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Monetary Policy Statement for March 2024

On March 6, 2024, a special Monetary Policy Committee (MPC) meeting increased the Central Bank Rate (CBR) to 10%.

The unfolding of some of the risks mentioned in the monetary policy statement of February 2024, which includes the depreciation of the shilling exchange rate, has triggered the need for monetary policy to be tightened. The inflation outturns in February 2024 indicate that both headline and core inflation rose to 3.4% from 2.8% and 2.4% in January 2024, respectively. Whereas the main contributors to the rise in inflation are services and Energy Fuel and Utilities (EFU), this combined with the shilling depreciation could spill over into a generalized price increase if not contained. The exchange rate depreciation since November 2023, with sharp depreciation in February 2024, was in part caused by the outflow of some offshore investor funds from the domestic market pursuing more attractive yields available in other markets, strong domestic demand partly as a hedging mechanism against further depreciation, and seasonal factors.

Further exchange rate depreciation could drive inflation above the medium-term target of 5% by the second half of 2024. Additionally, whereas there are downward inflationary pressures arising from the continuing vanishing effects of supply-side shocks, receding inflation around the world, and improved domestic food supply, these are likely to be outweighed by the effects of a weaker shilling.

The inflation trajectory, going forward, would be shaped by the outlook of the shilling and the other goods inflation. The inflation forecasts have been revised upwards in the short term (12-month horizon) in light of the exchange rate depreciation. Inflation is projected to rise above the medium-term target of 5% by quarter 1 of FY 2024/25 and stay above 5% throughout 2025 unless monetary policy is tightened.

Risks to the inflation outlook remain highly dependent on the global and domestic environment. Specifically, higher global commodity prices partly due to geopolitical tensions and an increase in shipping costs resulting from the Middle East conflict as well as tighter global financial market conditions could result in higher domestic inflation. MPC assessed the risks and the uncertainties of the outlook as being broadly on the upside.

Economic growth for FY 2023/24 is projected to remain unchanged with growth of 6%. However, economic growth in the outer years is projected in the range of 5.5% to 6.5% compared to an earlier projection of 6.5% to 7.0%. The downward revision of growth in the outer years largely reflects the likely impact of tighter monetary policy, which is required to stabilize inflation around the medium term. In addition, the rise in inflation could depress household real incomes, reducing consumer spending while investment expenditure could be dampened by high raw materials import costs. Moreover, tax revenue underperformance could increase domestic financing which would crowd out private sector credit growth and dampen economic activity. Furthermore, a sluggish recovery in external demand could reduce Uganda's exports. However, strengthening activity in the oil sector and the Financial Action Task Force's (FATF) removal of Uganda from the Grey List, on February 23, 2024, could unlock additional FDI inflows and somewhat mitigate the negative effects above. Overall, risks to growth are tilted to the downside.

The risks to the inflation outlook are elevated and this requires a tighter monetary policy stance. Therefore, the MPC raised the CBR by 50 basis points to 10%. The bands on the CBR remain at +/-2 percentage points and the margins on the CBR for rediscount and bank rates at 3 and 4 percentage points, respectively. As a result, the rediscount and bank rates will rise to 13% and 14%, respectively. Going forward, there are prospects for a higher CBR to bring inflation down and anchor inflation expectations or a lower CBR if the risks do not materialize.

Faster sustainable growth can only occur in an environment where inflation is low and stable. High inflation rates hurt economic growth, leading to significant and permanent reductions in per capita income. Therefore, tightening monetary policy in the current circumstances is consistent with supporting sustainable growth which is a prerequisite for socio-economic transformation.

Michael Atingi-Ego
Deputy Governor
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