

# Bond market: Loved, yet troubling for economists

While government paper makes returns easier to earn, it also reduces the need to look elsewhere.

## Markets. |

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In today's markets, allocating capital has become a little easier, particularly in economies where governments, under fiscal pressure, compete for domestic liquidity by offering high, risk-free returns that effectively set the market's baseline.

In such settings, that pricing power does most of the work: once returns on sovereign instruments are high enough, much of the allocation decision begins to make itself.

Take Uganda. For much of 2025, government securities yielded about 16 to 18 percent before tax.

After withholding tax, 20 percent on treasury bills and about 10 percent on longer-dated bonds, returns settled at roughly 13 to 16 percent.

With inflation hovering around 3 to 4 percent, real returns still stood firmly in positive territory, at about 9 to 12 percent.

That is powerful.

For a fund manager, it creates a very comfortable starting point.

Put a large share of the portfolio, often more than 60 percent, as happened last year, into sovereign paper, and a big part of the return target is already being met.

The job then becomes less about searching for return and more about managing what remains: where to place the rest of the capital, how much risk to take, and whether the alternatives are worth the effort.

That is where the structure of Uganda's market starts to matter.

By December 2025, assets under management by collective investment schemes had climbed to Shs5.66 trillion, up 13.7 percent in just three months and 47.3 percent over the year, according to data from the Capital Markets Authority (CMA) Uganda.

Funded accounts rose 14.3 percent to 206,405.

That means more money, more people, more momentum.

But markets are rarely about what is obvious. They are more about how they unfold.

A large part of that story sits in the bond market.

## The allure

By December 2025, allocations to Government of Uganda bonds had risen to 68.9 percent, while treasury bills also increased their share to 12.4 percent. Together, they now form 81.3 percent of CIS asset portfolios.

By most measures, 2025 was an exceptional year for fixed income.

Trading activity surged, and investor demand rose sharply.

More money was chasing government paper than ever.

That demand reflects Uganda's position as a higher-yield market within the region, with elevated yields last year driven by increased government borrowing and major infrastructure developments, particularly oil and Africa Cup of Nations (AFCON).



Banks and institutional investors allocate more capital to government securities, often at the expense of business lending. PHOTO/FILE

This led to more aggressive discounting at primary auctions, pushed the yield curve higher, and spilled into the secondary market, where trading activity picked up as investors repositioned into the higher-yield environment.

At the August 2025 auction, for instance, Uganda priced its 10-year bond at about 16.25 percent, with longer tenors such as the 25-year bond hovering around 16 percent.

Kenya's 10-year bond, by comparison, offered about 13.4 percent, while Rwanda's market remained in the 8 to 9 percent range.

Uganda was paying more, and capital responded accordingly.

But higher returns rarely come without trade-offs.

## The other side

Uganda's public debt has climbed to about \$34.86 billion (Shs130 trillion) by December 2025, up from \$34.21 billion (Shs128.5 trillion) in September, according to the Treasury.

The bulk of this was domestic, accounting for 54.5 percent of the total, equivalent to \$19.02 billion or Shs68.86 trillion, while external debt made up 45.3 per-

cent, at \$15.84 billion or Shs57.33 trillion. The increase, most of it concentrated in the final quarter of the year, was largely driven by a ramp-up in domestic debt issuance.

Higher yields, in that sense, are not just an incentive. They are also a signal of tightening fiscal conditions.

Uganda's fiscal position shows a persistent gap between revenue and spending. Over the last three quarters, revenue averaged about Shs8.8 trillion, against expenditure of about Shs11.5 trillion, leaving a quarterly deficit of around Shs2.7 trillion, Finance Ministry data show.

The shortfall has also widened, from Shs2.29 trillion to Shs3.1 trillion, highlighting ongoing fiscal pressure and the need for increased borrowing to close the gap.

As borrowing increases, the effects begin to spread.

Government demand for funds starts to compete with the private sector. Banks and institutional investors allocate more capital to government securities, often at the expense of business lending. This leads to higher lending rates, constrained credit, and a private sector that struggles to expand.

Over the last three quarters, for example, lending rates have stayed high at about 18.7 to 19 percent, reflecting the risk in private sector borrowing.

By contrast, government securities have offered similarly strong yields, up to around 18 percent, without that risk, making them a more attractive option for investors.

But from an investor's perspective, the logic still holds.

## Limited options

Treasury bills and bonds are widely viewed as risk-free. In an environment where returns are high and predictable, they become the default destination for capital.

And that is exactly what is showing up in portfolios.

Even as assets spread across fund managers, they did not spread across asset classes.

Instead, portfolios tightened around government securities, with bonds rising from about 64 percent to nearly 69 percent and Treasury bill exposure also growing.

This has come at the expense of other assets. Fixed deposits are declining, corporate instruments have nearly vanished, and equities remain negligible at about 0.03 to 0.04 percent.

This is not just a yield story. It is also a structural one.

A 2023 survey by the CMA Uganda showed that fund managers are not choosing government securities only out of preference, but also out of constraint.

Investment options in the capital markets remain limited.

Few new instruments come to market, while equities and corporate bonds remain shallow and relatively illiquid.

In that kind of market, diversification is not only difficult but also impractical. The alternatives, like real estate, de-

## Key data

# 19%

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# Shs5.6t

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mand more work. Some offer lower returns. Some come with more risk. Others are too small or too illiquid to take in large amounts of money without distorting prices or tying up funds.

SACCO managers face a similar choice. When government paper is offering double-digit returns with relative safety, the rational move is not to stretch for risk but stay where outcomes are more predictable.

And as long as fiscal pressure remains strong, that attraction is unlikely to fade.

So far, this has not produced an obvious macroeconomic problem.

In 2025, inflation averaged at about 3.6 percent, meaning these high yields did not directly undermine monetary policy.

In other words, the bond market has been generous without, at least for now, destabilising the wider economy.

But that balance is delicate.

## Collateral damage.

While government paper makes returns easier to earn, it also reduces the need to look elsewhere. When that happens, capital concentrates. Safe, yes. Efficient, yes. But not necessarily broad.

The private sector is left short of long-term capital.

Institutional funds, better suited than short-term bank money, could finance housing, infrastructure and productive assets.

Instead, they sit in government debt, forcing the state to channel roughly 30 percent of revenues into debt servicing.

Part of the reason is structural. There are no clear mandates directing capital into alternatives like private equity or venture capital, making diversification optional.

Fund managers also resist being compelled, arguing that if returns sour under forced allocations, accountability shifts to the regulator.

That points to a market that is maturing, but also a government that is becoming more dependent on it.

For now, the system is holding together. Returns are strong, demand is steady, and government financing is secured.

But over time, a market that leans too heavily on the state risks becoming inefficient at funding debt, and less effective at building everything else.