increasing from 38.9 percent to 41.1 percent in the year to June 2013. However, there is growing reliance on offshore markets, including parent banks, to cover liquidity positions among Ugandan banks. Foreign currency borrowing from non-resident banks rose

significantly during the financial year from Ushs.115 billion in June 2012 to Ushs.230 billion in June 2013. In addition, amounts due to parent banks abroad more than doubled to reach Ushs.496 billion in June 2013. Although this is mainly due to exposure at two banks, it is approximately 9.6 percent of total foreign currency liabilities. This increases risks of spill-over effects in the event of distress in the parent bank or deterioration in global market conditions.

Chart 35: Borrowing from parent companies



Source: Bank of Uganda

3.2. Stress test results

To assess the resilience of the banking sector to systemic risks, the Bank of Uganda carries out quarterly stress tests. These tests use a framework based on work by Cihak⁸ to identify the breaking point for each risk i.e. shocks are applied to selected variables until banks fail to meet a minimum requirement. The stress tests for June 2013 focused on the two main potential sources of vulnerabilities for the Ugandan banking sector i.e. **credit** and **liquidity** risks. BOU's stress tests employ sensitivity analysis as opposed to a scenario-based analysis. The different breaking points⁹ which were defined for each type of shock are summarised in Table 10.

⁸ Cihak, M. "Introduction to applied stress testing" (2007) IMF Working Paper No. WP/07/59, International Monetary Fund, Washington DC

⁹ IMF Working paper Ong et al. This approach analyses the maximum magnitude of a specific type of shock before which banks breach a regulatory requirement or 'fail'. This reverse analysis, called the **breaking point method**, involves "stressing until the system breaks". For each risk factor, this method applies shocks to different variables until a bank(s) fails to meet a regulatory requirement.

Table 10: Summary of stress test shocks and breaking points

RISK-TYPE	SHOCK	BREAKING POINT
Credit	Assesses the effect of a decline in banks' existing total and sectoral performing loans.	The first large bank fails following a gradual increase in NPLs.
Liquidity	A simulated bank run test which models the number of days banks would be able to survive a systemic liquidity drain without resorting to liquidity from external sources.	The first bank's liquid assets are depleted following sudden withdrawal of deposits.

Credit risk

Three credit shocks were conducted to assess the effect a further deterioration in asset quality would have on bank capital. The ratio of non-performing loans to total loans is taken as the main measure of credit risk, since credit risk is associated with the quality of the sector's loan portfolio.

The first test applied a uniform shock to the baseline level of performing loans so that a proportion of them became non-performing loans. The results showed

that the NPL ratio would have to increase by 5.8 percent over a six-month period for the first large bank to fall below the regulatory minimum capital adequacy requirement, along with ten other banks. The capital adequacy and NPL ratios for the banking system at this point are 16.2 percent and 9.2 percent respectively. Furthermore, if the changes in asset quality that were registered between December 2012 and June 2013 carried on to the end of 2013, four banks would require capital injections.

Table 11: Summary of stress test results for credit risk

		CAR (%)	Tier 1 capital (in Ushs. billion)	NPL ratio (%)	No. of under-capitalised banks
BASELINE SCENARIO		21.2	2,200.6	4.0	2
Shock	Key indicators	Jun 2013	Dec 2012	Jun 2012	
Reduction in performing loans that fails the first large bank	Change in NPL ratio that breaks first large bank (%)	5.8	5.4	4.7	
	CAR (%)	16.2	12.1	12.7	
	NPL ratio	9.2	9.6	8.6	
	Tier 1 capital (Ushs. bn)	1,584.1	1,176.4	1,207.0	
	No. of undercapitalised banks	11	10	7	
Increase in NPL ratio equivalent to 6-month trend	CAR (%)	20.3	17.2	15.6	
	NPL ratio	3.7	4.5	5.6	
	Tier 1 capital (Ushs. bn)	2,013.3	1,766.2	1,533.6	
	No. of undercapitalised banks	4	5	3	

The second shock aimed to establish the effect of a deterioration of bank loans to four key sectors, that is, manufacturing, trade and commerce, building and construction and personal and household loans, on bank capital. The results showed that the building and

construction sector has the highest sensitivity to loan losses; because an increase in NPLs equivalent to only 5.0 percent of performing loans would require three banks (two of which have significant exposure to the sector) to recapitalise. Banks appear to be

more resilient to losses from other sectors and would require relatively larger losses in these sectors'

performing loans to have a significant impact on capital.

Table 12: Stress test results for sectoral shocks

	Breaking point (%)	CAR (%)	Tier 1 capital (in Ushs. billion)	NPL ratio (%)	No. of under-capitalised banks
BASELINE SCENARIO		21.2	2200.6	4.0	2
SHOCKS & RESULTS FOR JUNE 2013					
Reduction in performing loans that fails the first exposed bank for;					
Manufacturing	348.5	3.7	317.2	53.2	6
Trade & commerce	12.7	20.6	2,117.2	6.3	4
Building & construction	5.0	21.0	2,168.3	5.0	3
Households	67.0	18.6	1,869.6	12.8	6

Although the tests do not assist in determining the likelihood of the stated shocks or give an indication of the probability of default on loans, they do reveal that as at the end of June 2013, the aggregate impact of a shock to the banking system's credit portfolio was mild given the significant increase in non-performing loans required to bring banks to the point of recapitalisation. The resilience of the banking sector to these shocks is attributed to the high levels of capital held by banks. However, a bank-by-bank analysis shows a mixed picture with some banks having low resilience to credit shocks. In addition, note should be taken of the higher impact a shock on the loan performance of the building and construction sector would have on bank soundness.

Liquidity risk

Although indicators show that overall liquidity risk for banks reduced in the year to June 2013, concerns remained about the potential risks from capital flow volatility and whether some banks have adequate

liquid assets to fund their activities in a period of stressed liquidity.

BOU conducted a stress test for liquidity risk, in which a simple bank run was simulated to determine the impact of adverse uniform shocks to banks' liquidity, brought on by a sudden withdrawal of customer deposits. The resilience of banks to liquidity risk is judged by the number of days banking institutions would be able to withstand a liquidity drain without resorting to external liquidity support. This test does not consider assumptions about rollovers, increases in borrowings and maturity extensions. The results from the test revealed that liquid assets of nine banks would be depleted over a 7-day period of distress, assuming a daily withdrawal rate of 6.8 percent of total deposits. Compared to June 2012, the results suggest that as at the end of June 2013, banks were more sensitive to liquidity risk since the bank run test resulted in more bank failures and a higher reduction in deposits.

Table 11: Summary of stress test results for liquidity risk

Shock	Key indicators	Jun 2013	Dec 2012	Jun 2012
Simulated bank run	Liquid assets to total deposits (%)	18.3	20.9	15.4
	Reduction in total deposits (%)	40.8	37.8	39.9
	No. of days to depleted liquid assets	6.5	6	7
	No. of banks failing test	9	11	4

In addition, a number of banks passed this test marginally and all banks should assess and ensure

the stability of their funding on a continuous basis. However, most banks continue to hold enough funds

to meet their short-term obligations, with the ratio of liquid assets to total deposits rising to 41.2 percent as at end-June 2013, well above the regulatory minimum¹⁰.

3.3. Conclusion and way forward

Looking forward to 2013/2014, banks' operating environment is likely to continue to improve, aided by an improvement in financial market sentiments, higher economic growth and a decline in non-performing loans.

Bank of Uganda has taken several measures to reduce systemic risk. Regarding credit risk, the Bank will continue to enforce the commercial banks Foreign Exchange Business Guidelines 2010. This will ensure that commercial banks only lend money to borrowers with proven foreign income streams. In addition, all commercial banks will be required to provide data on foreign currency non-performing loans starting from September 2013. BOU will also start publishing quarterly property price indices on its website and other publications, to increase the information available to banks and borrowers for credit decisions.

With regard to liquidity risk, Bank of Uganda will roll out the liquidity coverage ratio (LCR) to all commercial banks starting in September 2013. This is a Basel III measure which aims to ensure that banks hold sufficient high quality liquid assets to cover their net cash outflow over a 30-day period of stressed funding conditions. The pilot phase involving four systemically important banks showed that it is an effective tool at mitigating liquidity risk and enabling banks to maintain liquidity buffers.

¹⁰ The BOU liquidity regulation requires banks to hold liquid assets (defined as cash, net due to and from other banks, balances with BOU, and government securities) of at least 20 percent of total deposits.

4. SPECIAL TOPIC: IDENTIFYING DOMESTIC SYSTEMICALLY IMPORTANT BANKS (D-SIBS) IN UGANDA

4.1. Introduction

On 24th May 2013, the Minister of Finance signed The Financial Institutions Enhancement of Minimum Ongoing Capital Requirements Instrument of 2013. The objective of the Instrument is to further strengthen the stability and resilience of Uganda's banking system, by requiring banks to hold a capital conservation buffer of 2.5 percent of risk-weighted assets. The instrument also allows BOU to impose a countercyclical capital buffer of 2.5 percent above the minimum ratios during periods when excessive credit growth threatens financial stability. Domestic systemically important banks (D-SIBs) will be required to hold an additional loss absorbency capital buffer of 1-3.5 percent of RWAs. The Instrument empowers the BOU to designate a commercial bank as a D-SIB and impose, remove and/or vary the level of the SIBs capital requirement based on its assessment of the systemic importance of the bank. The Instrument also requires the BOU to prescribe the framework it will use to identify and designate SIBs. In June 2013, the Bank's Financial Stability Committee (FSC) discussed and approved the publication of the proposed criteria for designating D-SIBs, which are presented in this section, with a view to soliciting comments before they are finalised in December 2013.

4.1.1. What is a systemically important financial institution?

The Financial Stability Board (FSB, 2010) defines a systemically important financial institution (SIFI) as a firm, market or instrument whose failure, because of its size, complexity and systemic interconnectedness, would cause significant disruption to the financial system and economic activity. Similarly, under the Dodd-Frank Act, the US Financial Stability Oversight Council (FSOC) can designate an institution as a SIFI if its material financial distress or whose scope, size and scale of activities could pose a threat to the financial stability of the United States. A non-bank financial company can be designated a SIFI if it "predominantly engages in financial activities" that is,

either: (i) its annual revenues derived from financial activities represent 85 percent or more of its consolidated annual gross revenues, or (ii) its assets related to financial activities represent 85 percent or more of its total consolidated assets.

When referring specifically to banks, the term systemically important bank is used rather than SIFI. The Basel Committee on Banking Supervision (BCBS, 2012) differentiates between global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs). D-SIBs are defined as banks that may not be significant from an international perspective, but nevertheless have an important impact on their domestic financial system and economy.

Echoing the definitions reviewed above, the BOU will designate a bank as a D-SIB if its material financial distress or failure could pose a threat to the stability of the financial system.

4.2. Rationale and BOU macroprudential policy objectives

4.2.1. SIBs and financial stability

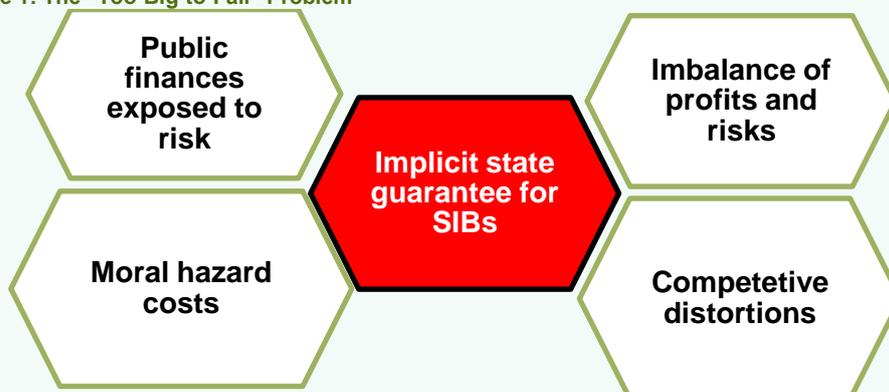
The negative externalities posed by large SIBs were starkly exposed in the last global financial crisis that started in 2007. During the crisis, many jurisdictions experienced the failure or impairment of a number of large, sometimes global financial institutions which, in turn, harmed the real economy. Supervisors had limited options to prevent problems affecting individual firms from spreading and thereby undermining financial stability and as a consequence, public sector intervention to restore financial stability during the crisis.

The operations of SIBs generate negative externalities because of the perception that they will not be allowed to fail ('too big to fail') by the authorities, because the cost of failure would be too large. This perception gives rise to moral hazard concerns. To the extent that creditors of a SIB can

expect to be bailed-out in case of its failure, incentives for risk management are reduced. The investors in, and creditors of, a SIB benefit from the upside risk-taking whereas the risks are shared with tax payers. Moral hazard amplifies risk-taking, reduces market

discipline and creates competitive distortions in the financial system, which increases the probability of financial distress. As a result, the costs associated with moral hazard add to any direct costs of support that may be borne by taxpayers (FSOC 2011).

Figure 1: The “Too-Big-to-Fail” Problem



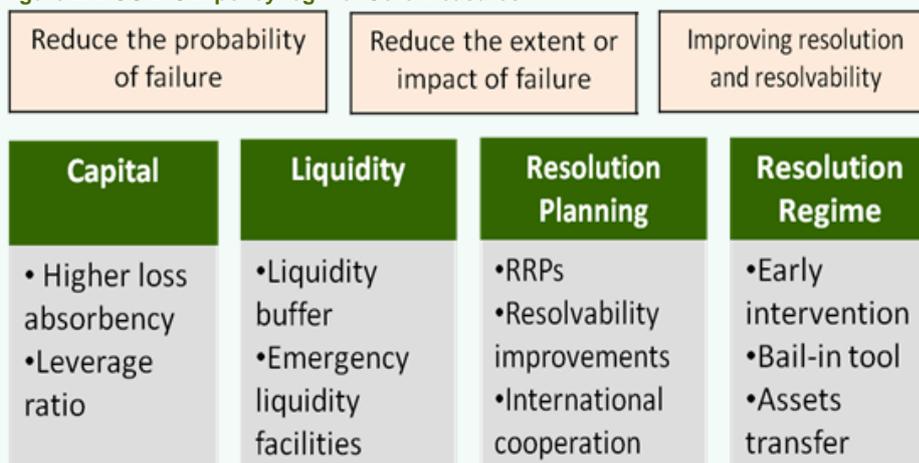
Source: Bank of Uganda

Reforms by the Basel Committee and other authorities to reduce moral hazard are underway internationally. It is a Basel Committee regulatory requirement that all jurisdictions should put in place a policy framework to reduce the risks and externalities associated with domestic and global systemically important financial institutions in their jurisdictions. In addition, SIBs resolution regimes and supervisory frameworks and policies will be the subject of FSB thematic or country peer review assessments for all member jurisdictions and they will also be assessed as part of the IMF/World Bank Financial Sector Assessment Programme (FSAP) (FSB 2010).

4.2.2. Bank of Uganda D-SIB policy objectives

The policy measures pertaining to D-SIBs are intended to enhance the BOU’s macroprudential toolkit for mitigating systemic risk. The broad aims of the policy, as illustrated in Figure 2, are threefold; to reduce the probability of the failure of D-SIBs by requiring them to hold more capital, to reduce the cost of failure of D-SIBs by improving recovery and resolution planning and, to improve the resolvability of D-SIBs through early intervention, bail in tools and crisis recovery and management arrangements.

Figure 2: BOU D-SIB policy regime: Core measures

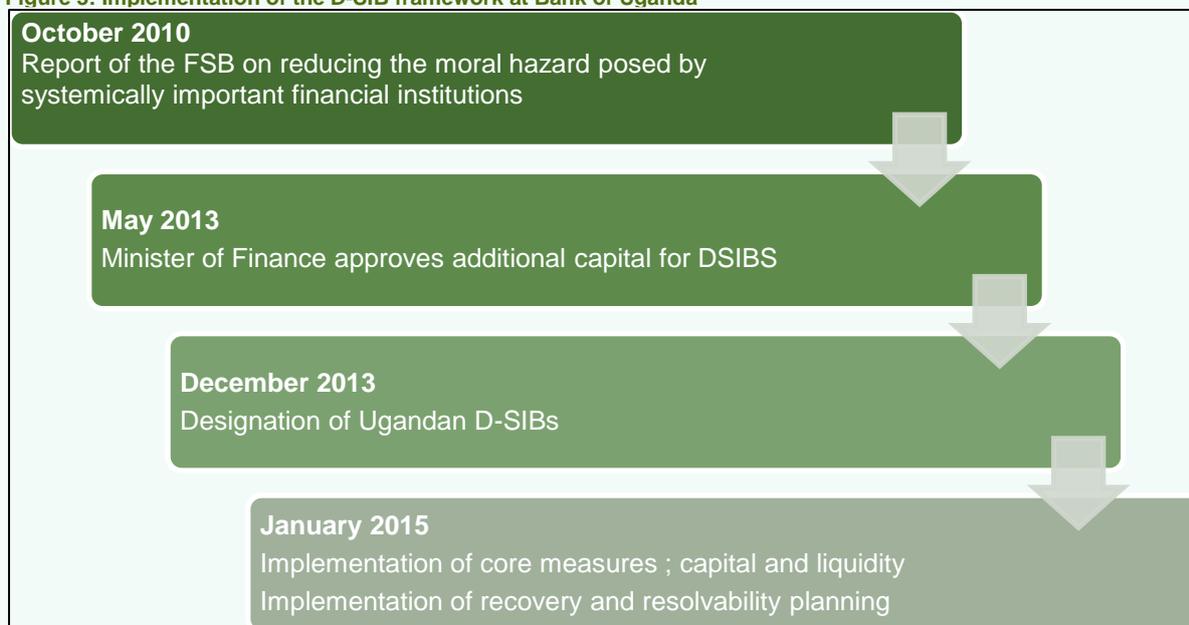


Source: Bank of Uganda

How will this framework be implemented? The key implementation steps are summarised in Figure 3. The Instrument that empowers the BOU to enhance additional ongoing capital requirements for DSIBs has already been approved. The next step will be the designation of D-SIBs, the criteria for which are set

out in this section. Following the designation of D-SIBs, the BOU will conduct further work on the introduction of additional capital and liquidity requirements for D-SIBs, and banks will be given a grace period to comply with these requirements.

Figure 3: Implementation of the D-SIB framework at Bank of Uganda



Source: Bank of Uganda

4.3. Review of criteria for identifying SIFIs

A review of empirical and theoretical studies shows that two basic ways to identify systemically important banks can be distinguished, both of which are supplemented by supervisory judgment. The first is the **model-based approach** which applies methodologies such as models of risk based on market data, stress testing and scenario analysis to extract information on systemic risk in a portfolio context. Modelling work in this area is largely based on asset price correlations and other market-based risk measures, such as CoVaR developed by Adrian and Brunnermeier (2011) and marginal expected shortfall (MES) studies led by Acharya *et al* (2010). Although market-based measures of systemic importance have their role in risk monitoring and supervision, they share a number of traits that make them less suitable as supervisory benchmarks. More importantly, these measures require market-based indicators, which are not available for many banks in

Uganda and even where available, are not stable over the business cycle.

The second is an **indicator-based approach** which incorporates bank-level data. The indicator-based measurement of systemic importance is the preferred approach from a supervisory perspective (IMF 2011) because it is often effective in assessing systemic importance. At the international level, work in this area is fairly advanced and indicators have been developed by IMF (2010), BCBS (2010) and the Dodd Frank Act of 2009. The BCBS in October 2012 proposed five indicators and used them to designate G-SIBS. The indicators include size, the degree of substitutability/concentration, interconnectedness, complexity, and cross jurisdictional activity. A framework for dealing with D-SIBs has also been set out by the BCBS and it indicates that domestic systemic importance should be assessed with reference to the impact that a bank's failure could have on the domestic economy. Further, it notes that this assessment should consider bank-specific

characteristics of systemic importance, such as size, interconnectedness and substitutability, which are correlated with the systemic impact of failure. An important drawback is the inability of the indicator-based measures to differentiate between an institution's systemic risk contribution and its probability of participation in a systemic event. The indicator-based measures provide a guide to the systemic impact of an institution in the event of failure, but provide no information on the likelihood of failure.

4.3.1. Proposed methodology for identifying Ugandan D-SIBs

The BOU will utilise an indicator framework based on the guidelines issued by the BCBS (2010) and IMF (2011) to measure the systemic importance of Ugandan banks and to designate D-SIBs. This framework will utilise four indicators; size, degree of substitutability, interconnectedness and complexity. It should be noted that while the Basel Committee proposed an additional indicators i.e. *cross-jurisdictional activity* in identifying G-SIBs, it is excluded in identifying D-SIBs because it is not directly relevant since it measures the degree of global (cross-jurisdictional) activity of a bank, which is not the focus of the D-SIBs framework.

Table 12: Adjusted indicator-based measurement approach for identifying Ugandan D-SIBs

Category	Individual indicator
1. Size (25%)	Total exposures (including off-balance sheet items)
2. Interconnectedness (25%)	Intra-financial system assets Intra-financial system liabilities Wholesale funding ratio
3. Substitutability (25%)	Branch network Payments cleared and settled through payment systems Sectoral lending
4. Complexity (25%)	Swaps notional value Trading book value and available for sale value

Source: Bank of Uganda

Following the BCBS approach, a weight of 25 percent is allocated to each of the four categories of systemic importance as shown in the Table below. Note that summing the scores for all the individual indicators

gives the overall score for each bank out of 100 being maximum possible total score (i.e. if there were only one bank in the country).

Below, a description of each indicator is provided.

a) Size

In general, a bank's distress or failure is more likely to damage the Ugandan financial system or economy if its activities comprise a large share of domestic banking activity. The failure of a large bank will affect more bank customers in the real economy, borrowers who will face disruption to their access to credit and depositors who risk the loss of their savings, than in a small bank. It is also indicative of the extent to which its clients will be starved of funds, its business with other institutions will be disrupted and the magnitude of losses its counterparties may face. In the Ugandan framework, the size of a bank will be measured as the sum of its total consolidated assets and off-balance sheet items.

b) Interconnectedness

The more interconnected a bank is to other financial institutions, the greater is the potential for the failure of that bank to transmit financial distress throughout the financial system and to the broader economy because of the network of contractual relations in which the institution operates. The Ugandan framework adopts FSB and BCBS guidelines that measure interconnectedness by the volume of its intra-financial system assets and/or intra-financial system liabilities. The former reflects an institution's credit exposure to the rest of the system and determines its participation in a systemic event. The latter captures credit risk to the rest of the system and thus an institution's potential contribution to a systemic event. The BOU proposes to adopt the recommendation of the Basel Committee to use the wholesale funding ratio, i.e. the share of funding raised from sources other than retail deposits in total liabilities.

c) Substitutability/concentration

The systemic impact of a bank's distress or failure is greater the less easily it can be replaced as both a market participant and a financial service provider.

Some institutions lack immediate substitutes for the key role they play in the economy. As a result, identification of D-SIBs also takes into account the types of roles that banks play in domestic financial markets and in domestic financial infrastructures, which inform views regarding substitutability. The BOU has revised the BCBS metrics of substitutability (assets under custody, value of payments cleared and settled, as well as values of underwritten transactions in debt and equity markets) and substituted these for branch network, the bank's sectoral lending exposure and payments that are cleared through the payment system.

d) **Complexity**

The use of complexity as a measure of systemic relevance rests on the notion that more complex financial institutions are more difficult to resolve if they fail. More complex assets are harder to sell and more complex corporate structures more difficult to disentangle. The IMF (2010) defines a complex institution as an institution or financial group that (a) operates diverse types of activities through numerous legal entities. The BCBS measures complexity by the notional value of OTC derivatives, level 3 assets for which no market value can be observed, as well as the value of assets held on the trading book or available for sale. The nature of financial institutions business in Uganda at present does not include overly complex assets. Complexity will therefore be determined by the bank's swap notional value, its trading book value and available for sale value.

4.4. **Preliminary list of Ugandan SIBs**

Utilising quarterly bank data, the BOU has applied the criteria described above to identify and track D-SIBs over the last two years, with a view to testing the consistency of the indicators. When Ugandan banks are ranked according to their score on the first indicator; **size**, as measured by total consolidated assets and off balance sheet items, the data show that the largest two banks account for more than a third of total banking assets and relative importance declines rapidly after the top three banks. Regarding **interconnectedness**, comparing Ugandan banks according to measures of intra-financial assets (i.e.

claims on other financial institutions) and intra-financial liabilities (i.e. obligations to other financial institutions) again points to the dominance of the largest three banks. The rank-ordering among these banks, however, depends on the specific inter-connectedness measure under consideration. On the element of **substitutability and complexity**, the largest banks are also the dominant participants in the payment systems particularly the RTGS and almost exclusively the only participants in the foreign currency swap market.

What is the threshold of systemic importance? The overall benchmark score for systemic importance is set at 10 percent. Thus, a bank will be designated as a D-SIB if its weighted score (including size, interconnectedness, substitutability and complexity) is 10 percent and above, supplemented with supervisory judgement. Given these various considerations, the D-SIBs at end June 2013 are Stanbic Bank, Standard Chartered Bank and Citibank. The designation of D-SIB status will be reviewed and updated at December 31 of each year.

4.4.1. **Higher loss absorbency capital targets for D-SIBs**

D-SIBs will be subject to additional loss absorbency capital targets compared to non-systemic institutions, with the goal of reducing their probability of failure, reflecting the greater impact that a D-SIB failure may have on the domestic financial system and the economy.

The Basel Committee has proposed a five-bucket tiered approach to setting this additional capital for G-SIFIs. A tiered bucket for additional capital is important to provide banks an incentive to reduce their risk profile, or otherwise face being upgraded to a higher bucket and higher capital requirement. However, the BCBS D-SIB framework provides for national discretion to accommodate the characteristics of the domestic financial system including the domestic policy framework. Thus, taking into account the structure of the Ugandan financial system and the expanded supervisory and regulatory capacity requirements of implementing a D-SIB

framework, a simplified three-bucket approach is proposed for Ugandan D-SIBs with the additional capital starting at 1 percent, then 2 percent and the upper limit set at 3.5 percent of RWA.

At the introduction of the D-SIB framework, the common equity surcharge associated with D-SIB status in Uganda will be set by BOU as follows; a weighted score above 30 percent will have a capital surcharge of 3.5 percent of RWAs, for a weighted score between 20 percent and 30 percent, the capital surcharge will be 2 percent, and for a weighted score between 10 percent and 20 percent the additional capital will be 1 percent. For each D-SIB the capital surcharge can be reduced or increased by Bank of Uganda if the systemic importance of the SIB changes.

Relationship with other capital arrangements

The capital surcharge for D-SIBs will be implemented through an extension of the capital conservation buffer. Thus, all banks subject to a D-SIB surcharge will have an additional capital requirement added to the minimum capital ratios.

Table 13: Capital targets for D-SIBs as a ratio of risk-weighted assets (percent)

Capital	Tier 1	Tier 2
Plus additional capital for D-SIBs (for a bank set at 1 percent)	11.5	15.5
Plus capital conservation buffer – for all banks (2.5 percent)	10.5	14.5
Minimum ongoing capital requirement - for all banks	8.0	12.0

Source: Bank of Uganda

This is in line with the treatment of the additional loss absorbency requirement for global systemically important banks (G-SIBs). Given that all banks will have to maintain the minimum capital ratios of 8 percent and 12 percent plus a capital conservation buffer of 2.5 percent, this means that a bank designated as a D-SIB will be required to meet a tier one capital target of at least 11.5 percent of RWAs

and total regulatory capital of 15.5 percent of RWAs commencing 1st January 2015.

4.5. Conclusion and way forward

In response to the externalities created by systemic institutions during the 2007 financial crisis, it has become important to develop a framework to deal with the too-big-to-fail problem in banks. A main building block of this new regime will be enhanced regulatory and supervisory requirements to be met by domestic systemically important banks.

The objective of this section was to put forward Bank of Uganda proposals on how D-SIBs will be identified and the additional capital targets they will have to meet. This analysis utilised indicators adopted from the Basel Committee indicator approach, to propose the way D-SIBs will be identified in Uganda, and to outline the proposed capital framework associated with D-SIB status. The final criteria will incorporate comments on the proposals outlined here, which must be received by BOU by 31st December 2013.

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5. STATISTICAL APPENDICES

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

		Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Regulatory Capital to Risk-Weighted Assets	Uganda	19.3	18.3	20.3	21.8	20.7	20.9	21.9	24.5	24.3
	Kenya	19.0	18.1	19.4	20.3	20.3	20.5	21.9	23.2	23.3
	Tanzania	18.2	17.4	17.6	18.5	18.1	17.7	17.9	19.5	18.1
	Rwanda	-	25.7	25.0	26.6	25.4	24.1	23.9	-	23.1
	Burundi	20.7	20.0	19.8	19.8	-	19.8	20.2	23.9	21.8
NPLS to Total Gross Loans	Uganda	1.6	1.8	2.2	3.4	3.9	4.7	4.2	4.7	4.0
	Kenya	5.4	4.9	4.4	4.4	4.5	4.6	4.5	5.0	5.3
	Tanzania	9.1	8.1	6.8	6.5	8.1	7.6	7.3	7.9	8.1
	Rwanda	-	9.3	8.0	6.3	5.8	6.3	6.0	-	6.9
	Burundi	7.6	7.3	7.7	8.1	-	8.0	8.7	10.0	10.1
Return on Assets (ROA)	Uganda	4.2	4.8	5.3	5.8	5.8	5.8	5.3	4.9	4.7
	Kenya	3.3	3.1	3.3	3.8	4.0	3.7	3.7	4.4	3.9
	Tanzania	3.0	3.0	2.5	3.0	2.5	2.7	2.5	2.9	2.7
	Rwanda	-	2.4	2.2	2.5	2.3	2.3	2.2	-	2.1
	Burundi	1.9	2.9	3.2	3.2	-	2.1	2.4	0.6	1.1
Return on Equity (ROE)	Uganda	22.4	25.4	27.4	28.1	29.5	27.9	24.2	21.0	20.4
	Kenya	30.8	30.2	32.2	33.0	33.3	32.0	29.7	30.1	31.2
	Tanzania	17.9	17.3	14.5	17.5	13.6	14.5	13.2	16.0	15.1
	Rwanda	-	11.9	10.6	11.6	10.9	11.1	10.4	-	9.9
	Burundi	13.2	20.3	23.0	23.0	-	10.2	10.1	2.0	5.0
Foreign Currency Denominated Assets to Total Assets	Uganda	26.6	29.6	27.9	30.9	33.2	30.7	31.7	31.5	30.8
	Kenya	12.4	13.5	11.8	12.1	12.9	12.8	13.2	12.9	12.1
	Tanzania	31.8	33.1	33.8	31.2	30.2	30.4	31.2	30.9	30.4
	Rwanda	-	15.2	16.5	14.8	8.4	12.8	13.3	-	12.5
	Burundi	-	16.1	13.0	19.0	-	14.3	19.1	20.1	17.4

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

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

	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Capital Adequacy									
Regulatory capital to risk-weighted assets	19.3	18.3	20.3	21.8	20.7	20.9	21.9	24.5	24.3
Regulatory tier 1 capital to risk-weighted assets	17.3	16.2	17.9	19.0	18.3	18.5	18.8	21.4	21.3
Leverage ratio	10.2	9.4	10.4	11.2	10.6	10.7	10.6	12.1	12.2
Asset quality									
NPLs to total gross loans	1.6	1.8	2.2	3.4	3.9	4.7	4.2	4.7	4.0
NPLs to total deposits	1.1	1.4	1.7	2.6	2.9	3.4	3.2	3.5	2.9
Sectoral distribution of loans									
Agriculture	6.5	6.7	6.9	6.9	6.4	6.0	7.2	7.3	7.3
Mining and quarrying	0.3	0.2	0.3	0.3	0.4	0.5	0.5	0.4	0.4
Manufacturing	14.1	13.0	12.7	12.4	13.9	14.9	15.6	14.0	14.4
Trade	21.5	22.0	20.8	22.0	21.7	19.9	19.3	21.5	20.3
Transport and comm..	7.8	7.1	6.8	7.3	6.6	6.5	6.9	5.5	5.8
Utilities	0.5								
Building and construction	20.5	20.4	21.0	21.7	23.3	24.6	23.7	23.8	23.3
Personal loans	15.8	16.6	16.7	15.4	15.4	13.8	13.0	13.4	13.8
Others	13.5	14.1	14.8	14.1	12.3	12.6	12.2	12.6	13.4
Large exposures to total capital	156.2	145.4	120.8	109.4	111.5	104.2	104.8	95.4	103.4
Earnings & profitability									
Return on assets	3.1	3.6	4.0	4.4	4.4	4.3	3.9	3.6	3.3
Return on equity	22.4	25.4	27.4	28.1	29.5	27.9	24.2	21.0	20.4
Net interest margin	10.5	11.0	11.7	12.5	12.8	12.9	12.8	12.5	12.2
Cost of deposits	2.5	2.8	3.2	3.4	3.6	4.0	4.2	4.3	4.1
Cost to income	71.2	68.8	68.2	67.5	68.1	68.8	70.9	72.0	72.4
Overhead to income	50.4	47.5	43.9	40.9	39.6	38.5	40.1	41.9	43.2
Liquidity									
Liquid assets to total deposits	35.6	36.2	37.6	37.5	38.9	42.5	42.0	42.7	41.1
Total loans to total deposits	71.5	76.4	78.4	77.9	74.2	73.3	74.5	74.3	73.9
Market Sensitivity									
Foreign currency exposure to regulatory tier 1 capital	-0.9	-3.4	-3.6	-4.1	-5.2	-5.2	-0.6	-5.1	-6.7
Foreign currency loans to foreign currency deposits	68.6	66.8	67.9	74.7	67.1	67.2	79.3	72.3	70.6
Foreign currency assets to foreign currency liabilities	100.1	98.1	100.2	103.2	103.4	100.7	105.0	104.8	104.9

Source: Bank of Uganda

TABLE 3: Commercial banks' quarterly balance sheet

	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
ASSETS (Ushs. Billion)									
Cash & cash assets	476.7	519.9	583.0	411.4	384.9	460.3	667.4	523.1	519.4
Balances with BOU	817.6	792.5	835.8	917.0	874.7	1087.9	1341.6	1601.5	1689.5
Due from financial institutions	1338.9	1711.2	1681.1	1842.1	2384.9	2116.4	1649.6	1904.3	1753.5
Government securities	2498.2	2158.6	2073.5	2327.0	2579.3	2932.6	3053.2	2969.9	3116.2
Total gross loans & advances	6516.2	7061.7	6981.0	7098.8	7217.0	7334.4	7789.7	7665.6	7677.4
LESS: Provisions	-77.2	-85.7	-89.5	-124.4	-156.8	-192.2	-187.9	-239.7	-198.2
Net loans & advances	6439.0	6975.9	6891.5	6974.4	7060.2	7142.1	7601.8	7425.9	7479.2
Net fixed assets	400.9	402.1	429.5	437.6	462.1	485.6	519.3	520.6	522.3
Other assets	545.2	517	488	553.4	665.6	550.6	633	866.2	612.9
TOTAL ASSETS	12516.5	13077.2	12982.4	13462.9	14411.7	14775.5	15465.9	15811.5	15693.0
LIABILITIES (Ushs. Billion)									
Deposits	9118.7	9244.4	8903.7	9115.1	9732.5	10003.4	10457.7	10316.6	10385.3
Due to financial institutions	308.2	350.1	377.7	623.1	661.8	566.6	513.7	515.0	540.9
Administered funds	303.9	344.3	339.9	327.5	364.7	372.4	359.1	455.8	484.5
Other liabilities	1046.2	1278.6	1359.5	1210.6	1412.3	1399.9	1558.3	1726.1	1611.8
TOTAL LIABILITIES	10777.0	11217.4	10980.8	11276.3	12171.3	12342.3	12888.8	13013.5	13022.5
CAPITAL (Ushs. Billion)									
Paid-up capital	743.4	749.2	789.6	796.0	812.3	917.7	973.6	1057.5	1172.4
Share premium	77.0	77.0	81.5	81.5	81.5	61.1	75.7	108.4	114.8
Retained reserves	621.6	610.4	581.2	1054.8	939.0	867.4	830.6	1346.4	975.4
Other reserves/subordinated debt	84.9	81.6	61.0	104.3	103.8	139.8	152.7	160.3	150.6
Profit – Loss (current year)	212.6	341.6	488.3	150.0	303.7	447.2	544.5	125.5	257.3
TOTAL SHAREHOLDERS' FUNDS	1739.5	1859.8	2001.6	2186.6	2240.4	2433.2	2577.0	2798.0	2670.5
OFF BALANCE SHEET ITEMS (Ushs. Billion)									
Letters of Credit	419.6	442.8	392.4	351.0	307.4	335.8	352.0	329.3	347.6
Guarantees & performance bonds	706.5	712.3	786.6	1010.1	1022.8	1060.5	1046.3	1071.0	983.0
Unused loans/overdrafts commitment	601.5	852.9	802.2	825.7	925.5	925.8	1023.3	838.3	938.4
Other off balance sheet items	457.3	984.0	1000.2	913.6	1050.3	444.7	765.1	660.6	409.5
TOTAL OFF BALANCE SHEET ITEMS	2184.9	2992.0	2981.4	3100.4	3306.0	2766.9	3186.7	2320.8	2389.5

Source: Bank of Uganda

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

	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
INCOME (Ushs. Billion)									
Interest income									
Advances	903.8	1017.9	1178.1	1325.0	1443.8	1495.0	1465.3	1425.9	1391.1
Government securities	194.6	205.1	210.7	229.3	245.1	268.6	296.5	310.2	326.4
Deposits abroad	12.8	16.3	22.2	29.6	39.6	46.4	49.3	48.6	42.5
Other	52.3	60.3	72.2	84.9	97.2	106.0	105.4	98.4	95.0
Charges, fees & commissions	236.5	247.3	250.4	258.8	273.3	294.8	326.9	340.1	347.0
Foreign exchange income	138.1	156.6	186.5	218.1	236.7	255.0	250.6	235.7	234.2
Other income	103.7	103.5	94.3	96.1	95.1	97.1	101.4	105.1	113.1
TOTAL INCOME	1641.9	1807.0	2014.2	2241.8	2430.9	2562.8	2595.5	2563.9	2549.3
EXPENSES (Ushs. Billion)									
Interest expense on deposits	205.4	232.6	266.9	298.3	343.7	380.5	401.5	419.5	415.8
Other interest expenses	69.1	92.8	145.3	196.7	220.0	224.8	193.3	150.6	137.6
Provisions for bad debts	67.6	59.9	77.2	99.7	128.2	169.9	205.9	202.1	192.6
Salaries, wages, staff costs	354.1	369.1	383.1	397.7	417.2	428.6	437.8	450.4	462.4
Premises, depreciation, transport	162	163.0	178.9	182.9	185.4	191.2	198.1	203.7	208.0
Other expenses	312	326.0	320.6	337.6	359.0	365.7	405.2	420.1	430.6
TOTAL EXPENSES	1102.6	1243.3	1371.9	1512.8	1653.5	1760.8	1841.7	1846.3	1847.0
ADD: Extraordinary credits/charges	0.6	-0.9	0.9	0.8	0.9	1.2	0.9	0.5	0.5
Net profit before tax	472.2	564.7	641.4	728.1	776.4	800.8	754.7	718.1	702.8
LESS: Corporation tax	117.5	141.5	152.5	176.7	189.5	201.5	199.9	194.9	205.8
NET PROFIT AFTER TAX	354.7	423.2	488.9	551.4	587.0	599.3	554.8	523.3	497.0

Source: Bank of Uganda