BANK OF UGANDA

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Monetary Policy Statement for February 2022

The Bank of Uganda (BoU), at the Monetary Policy Committee (MPC) meeting of February 2022, **maintained the Central Bank Rate (CBR) at 6.5 per cent**.

The economy is estimated to have bounced back in 2021, growing in the range of 6.5-7.0 per cent, although it came after a 1.5 per cent contraction in 2020 as the pandemic forced parts of the economy to shut. Indeed, the high-frequency indicators of economic activity for October 2021 to January 2022 suggest that the economy was on a strong rebound. Domestic demand is making a strong comeback as COVID-19 related restrictions are eased, adding to the gains from robust external demand. Considering this recovery and signs that the effect of the Omicron outbreak on economic activity has been relatively small, the outlook for economic growth is more positive than earlier projected. In 2022, there could be a loss of growth momentum as global factors turn adverse, but real GDP is projected to grow by around 6 per cent as domestic demand recovery broadens. However, lower global growth, continued supply chain disruptions, and tighter global monetary and financing conditions could constrain external demand. In addition, the recovery might remain fragile and uneven across sectors. Over the medium term, government investment in infrastructure is expected to enhance productive capacity and, coupled with increased social spending and a recovery in tourism, should bring annual growth above 7 per cent.

Risks to the growth outlook remain tilted to the downside. On the domestic front, uncertainty about the evolution of the pandemic continues to cast a shadow on the economic recovery. New COVID-19 variants and a resurgence of lockdown measures would weigh on the outlook. Another important source of uncertainty for the outlook is the public investment and how this will be financed under the fiscal consolidation path, which is necessary to keep debt sustainable and avoid the risk of debt distress. The slow execution of public investment projects and further delays in oil investments could dampen the growth outlook. Moreover, the increasing frequency and intensity of climate shocks could undermine agricultural activity. Additionally, risks remain from the global economic slowdown, the prolonged supply chain bottlenecks, and geopolitical tensions. Furthermore, global inflationary pressures, which calls for a faster withdrawal of monetary accommodation, could result in a change in investor risk sentiment and the associated tighter domestic financial conditions, and this could stall the domestic economic recovery. On the upside, accelerated vaccine rollout, waning of the pandemic, and improved efficiency in the execution of public investments would help boost economic activity.

Inflationary pressures remain modest. The January 2022 inflation outcomes indicate that annual headline inflation declined to 2.7 per cent while annual core inflation declined to 2.3 per cent, from the 2.9 per cent reported for both in December 2021, despite the continued rise in food crop, and energy, fuel, and utilities (EFU) prices. The downturn has largely been driven by a decline in transport costs because of the lifting of travel restrictions. The outlook for inflation remains largely unchanged from that of the December 2021 MPC meeting. While demand-side inflationary pressures remain subdued, upside inflationary risks remain, and inflation could accelerate in months ahead owing to the rises in energy and food prices. Moreover, household spending, particularly on services, is forecast to be higher due to the full opening of the economy. The rise in inflation will also reflect strong producer price inflation domestically and import prices. In the medium-term (2-3 years ahead), as demand fully recovers, inflation is forecast to rise but stabilise around the 5 per cent target, contingent on the evolution of the pandemic. There could be inflation surprises, however, because of a stronger rise in food crop, commodity and imports prices, and the exchange rate depreciation.

There are considerable uncertainties surrounding this outlook. The most significant risk is the duration of disruptions to the global production chain and related stronger inflation pressures. If the upswing in global cost-push inflation pressures turns out to be larger or more persistent than currently expected, it could spill over into the domestic economy, especially so, if combined with a weaker shilling. If the exchange rate were to depreciate significantly, partly on account of higher demand for foreign currency and monetary policy tightening in advanced countries, this would increase the overall inflation pressures and foster a need for tightening monetary policy going forward. In addition, containment of the COVID-19 outbreaks and benign health-related developments could provide a strong boost to confidence and result in a greater domestic demand resulting in the economy recovering much stronger than currently being projected. On the downside, a faster resolution of global supply chain disruptions, lower international commodity prices, and good food crop harvest could cause inflation to remain subdued. Additionally, inflationary pressures could weaken in the event of a more protracted and damaging COVID-19 outbreak.

The MPC assessed that the economic recovery continues to require monetary policy support. Based on an assessment of the current macroeconomic situation and the outlook and balance of risks, the MPC judged that keeping CBR unchanged at 6.5 per cent would be consistent with meeting the inflation target of 5 per cent sustainably in the medium term while supporting economic growth recovery. The band on the CBR is also maintained at +/-2 percentage points, and the margins on the rediscount rate and bank rate have been kept unchanged at 3 and 4 percentage points on the CBR, respectively. Consequently, the rediscount rate and the bank rate have been maintained at 9.5 per cent and 10.5 per cent, respectively. Going forward, the monetary policy stance will be adjusted depending on how fast the economy recovers relative to its long-run growth path and how quickly inflation evolves to its medium-term target.

The BoU will continue with targeted credit relief measures for the education and hospitality sectors which remained under lockdown for an extended time. Furthermore, BoU will maintain the COVID-19 Liquidity Assistance Program (CLAP) to manage potential liquidity risks arising from the pandemic until the economic situation normalises.

Michael Atingi-Ego
Deputy Governor

February 14, 2022