Bank of Uganda

Monetary Policy Report

October 2022

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ACRONYMS AND ABBREVIATIONS

AEs	Advanced Economies
BoP	Balance of Payments
BOU	Bank of Uganda
CAD	Current Account deficit
CBR	Central Bank Rate
CRM	Credit Relief Measure
CIEA	Composite Index of Economic Activity
COVID-19	Corona Virus Disease 2019
CPI	Consumer Price Index
EAC	East African Community
ECB	European Central Bank
ECF	Extended Credit Facility
EIU	Economic Intelligence Unit
EU	European Union
EFU	Energy, Fuel, and Utilities
EMs	Emerging Market Economies
EMDEs	Emerging Market and Developing Economies
FID	Final Investment Decision
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
LICs	Low Income Countries
NEER	Nominal Effective Exchange Rate
NPLs	Non- Performing Loans
OPEC	Organization of Petroleum Exporting Countries
OPEC+	OPEC and partners
PSC	Private Sector Credit
SDR	Special Drawing Rights
SOPs	Standard Operating Procedures
SSA	Sub-Saharan Africa
REER	Real Effective Exchange Rate
UK	United Kingdom
US	United States
US	United States of America
US$	United States Dollar
URA	Uganda Revenue Authority
WTI	West Texas Intermediate
WEO	World Economic Outlook

EXECUTIVE SUMMARY

1. The Monetary Policy Committee (MPC) assessed that the risks to inflation were significantly tilted to the upside and therefore decided to raise the CBR by one percentage point to 10.0 percent. The band on the CBR was maintained at +/- 2 percentage points and the margins on the CBR for the rediscount and bank rates remain at 3 and 4 percentage points, respectively.
2. The economy continues to face strong inflationary pressures driven by a combination of global factors, dry weather conditions in the region, and a weaker shilling. The impact of these factors has pushed consumer price inflation to a decade-long high with headline and core inflation reaching 10 percent and 8.1 percent in September 2022, respectively. However, the drop in the Electricity, Fuel, and Utilities (EFU) inflation provided some respite with inflation in this category declining to 18.7 percent in September 2022 from 19.6 percent in August 2022.

3. The BOU forecasts headline inflation to rise in the near term and average 7.3 percent in 2022 and rise to range between 8 and 10 percent in 2023 before declining back to around 5 percent in 2024. The risks to the outlook for inflation are tilted to the upside and include escalation of geopolitical tensions and the associated supply chain disruption, entrenchment of higher inflation expectations, stronger monetary policy tightening by major central banks precipitating a further weakening of the shilling, and the impact of adverse weather conditions on food production. However, possible downside risks include a global recession resulting from the aggressive fight against inflation, a faster decline in commodity prices, and lower domestic demand due to declining real incomes.

4. Although inflationary pressures remain elevated, recent CBR increases coupled with fiscal tightening have contributed to the stability of the shilling which is expected to cushion inflationary pressures. Indeed, growth in private sector credit and monetary aggregates have moderated, signaling the eventual impact on aggregate demand, and as such inflation pressures are forecast to peak in the first half of 2023.

5. The growth outlook has been revised slightly upwards, with GDP growth expected in the range of 5-5.5 percent in FY 2022/23, up from the previous projection of 4.5-5 percent for the same period. Nevertheless, economic growth is expected to remain below its long-run trend until FY2025/26. There are however substantial risks to the growth outlook with the balance of risks tilted to the downside including a worsening of the Ebola outbreak, delayed implementation of oil-related projects, steeper fiscal consolidation, and a global recession.

6. Money market rates hovered around the upper band of the central bank rate (CBR) in the quarter to September 2022 as tight liquidity conditions. The 7-day interbank weighted average rate increased to 10.3 percent while the overnight rate increased to 9.7 percent in the quarter to September 2022,

7. Private Sector Credit (PSC) growth remains weak owing to weak aggregate demand amplified by weakening balance sheets of both households and firms as the rising inflation takes a toll on the cash flows of both households and business sectors, inducing higher risk aversion of the lenders. Both the value of loans received and approved continued a downward path in the quarter to August 2022.

8. The first two months of the FY saw fiscal operations less expansionary than earlier programmed. Despite revenues (inclusive of grants) at Shs. 3,805.7 billion overperforming its target, total government expenditure in the period at Shs.4,639.4 billion was Shs. 1,848.7 billion lower than that programmed, mainly due to underperformance in development expenditure of shs.1,290.9 billion at the back of tight financing. Interest payments continue to exert pressure on the budget as the ratio of total interest payments to domestic revenues increased to 21.8 percent in August 2022 from 19.9 in August 2021 and 18 in August 2020. Accordingly, the resultant fiscal deficit of Shs. 833.9 billion was lower than projected by Shs.1,751.5 bn.

9. Uganda's remained in an overall balance of payments deficit position which more than doubled to US$390.9 million in the quarter to August 2022 relative to the deficit registered in the quarter to May 2022 as the current account deficit widened by 61.1 percent to US$1,204.2 million yet the financial account surplus at US$592.9 million was let down by increased outflow of short-term capital. The bulging of the current account deficit reflects wider deficits on the goods, services, and primary income accounts amidst a reduction of the secondary income surplus. Consequently, the resultant Balance of payment deficit was financed by drawing down on international reserves. As such the reserves declined by 2 percent to a stock of US$3,800.0 million at the end of August 2022 an equivalent of 4.3 months of import cover.

10. In the short term, the external sector outlook is subject to various downside risks, including intensifying geopolitical tensions and associated adverse spillover effects, including, high borrowing costs, elevated financial vulnerabilities, and subdued growth. The current account deficit is expected to remain elevated, driven by a high import bill and suppressed travel receipts in reflection of the recent outbreak of Ebola while the financial account surplus will likely remain constrained, as

suppression of global growth, financial market uncertainty, and expectations of further interest rate hikes may dampen foreign investor appetite and trigger further offshore exit from the domestic debt securities market.

11. The Shilling maintained relative stability with depreciation pressures substantially abating supported by continued tight liquidity conditions in the money market. In fact, the shilling gained by 0.2 percent against the US dollar in September 2022 in contrast to the depreciation of about 1.1 percent sustained in the previous two months.

1. GLOBAL DEVELOPMENT AND OUTLOOK

1.1 Global economic activity

Global economic activity is undergoing a sharper-than-expected slowdown reflecting the global cost of living crisis stemming from inflation reaching very high levels last seen in several decades. Consumer confidence has fallen in many Advanced Economies while business indicators point to stagnating output. The tightening global financial conditions induced by the need to bring down inflation, geopolitical tensions especially the Russia-Ukraine war, and the lingering Covid-19 in China are weighing heavily on the global growth outlook and the odds of a global recession in 2023 have intensified. Already the Organization for Economic Co-operation and Development (OECD) has downgraded the global growth forecast to 2.2 percent for 2023 from the 2.8 percent forecast in June 2022 (**Table 1**). The Euro Area is now expected to grow at 0.3 percent, 1.3 percentage points lower than the June forecast while the United States growth forecast at 0.5 percent, is 0.7 percentage points lower than the June 2022 forecast.

The ongoing Russia-Ukraine war has put upward pressure on commodity prices, prompting many central banks to hike interest rates to curb inflation at the expense of economic growth. In Europe, the humanitarian cost arising from displaced Ukrainians has significantly dampened growth. In addition, China's growth continues to slow down due to its zero tolerance to COVID-19. The increased number of lockdowns in China in combination to the significant weaknesses seen in its property market is limiting economic activity. The global slowdown is expected to cause reduced external demand for Uganda's exports which will negatively weighon domestic growth.

Table 1: Global economic growth projections

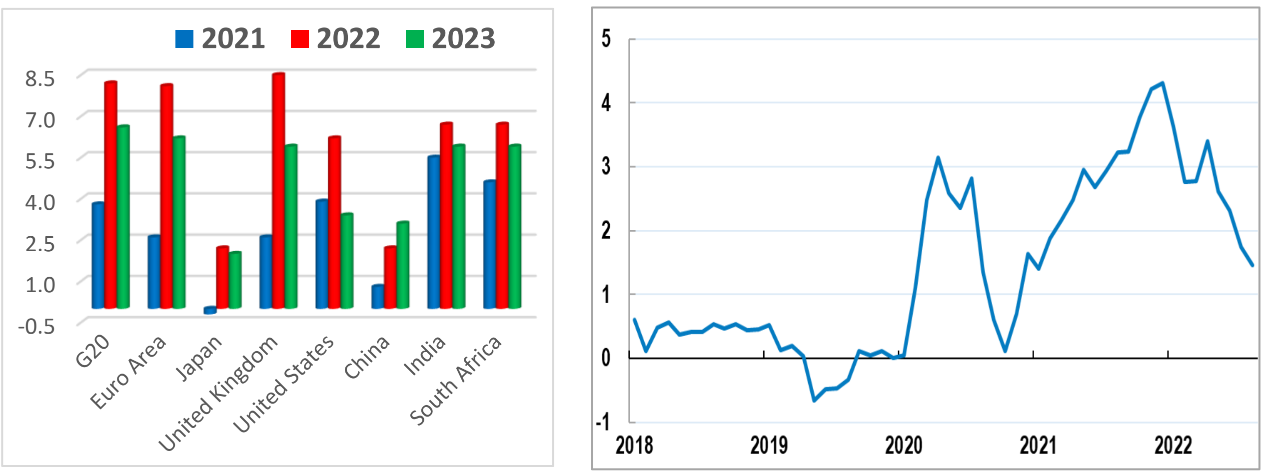
	2021	2022		2023	
		September 2022 Projections	Diff from June 2022 Projections	September 2022 Projections	Diff from June 2022 Projections
World	**5.8**	**3.0**	**0.0**	**2.2**	**-0.6**
Euro Area	5.2	3.1	0.5	0.3	-1.3
Japan	1.7	1.6	-0.1	1.4	-0.4
United Kingdom	7.4	3.4	-0.2	0.0	0.0
United States	5.7	1.5	-1	0.5	-0.7
Brazil	4.9	2.5	1.9	0.8	-0.4
China	8.1	3.2	-1.2	4.7	-0.2
India	8.7	6.9	0	5.7	-0.5
Russia	4.7	-5.5	4.5	-4.5	-0.4
South Africa	4.9	1.7	-0.1	1.1	-0.2

Source: OECD September 2022

1.2 Global inflation

Global inflationary pressures continue to prompt further contractionary monetary policies in several economies with hopes that the pressures will start to dissipate in 2023. From these policies, headline inflation is now expected to reduce from 8.2 percent in 2022 to 6.5 percent in 2023 in the G20 economies but high food and energy prices might slow the pace of decline (**Figure 1**). More interest rate hikes are needed to anchor inflation expectations. The easing freight costs would certainly add to the tight monetary conditions towards reducing inflation since this is one of the fronts through which global supply chain disruptions imposed an upward pressure on global commodity prices (**Figure 1, right**).

Figure 1: Inflation Projections (Left) and the NY Fed Global Supply chain pressure index (Right)



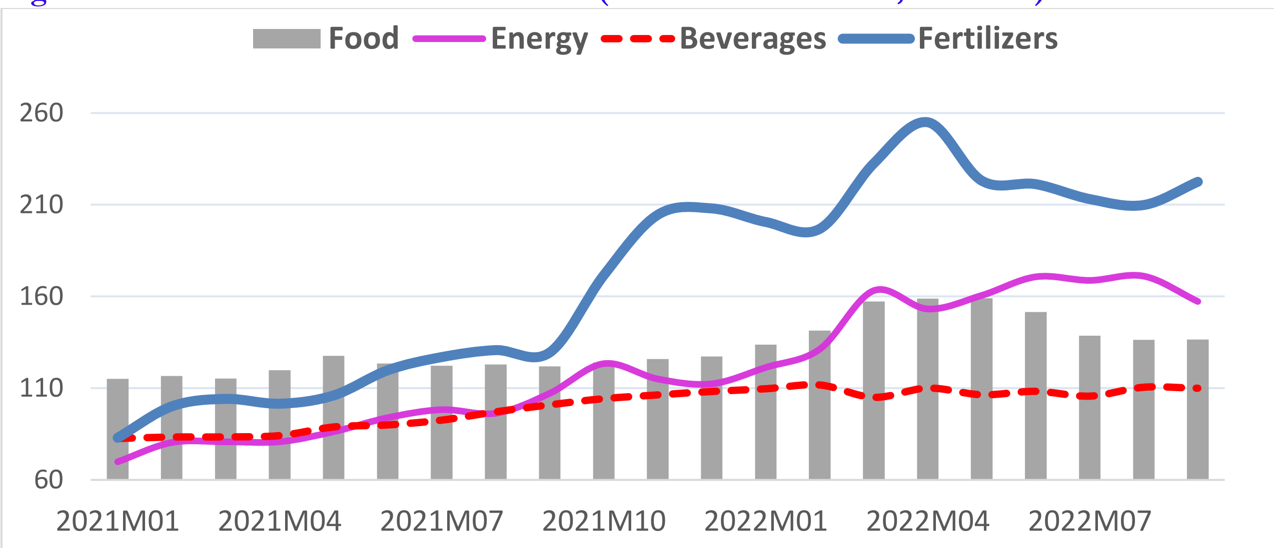
Source: OECD September 2022 **Source: OECD September 2022**

1.3 International commodity prices

Reflecting weaker global demand, the momentum for global commodity prices to rise is vanishing with several commodities registering declines in the recent period although the prices remain elevated compared to the levels a year before. (**Figure 2**). In September 2022, the FAO food price index indicated a decline in food commodity prices for the sixth month in a row due to the improved production prospects from North America and renewed exports from the Black Sea. Despite the continued decline, the pace of the decline was let down by the rise in prices of grains such as maize and wheat while the price of beverages has remained relatively stable, yet the prices of oils and sugar have sustained declines.

Similarly, Energy prices dropped by 8 percent with Brent Crude oil and gas prices falling by 8.6 percent and 14 percent, respectively in September 2022 while the price of metals has also witnessed a slump since peaking in April 2022. On the other hand, prices for fertilizers rose in September but remains below the peak reached in April 2022.

Figure 2: International Commodities Prices (in nominal US Dollar, 2010=100)

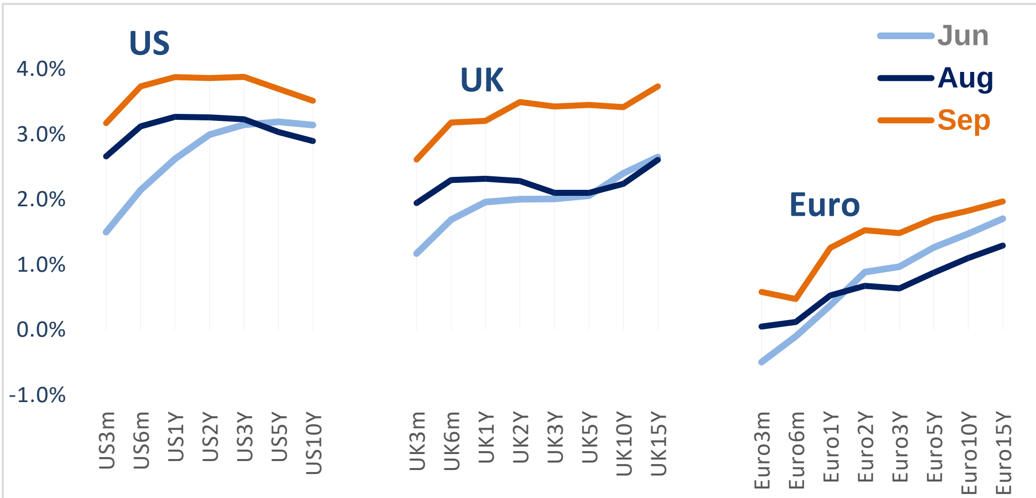


Source: World Bank pink sheet

1.4 Global financial markets

Global financial markets remain volatile as persistently high inflation pressures continue to prompt hawkish monetary policy responses in several economies. As interest rates continue to increase globally, the US dollar continues to strengthen and capital outflows from EMDEs are intensifying. The inversion of the yield curve which has been tightly linked to the propinquity of a recession is featuring prominently in the United States. The term spread between the two- and ten-year bond yields are turning more negative since July 2022 in the United States and the United Kingdom pointing towards a global cyclical downturn (**Figure 3)**.

Figure 3: Yield curve for Government securities in Advanced Economies



Source: Thomson Refinitiv

The housing market has turned down sharply in many countries with falling prices, which could cause further disruptions in the financial markets. The disruptions and tightness in the financial market could complicate further the exchange rate, and fiscal and monetary policies for EMDEs including Uganda.

2. DOMESTIC DEVELOPMENT AND OUTLOOK

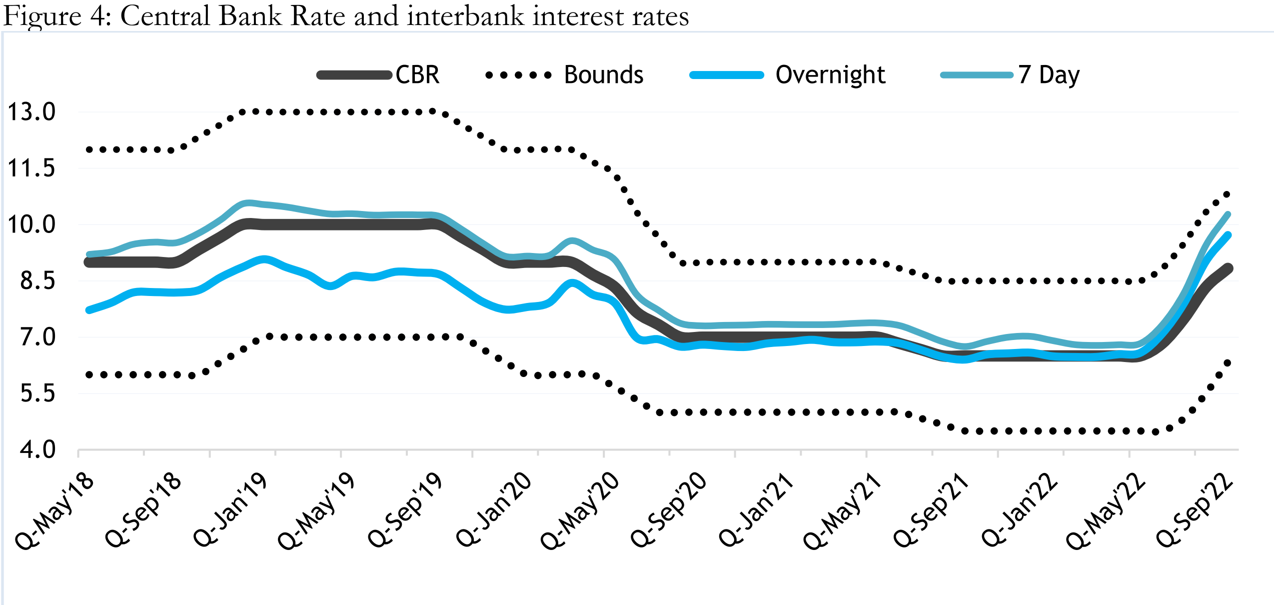
2.1 Domestic financial markets

A developed financial market efficiently channels liquidity from institutions with surplus funds to those in deficits, provides effective price-discovery mechanism and helps transmit monetary policy shocks to the real economy. A comprehensive assessment of the financial markets is therefore vital for judging the decisions and consequences of the central bank's actions.

2.1.1 Interbank money market

Money market rates spiked and stayed close to the upper band of the central bank rate in the quarter to September 2022 (**Figure 4)** reflecting the tightening of monetary policy and the continued tightness of the liquidity conditions at the back of a higher cash reserve requirement. The 1- and 7-day interbank weighted average rate climbed to 9.7 percent and 10.3 percent in the quarter. Owing to the tight liquidity, commercial banks accessed Shs. 11.9 trillion through the Standard Lending Facility (SLF) which was dramatically higher than the 911.3 billion accessed in the quarter to June 2022.

Figure 4: Central Bank Rate and interbank interest rates



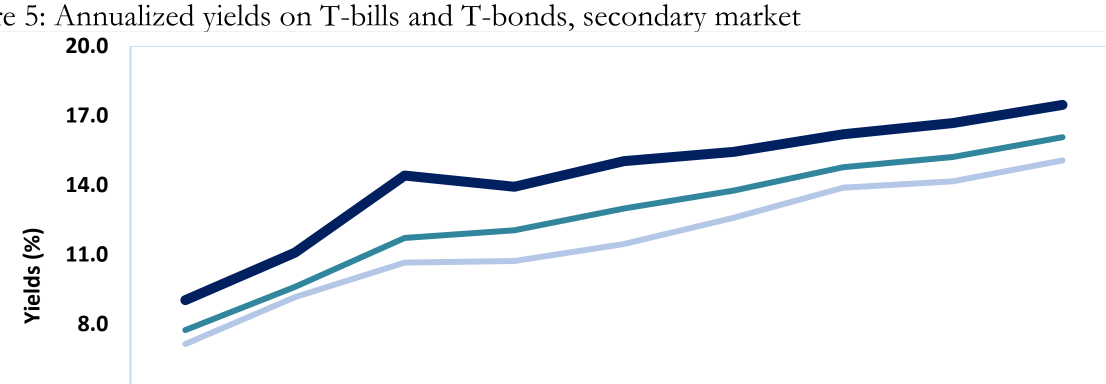
Source: Bank of Uganda

2.1.2 Primary market and secondary market for treasury securities

Primary market yields for all tenors of government securities increased in the quarter to September 2022. Yields for the 91-day, 182-day, and 364-day T-bills rose to 9.5 percent, 11.0 percent, and 13.4 percent respectively in the quarter to September 2022, compared to 7.2 percent, 8.5 percent, and 9.6 percent observed in the quarter to June 2022. Yields on the 2-year, 3-year, 5-year, 10-year, 15-year, and 20-year T-bonds rose to 14.0 percent, 14.8 percent, 16.3 percent, 16.3 percent, 16.8 percent, and 18.5 percent, respectively in the quarter to September 2022, compared to 12.1 percent, 13.2 percent, 14.8 percent, 14.6 percent, 15.3 percent, and 17.8 percent observed in the quarter to June 2022. The rising yields on government securities are complicating the financing of the budget.

Similarly, secondary market yields for bills and bonds rose across tenors reflecting the tightening of monetary and financial conditions to contain the escalating inflation both domestically and globally. At the short end and on average, yields rose by between 130 to 270 basis points and the 364-bill registered the biggest rise while bond yields also rose on average rose by between 120 to 190 basis points (**Figure 5)** reflecting a much-pronounced pass-through of monetary policy to the yields at the shorter end and could signify that long-run inflation expectations are relatively well anchored.

Figure 5: Annualized yields on T-bills and T-bonds, secondary market



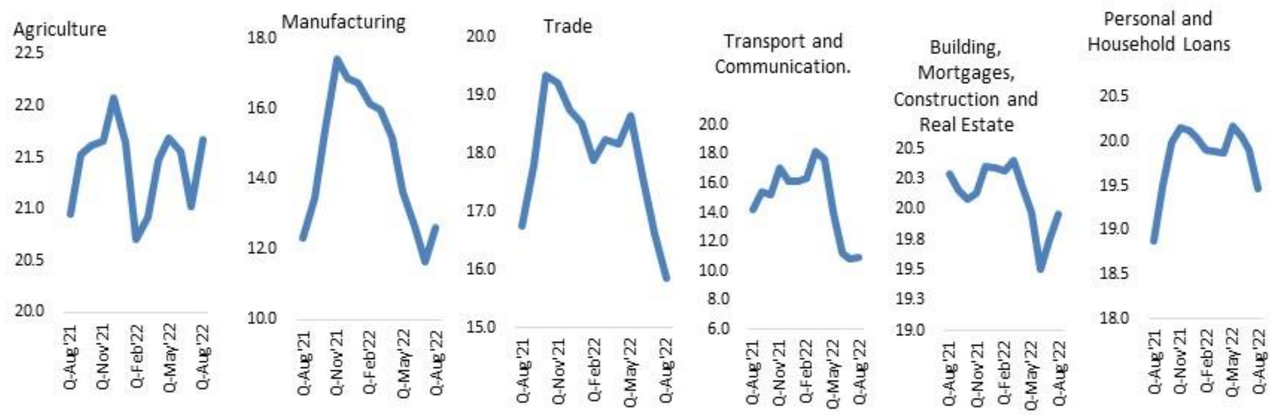
	91-days	182-days	364-days	2-years	3-years	5-years	10-years	15-years	20-years
Q-Sep'21	7.1	9.2	10.7	10.7	11.5	12.6	13.9	14.2	15.1
Q-Sep'22	9.0	11.1	14.4	13.9	15.0	15.4	16.2	16.7	17.5
Q-Jun'22	7.7	9.6	11.7	12.0	13.0	13.8	14.8	15.2	16.1

Source: Bank of Uganda

2.1.3 Lending interest rates

Lending rates on shilling-denominated loans declined to 17.4 percent in the quarter to August 2022 compared to 18.8 percent observed in the quarter to May 2022. Declines in shilling lending rates were observed in all sectors but were most pronounced in Trade, Transport & Communication, Manufacturing, and Personal and Household Loans as shown in **Figure 6**. The decline in the overall shilling lending rates was driven by significant lending to prime borrowers in the Trade, Manufacturing and Transport, and Communication Sectors in the first months of the quarter. However, in August 2022, the average weighted shilling lending rates increased to 20.2 percent from the 16.3 percent observed in June 2022.

Figure 6: Weighted moving average lending rates for selected Sectors

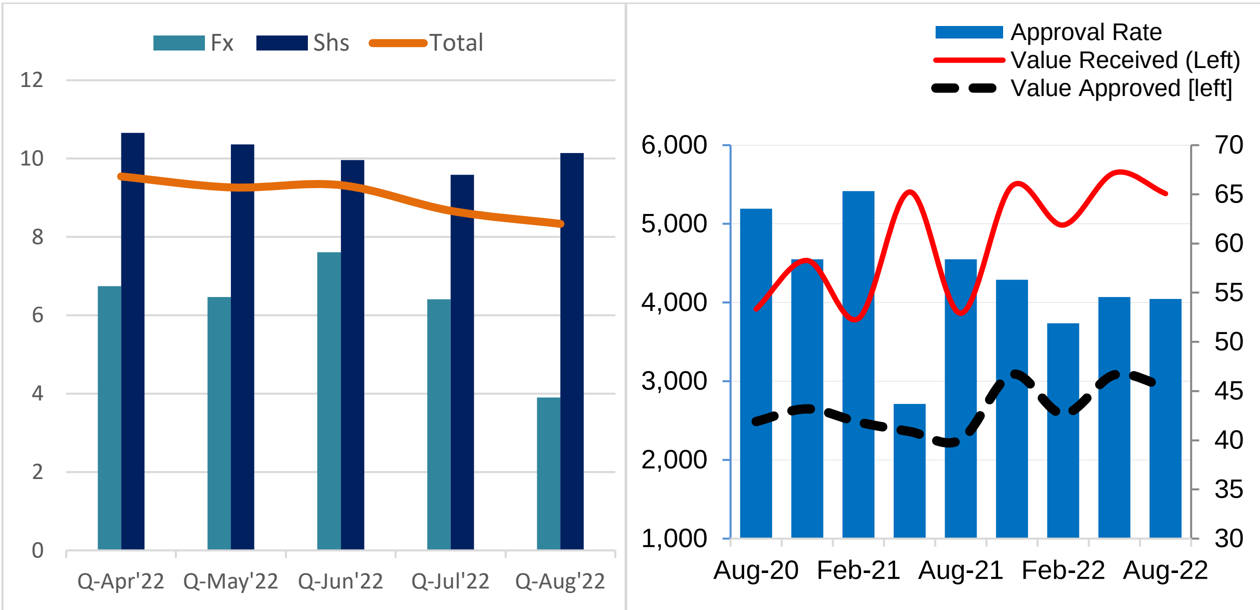


Source: Bank of Uganda

2.1.4 Credit to the private sector

Private Sector Credit (PSC) growth remains weak owing to weak aggregate demand in the economy. The weak demand is being amplified by weakening balance sheets of both households and firms as the rising inflation takes a toll on the cash flows of both households and firms, inducing higher risk aversion of the lenders. The increasing risk aversion is exhibited by the static and relatively lower loan approvals since the quarter to August 2021 (**Figure 7, Right**). Both the value of loans received and approved continued a downward path in the quarter to August 2022, with lenders approving just 54.4 percent of the value of loans applied for. Adjusting for capitalized interest and exchange rate changes, year-on-year growth in PSC averaged 8.3 percent in the quarter to August 2022, a slowdown from the 9.3 percent growth in the quarter to May 2022 (**Figure 7, the left**). Over the same period, growth of foreign currency-denominated loans also slowed to 3.9 percent from 6.5 percent while shilling-denominated loans growth fell to an average of 10.1 percent in the quarter to August 2022 from 10.4 percent in the quarter to May 2022.

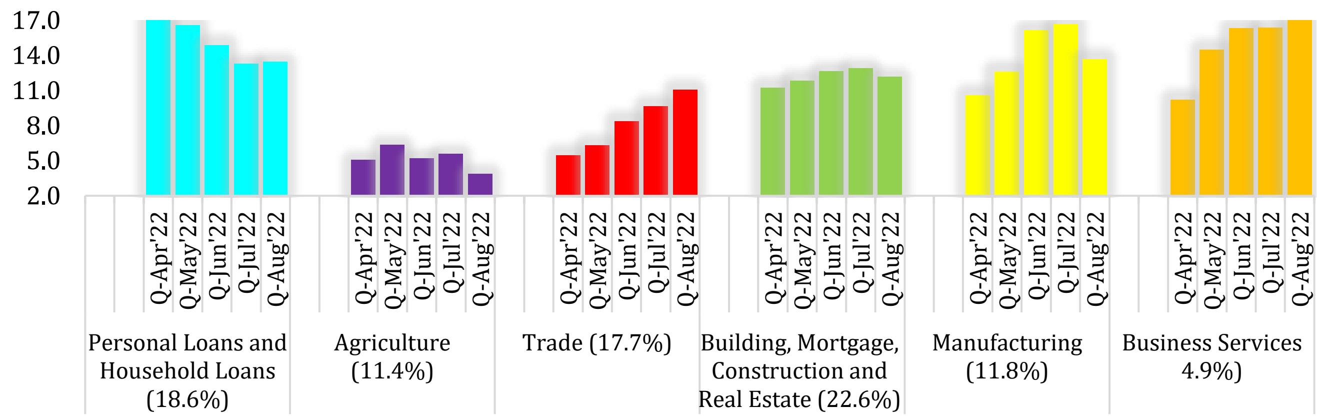
Figure 7: Annual Private sector credit growth (Net-recapitalized Interest, left) and loans demand and supply (Ushs, billions)



Source: Ban k of Uganda

Credit growth remains weak and embarked on a downward trend in most of the major sectors of the economy. The slowdown of credit growth is apparent in the Personal and Household loans sectors and Agriculture (**Figure 8**).

Figure 8: Sectoral PSC Growth (%, year-on-year, sectoral shares in brackets)



Source: Bank of Uganda

2.2 Domestic economic activity

Although monetary policy is the adjusting of the supply of money in the economy to achieve non-inflationary economic growth. It is generally agreed that in the long run, output is fixed and any changes in money supply only leads to increases in prices. Nonetheless, because prices and wages are sticky in the short run, changes in money supply affect investment and consumption of durable goods, which in turn affect aggregate demand and economic activity. Therefore, a comprehensive assessment of economic activity is important to judge both the stance and consequences of monetary policy.

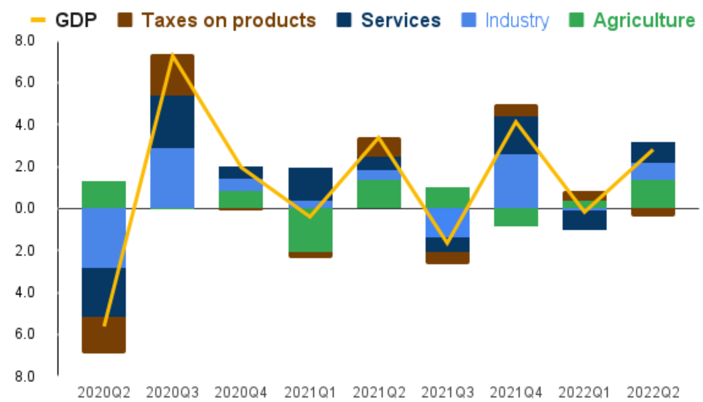
The domestic economic prospects continue to be darkened by negative spillovers from the global economic environment including the war in Ukraine, high global commodity prices, slowing global demand and lingering effects of Covid-19 in Asia, and tightening financial conditions while on the domestic front, lagged impact of the dry weather conditions and increasingly high cost of living feeding through to weak consumer confidence, and tightening financial conditions that are further slowing down credit to the private sector are weighing down on economic activity in addition to the prospective impact fiscal tightness on aggregate demand. Notwithstanding the above, business confidence seem to be making a comeback after dropping in the lead-up to July 2022.

The Composite Index of Economic Activity (CIEA) signaled stagnant growth after growing by 1.2 percent in the quarter to August 2022, relatively the same growth observed in the quarter to May 2022

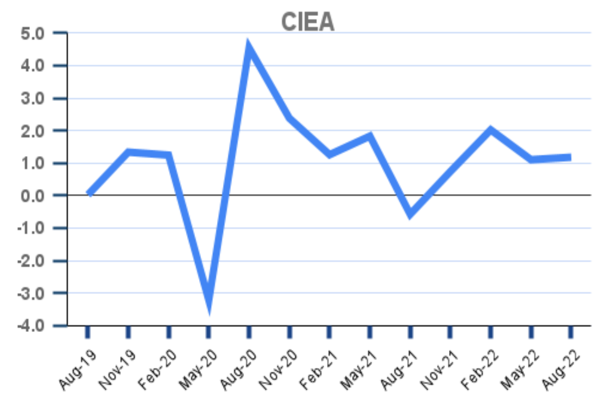
(**Figure 9, Right**). The CIEA growth largely reflects a rebound of in industrial activity and growth in the services sector. On a month-on-month basis, the CIEA grew by 0.7 percent in August 2022 which is a rebound from a 1.1 percent contraction of observed in July 2022.

The recently released Quarterly GDP by UBOS indicated that the output rebounded in the second quarter of 2022 after contracting by 0.2 percent in the first quarter of 2022. The 2.8 percent growth in output during the second quarter was largely driven by the acceleration of growth in agriculture output to 5.9 percent, a 3.1 percent rebound in industry reflecting a return of growth in the mining and construction activity and a resurgence of growth in services sector on account of the strong performance of trade, hotels, and real estate activities (**Figure 9, left**).

Figure 9: Growth in Real GDP Growth and CIEA (q/q, seasonally adjusted)



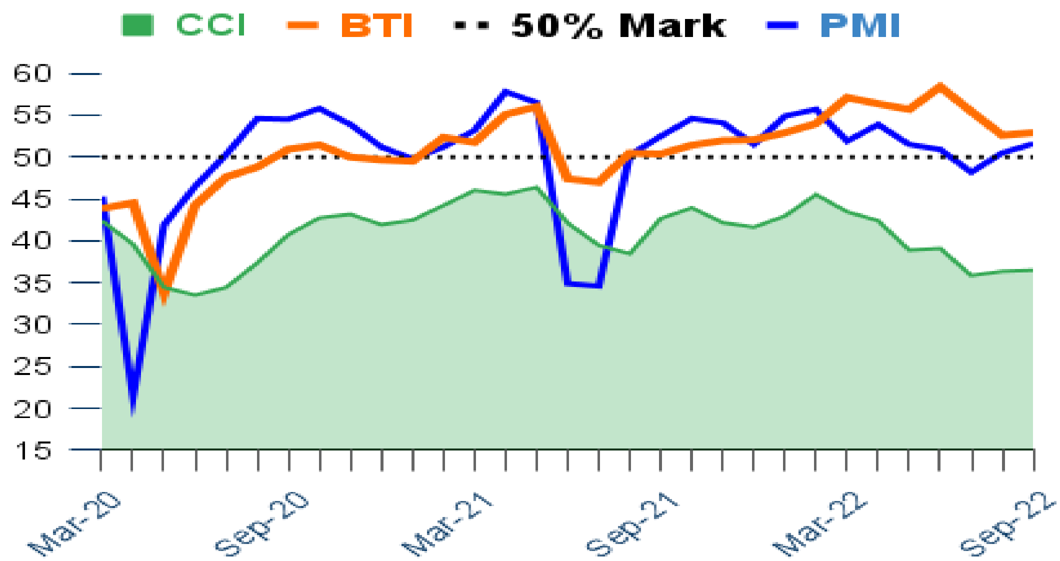
Source: UBOS



Source: BoU

The Bank of Uganda's Business Tendency Index (BTI) and the Stanbic Purchasing Managers Index (PMI) data signal an improvement in business operating conditions during September 2022. Both indices ticked up to 52.9 and 51.6 in September 2022 from 52.6 and 50.5 in August 2022, respectively (**Figure 10**). The improvement in business activity is reflected in increased Output and new orders while a dip in employment and purchasing activity was a drag on these indicators. However, Consumer sentiments about the present and expected economic situation remain negative and were more pessimistic in September 2022, declining to 38.2 which is a continued deterioration of consumer sentiments since March 2022 and reflects the effects of rising inflation on the cost of living.

Figure 10: Indicators of Business Conditions (seasonally adjusted) and Consumer Confidence Index



Source: BoU [CCI and BTI] and Stanbic

The growth outlook has been revised slightly upwards, with GDP growth expected in the range of 5-5. 5 percent in FY 2022/23, up from the previously assumed 4.5-5 percent. Nevertheless, economic growth is expected to remain below its long-run trend until FY2025/26. There are however substantial risks to the growth outlook with the balance of risks tilted to the downside. On the upside, growth could surprise if foreign direct investment associated with the oil-related projects is higher than anticipated. On the downside, a worsening of the Ebola outbreak, delayed implementation of oil-related projects, tighter financial conditions coupled with fiscal consolidation, and materialization of a global recession would weigh down on the economic growth prospects.

2.3 Fiscal operations

Fiscal policy is an important stabilization tool. In the short-term, counter-cyclical fiscal expansion can help support aggregate demand and economic activity, while fiscal contraction can help cool down an overheating economy. To ensure non-inflationary economic growth therefore, an enhanced coordination of fiscal and monetary policies plays a crucial role in the overall macroeconomic management and the attainment of sustainable economic growth.

2.3.1 Expenditure and revenue developments

The first two months of the financial year saw fiscal operations less expansionary than was programmed. Despite tax revenues overperformed the budget by Shs.147.5 bn on account of strong performance in international trade taxes reflecting a depreciated exchange rate and improvements in tax administration (**Table 3**), total government spending remains constrained by the tightness of the financing. Total government expenditure in the period amounted to Shs.4,639.4 billion, which was Shs. 1,848.7 billion lower than the programmed mainly due to underperformance in development expenditure of shs.1,290.9 billion. Interest payments continue to exert pressure on the budget with the rise of the ratio of total interest payments to domestic revenues to 21.8 percent in August 2022 from 19.9 in August 2021 and 18 in August 2020. Reflecting the tight financial conditions and the need to support monetary policy to bring down inflation the resultant fiscal deficit of Shs. 833.9 billion was much lower than projected by Shs.1,751.5 bn and financing on the net was on principal repayment of existing domestic and external debts (**Table 2**).

Table 2: Fiscal operations (billions of Shillings)

	Jul-Aug '21	Jul-Aug '22	Approved Budget	Variation	Annual change (%)
Revenue & Grants	**3,385.2**	**3,805.7**	**3,902.6**	**-96.9**	**12.4**
Revenue	2,927.5	3,584.1	3,436.6	147.5	22.4
Grants	457.7	221.6	466.0	-244.4	-51.6
Expenditure & Lending	**6,717.2**	**4,639.4**	**6,488.0**	**-1,848.6**	**-30.9**
Current Expenditure	3,705.6	2,981.8	3,545.0	-563.2	-19.5
o/w Interest payments	780.8	851.8	667.9	183.9	9.1
Domestic	601.2	605.8	429.8	176.0	0.8
External	179.6	246.0	238.1	7.9	37.0
Development Expenditure	2,759.7	1,433.0	2,723.9	-1,290.9	-48.1
Net lending/repayments	44.9	3.2	21.4	-18.2	-92.9
Domestic Arrears Repayment	206.9	221.5	197.3	24.2	7.1
Primary Deficit	**-2,554.1**	**17.9**	**-1,917.6**	**1,935.5**	**-100.7**
Deficit (excluding grants)	**-3,789.7**	**-1,055.5**	**-3,015.5**	**1,960.0**	**-72.1**
Deficit (including grants)	**-3,332.0**	**-833.9**	**-2,585.5**	**1,751.6**	**-75.0**
Financing (net)	**3,332.0**	**833.9**	**2,585.5**	**-1,751.6**	**-75.0**
External Financing (net)	1,428.3	-263.6	620.9	-884.5	-118.5
Domestic Financing (net)	833.3	950.3	1,946.6	-996.3	14.0
Errors & Omissions	1,070.4	39.9			

Source: Ministry of Finance Planning and Economic Development

Net URA tax and Non-Tax (NTR) collections combined amounted to Shs. 3,584.1 billion, of which tax revenue was Shs.3,326.2 billion (**Table 3**). This translated into an overperformance of Shs. 102.5 billion for the latter. The surplus in net URA tax was largely attributed to higher collections in taxes on international trade, PAYE, and NTR which respectively overperformed the targets by 13.6, 10.4, and 20.7 percent in the two months so far in the financial year.

Table 3: Revenue performance (billions of Shillings)

	Jul-Aug'20	Jul-Aug'21	Jul-Aug'22	URA Target Jul-Aug'22	Jul-Aug'22 Variation from Target	Annual change 2021 - 2020 (%)	Annual change 2022 - 2021 (%)
Total Net Tax & Non-Tax Revenue	**2,581.32**	**2,927.47**	**3,584.10**	**3,436.61**	**147.48**	**13.41**	**22.43**
Net URA tax revenue (excl. Refunds)	**2,474.62**	**2,805.14**	**3,326.18**	**3,223.69**	**102.49**	**13.36**	**18.57**
Gross Revenues	2,647.95	2,968.03	3,593.38	3,447.02	146.36	12.09	21.07
Direct Domestic Taxes	723.84	890.28	1,000.41	1,001.45	-1.04	22.99	12.37
o/w PAYE	394.62	488.98	574.53	520.37	54.16	23.91	17.50
o/w Corporate tax	40.36	50.59	66.69	64.45	2.24	25.36	31.81
o/w Withholding tax	141.35	229.75	213.34	269.58	-56.23	62.54	-7.14
Indirect Domestic Taxes	688.64	736.34	782.41	865.68	-83.28	6.93	6.26
o/w Excise duty	219.31	243.98	291.68	307.79	-16.11	11.25	19.55
o/w VAT	469.33	492.36	490.73	557.89	-67.17	4.91	-0.33
Taxes on international Trade	1,113.22	1,205.18	1,534.87	1,351.18	183.69	8.26	27.36
Stamp duty & Embossing Fees	15.55	13.90	18.62	15.78	2.84	-10.60	33.98
Non Tax Revenue	106.70	122.33	257.07	212.93	44.14	14.65	110.14
Tax refunds	-66.64	-40.56	-10.13	-10.41	0.27	-39.14	-75.01

Source: Ministry of Finance Planning and Economic Development

2.3.2 Public debt stock

Provisional data shows that total public debt stock (in Shilling terms) at the end of August 2022 stood at Shs. 78,388.3 billion which is approximately 47 percent of GDP, a decline of 1.8 percent in the Debt to GDP ratio when compared to the same ratio as at end of June 2022 (**Table 4**). The marginal decline in debt level is reflecting the tighter financial conditions which has made it difficult to accumulate new debt and the need to undertake fiscal consolidation to support the achievement of the price stability and this will undoubtedly provide a negative impulse to aggregate demand.

Table 4:Total public debt stock (Shs. billion)

Public Debt Indicator	Jun'21	Aug'21	Jun'22	Prov. Apr'22	Change Jun'21 - Aug'21 (%)	Change Jun'22 - Aug'22 (%)
Total Gross Debt (Shs.Bn)	**70,224.10**	**69,835.10**	**78,879.80**	**78,388.30**	**-0.55**	**-0.62**
External (Shs. Bn)	44,772.90	43,567.80	48,218.20	47,924.30	-2.69	-0.61
Domestic (Cost, Shs. Bn)	25,451.10	26,267.40	30,661.60	30,463.90	3.21	-0.64
External (US$, Mn)	12,588.30	12,324.20	12,835.40	12,599.50	-2.10	-1.84
UShs./US$ eop rate	*3,556.70*	*3,535.10*	*3,756.70*	*3,803.70*	-0.61	*1.25*

Source: Bank of Uganda

2.3.3 Fiscal Outlook

Government remains committed to the gradual implementation of consolidation in the coming year. This will allow a decline in public debt below 50 percent of GDP in nominal terms. Priority shall be accorded to contracting debt on concessional terms to lower interest payments; and obtaining debt service rescheduling through Debt Service Suspension Initiative (DSSI) which would offer additional fiscal space.

2.4 Balance of payments and exchange rates

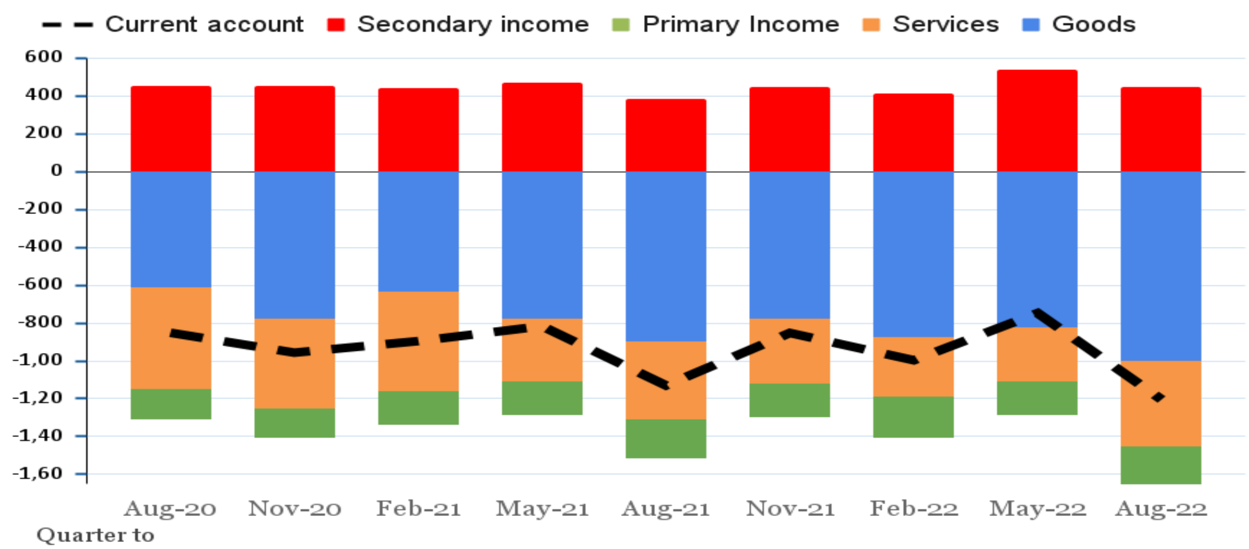
A large current account (CA) deficit usually implies an external imbalance, which in a flexible exchange rate regime can be corrected by a depreciation of the real exchange rate. However, persistent CA deficits reflects an unsustainable balance of payment position and requires structural reforms to enhance domestic productivity and financing capacity.

2.4.1 Balance of payments

The adverse spillovers associated with the challenging global environment on Uganda's net importing and borrowing positions are reflected in the developments in the balance of payments. Uganda's overall balance of payments position more than doubled to a deficit of US$390.9 million in the quarter to August 2022 as the current account deficit which widened by 61.1 percent to US$1,204.2 million largely due to higher deficits in both the goods and services accounts (**Figure 11**) overwhelmed the financial inflows. Although both imports and exports expanded quarter-on-quarter, the increase in import expenditure exceeded the increase in export revenue, resulting in a trade deficit of US$1,000.1 million in the quarter, which was 21.2 percent higher than the deficit in the quarter to May 2022. The trade deficit reflects volume effects on imports after the oil and non-oil imports keyed in a 50.5 percent and 28.1 percent surge in their respective volumes yet the 30 percent rise in the volume of experts was weighed down by an almost 10 percent decline in the price.

In addition, the services deficit widened by 59.2 percent to US$450.2 million, driven by increased transport and other business services payments while the primary income deficit at US$201.1 million was wider by 12.4 percent reflecting increasing interest payments on public debt and assets held by non-residents, and dividends payment to foreign direct investors. The secondary income also weighed down the current account with the surplus on this account narrowing by 17 percent to US$447.2 million on account of lower personal transfers and inflows of NGOs.

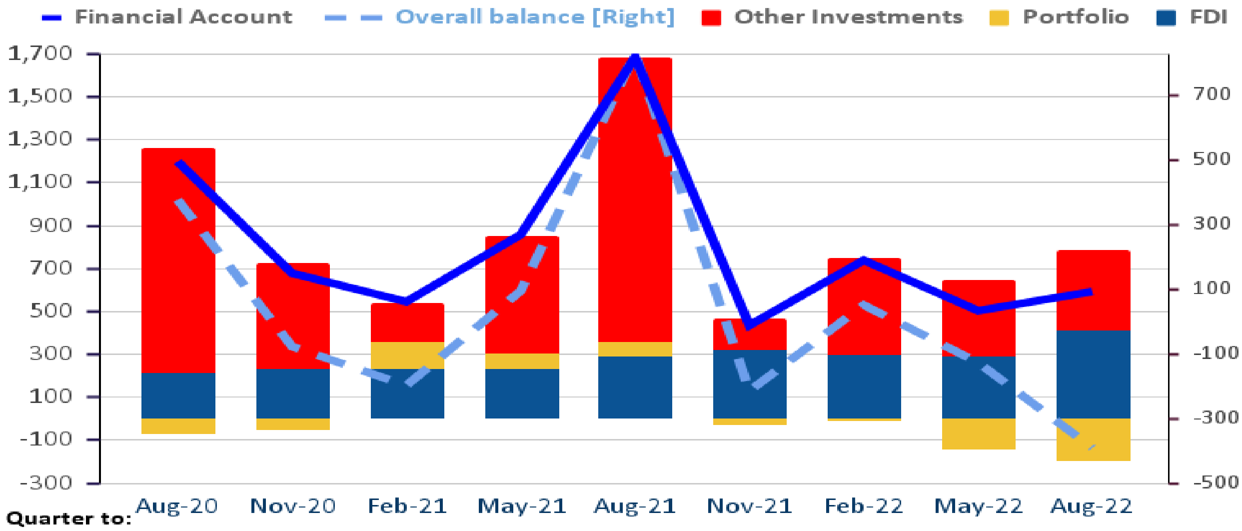
Figure 11: Current Account of BOP decomposition (USD million)



Source: Bank of Uganda

The financial account surplus expanded by 17.7 percent to US$592.9 million in the quarter to August 2022, driven by a 69.5 percent increase in banks' foreign currency deposit inflows, coupled with a 42.9 percent increase in the estimate for FDI inflows, especially to the oil sector. On the contrary, capital outflows through the net exit of portfolio investors more than tripled to US$ 390.9 reflecting the turbulence in the global financial markets (**Figure 12**).

Figure 12: Financial Account decomposition and Overall Balance (USD million)



Source: Bank of Uganda

The resultant Balance of payment deficit was financed through a drawdown on international reserves and the reserves declined by 2 percent to a stock of US$3,800.0 million at the end of August 2022 an equivalent of 4.3 months of import cover, down from a stock of US$4,232.7 million at the end of May 2022 (4.6 months of import cover).

2.4.2 Balance of payment outlook

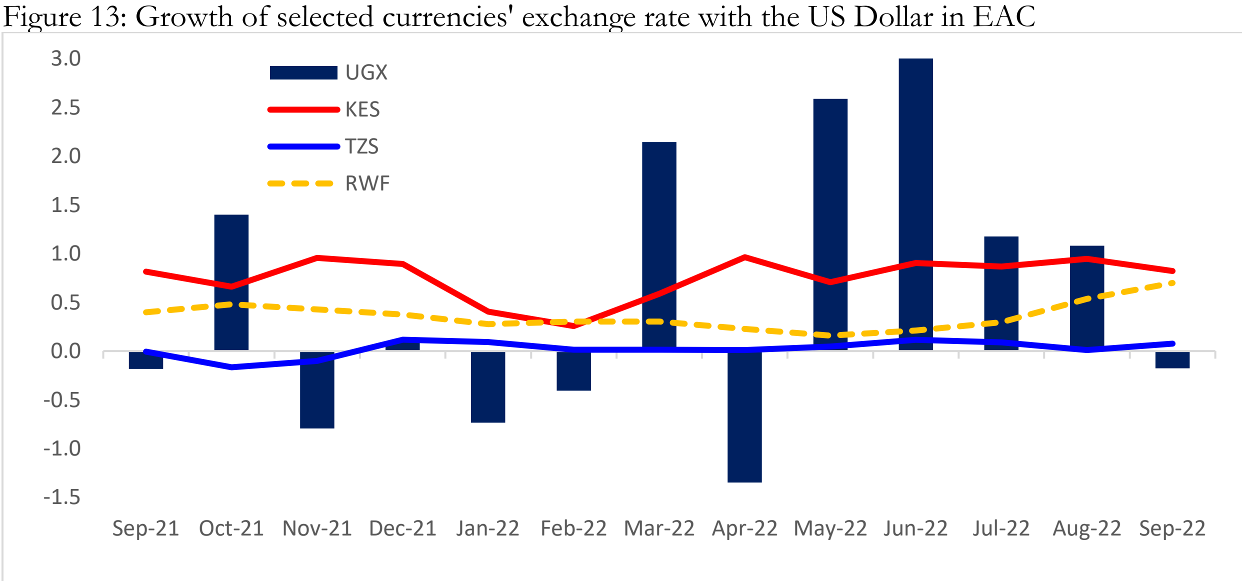
In the short term, the external sector outlook is subject to various downside risks, including intensifying geopolitical tensions and associated adverse spillover effects, including, high borrowing costs, elevated financial vulnerabilities, and subdued growth. The current account deficit is expected to remain elevated, driven by a high import bill and suppressed travel receipts in reflection of the recent outbreak of Ebola while the financial account surplus will likely remain constrained, as suppression of global growth, financial market uncertainty, and expectations of further interest rate hikes may dampen foreign investor appetite for Uganda's financial assets and trigger further offshore exit from the domestic debt securities market. During this period, reserve buildup may be constrained by high government expenditure on imports and debt service obligations.

In the medium term, the current account deficit is projected to widen, before progressively narrowing in the lead-up to FY2026/27 while the financial account surplus is projected to gradually narrow throughout the medium term, owing to decreased budget support loan inflows and rising external debt repayments in the medium term. Although the financial surplus will be supported by strong FDI inflows into the oil sector, the recent resolution by the European Union (EU) parliament to censure the oil projects presents a downside risk to Uganda's progress on oil and gas development, and the associated projected FDI inflows. Overall, BOP deficits are projected throughout most of the medium term, due to the projected narrowing of the financial surplus despite the widening current account deficit while the high cost of debt service weighs down on reserves.

2.4.3 Exchange rates

The Shilling maintained relative stability gaining 0.2 percent against the US dollar in September 2022 relative to the 1.1 percent depreciation observed in August 2022. The appreciation was supported by continued tight liquidity conditions in the money markets and inflows mainly offshores, remittances, forex bureaux, and coffee receipts. In September 2022, the shilling was 8.4 percent weaker against the US dollar year-on-year. On the contrary, the currencies of the East African Community (EAC) member states experienced depreciation pressures in the recent past except for the relatively stable Tanzanian shilling (**Figure 13**).

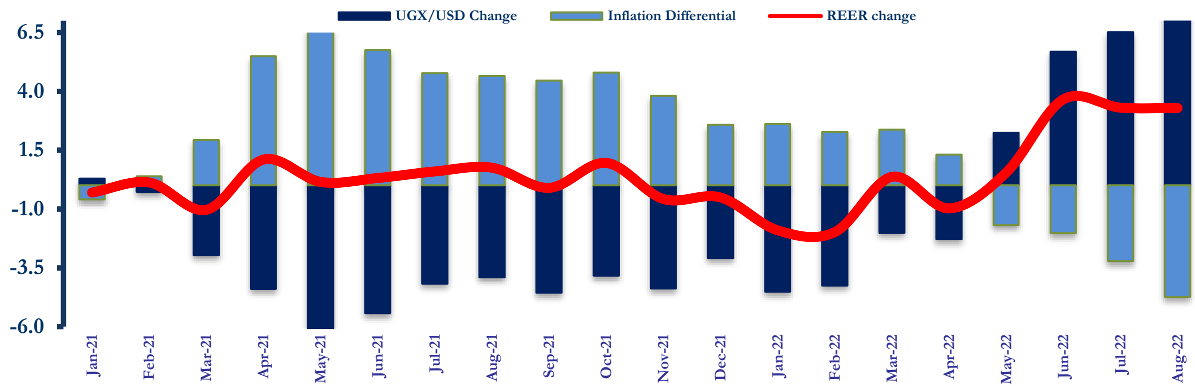
Figure 13: Growth of selected currencies' exchange rate with the US Dollar in EAC



Source: Bank of Uganda

In real effective terms, the shilling appreciated by 0.2 percent month-on-month in August but depreciated by 3.4 percent year-on-year largely reflecting the nominal depreciation. The year-on-year movement in the Real effective exchange rate is however losing momentum and could be a good sign that imported inflation is abating as the real marginal costs facing importers could be declining (**Figure 14**).

Figure 14: The real effective exchange rates



Source: Bank of Uganda

2.5 Domestic inflation and outlook

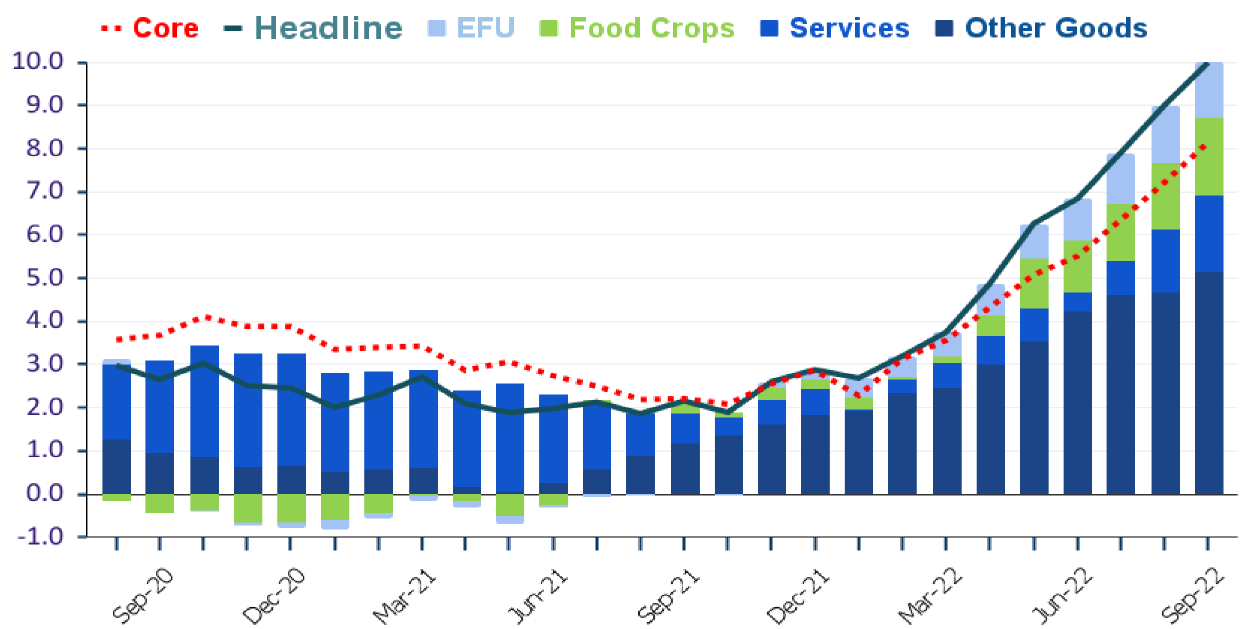
Domestic inflation is driven by domestic and external demand and supply-side factors. A careful assessment of the evolution and outlook for inflation is therefore critical for the design of appropriate monetary policy strategy, which in Uganda, is formulated to deliver a medium-term core inflation target of 5 percent and to ensure that output is as close to its potential level as possible.

2.5.1 Domestic inflation

Cost-push pressures continued to weigh on prices in September 2022, pushing inflation to the highest level recorded in the recent decade. The impact of the recent drought on food prices, spillovers from the adverse global shocks behind the elevated international commodity prices, and a pass-through from weaker shilling are to blame for the escalation of inflation. Driven by mainly processed and unprocessed food price inflation which accelerated to 19.5 percent in September 2022 from 16.7 percent in August 2022, headline inflation rose to 10.0 percent from 9.0 in the respective months (**Figure 15**). Similarly, core inflation also rose by 0.9 percentage points to 8.1 percent in September 2022 driven by a surge in prices of other goods particularly processed foods such as maize and cassava flour, sugar, and rice coupled with the acceleration in services Inflation. The other goods inflation ticked up to 11.2 percent from 10.2 percent while the services inflation rose to 4.5 percent from 3.7 percent driven by an increase in costs of transportation and education services.

Non-core inflation rose to 20.3 percent from 19.1 percent, mainly driven by food crops and related items inflation. Indeed, food crop inflation rose to 21.6 percent from 18.8 percent in August partly reflecting seasonal patterns as well as the effects of a protracted drought. On the other hand, energy, fuel, and utilities (EFU) inflation dropped to 18.7 percent in the year ending September 2022, down from 19.6 percent in the year to August 2022, reflecting a decline in prices of petrol, diesel, and cooking liquified gas. The drop in fuel prices reflects the recent drop in international crude prices since July 2022.

Figure 15: Domestic inflation decomposition (y/y)



Source: UBOS

2.5.2 Inflation outlook

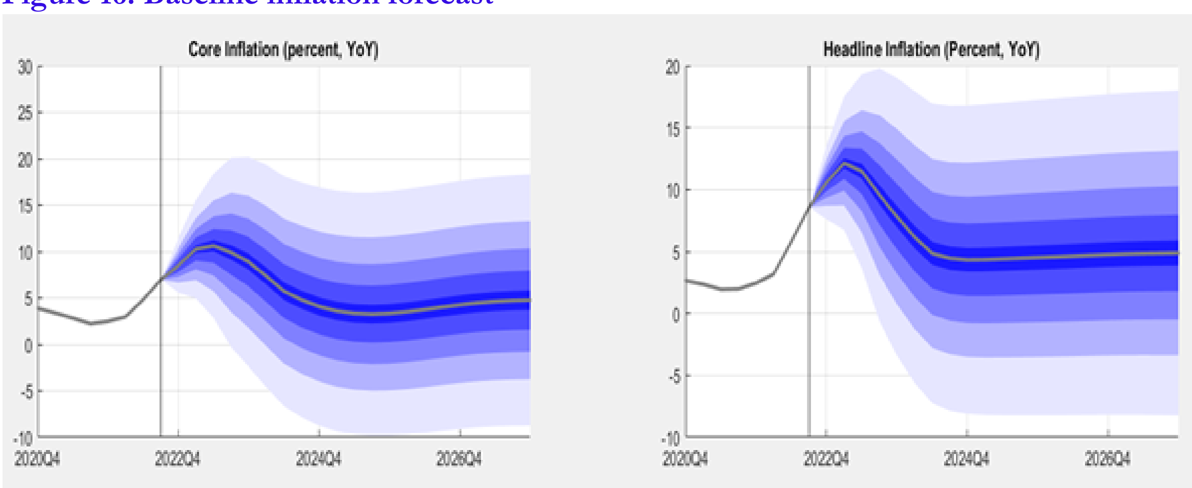
The inflation outlook is higher than projected in August 2022. Core inflation is expected to average 6.0 percent in 2022 and 10.4 percent in 2023, while headline inflation is expected to average 7.3 percent in 2022 and 10.7 percent in 2023 (**Figure 16**). The outlook is higher than was previously projected due to a higher expected depreciation of the Uganda shilling in response to the more hawkish tightening of monetary policy in many Advanced Economies which is likely to increase portfolio capital reversals from the domestic economy.

2.5.3 Baseline inflation forecast

The following assumptions underly the October 2022 forecasts. The global economy is expected to slow down, growing by 2.5 percent in 2023 from 2.9 percent in 2022. Global growth is affected by several factors including supply chain bottlenecks partly due to the war in Ukraine that has resulted in high inflation forcing many central banks in many countries to tighten their monetary policies which is most likely to result in a global recession. The growth outlook is further weighed down by geopolitical tensions and China's zero-Covid strategy whose strict containment measures have resulted in weaker demand.

In the near-term, foreign inflation is expected to decline reflecting lower international energy and food prices. However, this effect is likely to be temporary as crude oil prices are expected to return to US$100 per barrel due to increased demand in the winter months coupled with production cuts by OPEC+ countries. The US Federal Reserve Bank is also expected to hike its key interest rate by an additional 1 percentage point before the end of 2022. On the domestic scene, economic activity for FY 2022/23 is expected to be higher than previously assumed mainly driven by an uptick in industrial and services activity in addition to the strengthening of business confidence.

Figure 16: Baseline inflation forecast



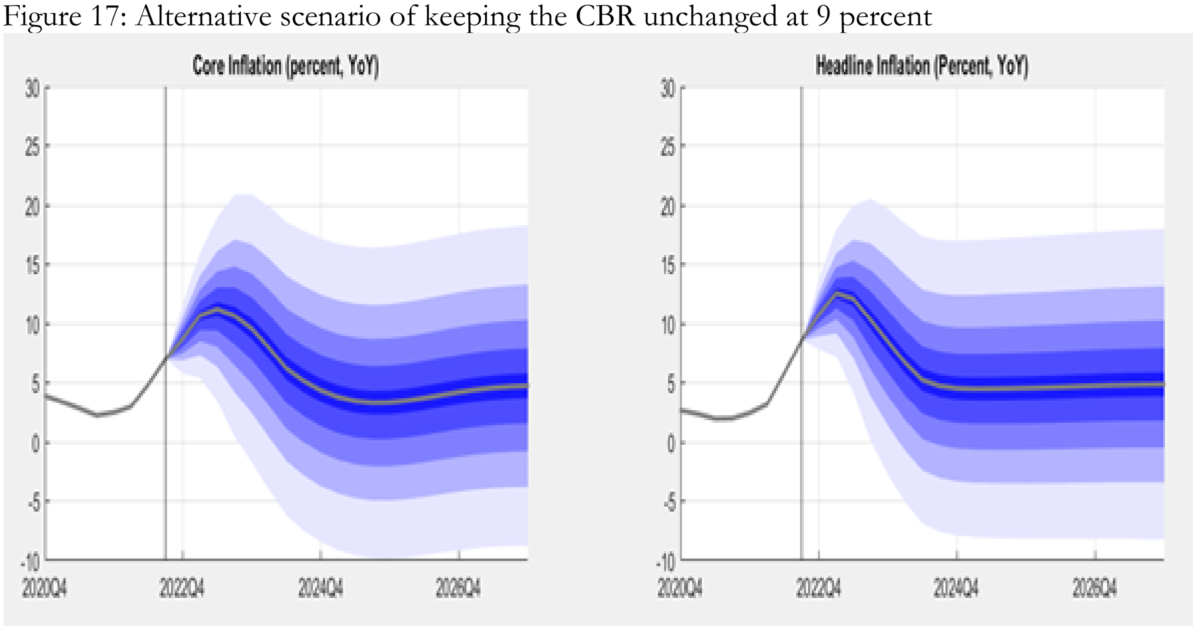
Source: Bank of Uganda

However, the inflation outlook is highly uncertain and the risks to the inflation outlook are primarily on the upside. The major upside risks include the possible entrenchment of higher inflation expectations, escalation of geopolitical tensions and the associated supply chain disruptions, stronger monetary policy tightening by major central banks which could further weaken the shilling exchange rate, and the adverse weather conditions that could further push up food crop prices. Conversely, inflation may turn out to be lower than projected if the actions taken globally to rein in inflation results in a global recession, energy prices decline faster than anticipated and domestic demand drops by more than anticipated due to lower real incomes.

2.5.4 Alternative scenarios

Considering the risks to the inflation outlook, three alternative scenarios were constructed. The first scenario considered the effect of maintaining the CBR at 9 percent till the end of December 2022. In this scenario, core inflation and headline inflation would be on average 0.7 percentage points higher than in the baseline in 2023 (**Figure 17**).

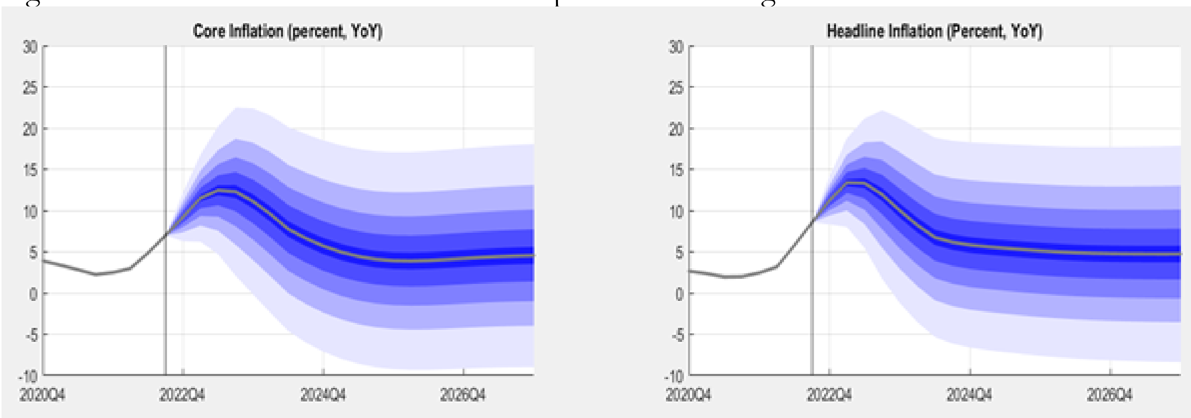
Figure 17: Alternative scenario of keeping the CBR unchanged at 9 percent



Source: Bank of Uganda

The second alternative scenario considers the effect of a more depreciated exchange rate by 5 percent over the forecast horizon due to stricter monetary policy tightening in Advanced Economies. In this scenario, headline and core inflation would be 2.2 percentage points higher than the baseline in 2023 **(Figure 18).**

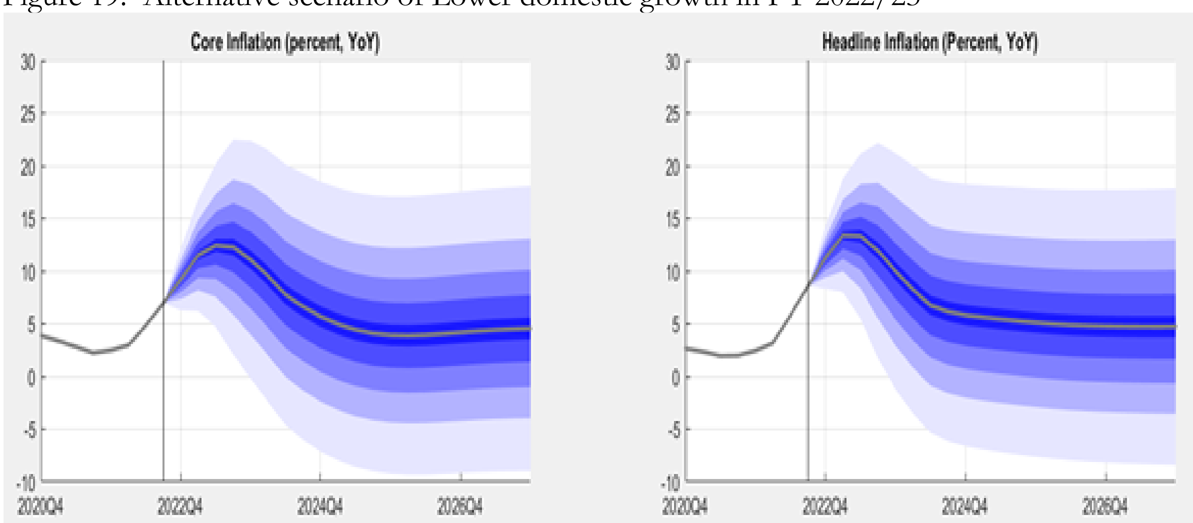
Figure 18: Alternative scenario of a more depreciated exchange rate



Source: Bank of Uganda

The third alternative scenario considered the effect of lower growth in the range of 2-3 percent in the financial year 2022/23 affected by a worsening of the Ebola outbreak and delays in the implementation of oil projects. In this scenario, headline inflation and core inflation would be 0.4 percentage points and 0.8 percentage points lower than the baseline in 2023 (**Figure 19**).

Figure 19: Alternative scenario of Lower domestic growth in FY 2022/23



Source: Bank of Uganda

3 MONETARY POLICY DECISION

Monetary policy affects the real economy and prices with a considerable lag. A critical assessment of the future trajectory of economic activity and inflation relative to their potential levels and targets is thus crucial to determine an appropriate forward-looking monetary policy strategy.

The economy continues to face tough conditions from the domestic and external environment. Inflation is at the highest level recorded since 2012 and the inflation outlook has further deteriorated on account of dry weather conditions, and exchange rate depreciation amidst several adverse global shocks. The annual headline and core inflation rose to 10 percent and 8.1 percent in September 2022 from 9 percent and 7.2 percent in August 2022, respectively. However, there was some relief against price pressures arising from annual Electricity, Fuel, and Utilities (EFU) inflation which declined to 18.7 percent in September 2022 from 19.6 percent in August 2022.

The BOU forecasts headline inflation to rise and average 7.3 percent in 2022 and rise to between 8 and 10 percent in 2023, before declining back to around 5 percent in 2024. The risks to the inflation outlook are tilted to the upside and include escalation of geopolitical tensions and the associated supply chain disruption, entrenchment of higher inflation expectations, stronger monetary policy tightening by major Central Banks precipitating further weakening of the Uganda shilling, and the impact of adverse weather conditions on food production. However, possible downside risks include the materialization of a global recession resulting from the aggressive fight against inflation, a faster decline in commodity prices, and lower domestic demand due to declining real incomes.

Inflation pressures are forecast to peak in the first half of 2023. Although inflationary pressures remain elevated, recent CBR increases coupled with fiscal tightening have contributed to the stability of the shilling which is expected to cushion inflationary pressures. Indeed, growth in private sector credit and monetary aggregates have moderated, signaling the eventual impact on aggregate demand.

The domestic economy, which has weathered several shocks, is showing signs of recovery. The Composite Index of Economic Activity (CIEA) grew slightly higher by 1.2 percent in the quarter to August from 1.1 percent in the quarter to May 2022, supported by a rebound of industrial and services activity. Also, business sentiments have improved since the previous forecast round. Accordingly, Real GDP growth is projected at 5 -5.5 percent in FY 2022/23 higher than the 4 - 4.5 percent projected in August 2022. Nevertheless, economic growth is expected to remain below its long-run trend until FY2025/26. The risks of global recession contracting Uganda's exports and tighter financial conditions will likely weigh down on domestic economic growth. In addition, higher domestic interest rates, declining private sector credit, and tight fiscal policy could further weigh down on economic growth.

Considering the deteriorating inflation outlook, the Monetary Policy Committee,, decided to raise the CBR by 1 percentage point to 10.0 percent. The band on the CBR remains at +/- 2 percentage points. The margins on the CBR for the rediscount and bank rates will remain at 3 and 4 percentage points, respectively. The BoU remains determined to rein in on inflation and will continue to take necessary actions to ensure that inflation reverts to its medium-term target of 5 percent.