BANK OF UGANDA

37/45 Kampala Road. P.O. Box 7120, Kampala.
Telephone: 256-414-258441/6, 258061, 0312-392000, 0417-302000
Telex: 61069/61344; Fax: 256-414-233818
www.bou.or.ug info@bou.or.ug

Monetary Policy Statement for June 2022

At the Monetary Policy Committee (MPC) meeting of June 2022, the Bank of Uganda increased the Central Bank Rate (CBR) by 1 percentage point to 7.5 percent.

Inflation is increasing rapidly and is spreading broadly across the basket of consumer goods and services. The annual headline and core inflation rose to 6.3 percent and 5.1 percent in May 2022 from 2.7 percent and 2.3 percent in January 2022, respectively. The prices of essential commodities such as cooking oil and soap, food, fuel and transportation, have risen sharply. Supply and demand imbalances that were caused by the Covid-19 pandemic and heightened by the Russia-Ukraine conflict are the main underlying sources of broader price pressures.

The weakening of the Uganda shilling against the US dollar coupled with rising food and energy prices have worsened the inflation outlook since the April 2022 forecast round. Higher business costs are likely to spread into consumer prices, thereby pushing inflation higher in the coming months. Consequently, annual headline and core inflation are now forecast to average 7 percent and 6.1 percent, respectively, in 2022, which is higher than earlier projections. Inflation is projected to peak in the second quarter of 2023 before gradually declining to stabilise around the medium-term target of 5 percent by mid-2024.

The inflation outlook is significantly uncertain, with the balance of risks tilted to the upside. The main upside risks include:

- Global inflationary pressures amidst persistently higher world food and energy prices. The Russian-Ukraine conflict continues to strain supply chains and stoke international commodity prices.
- A stronger tightening of monetary conditions by advanced economies aiming to control inflation could intensify portfolio outflows from frontier markets like Uganda, thereby further weakening the shilling exchange rate.
- Higher prices in the global markets that would further increase the demand for foreign exchange (US$ in particular) required to purchase the same quantity of goods, could further weaken the exchange rate
- Trade restrictions by some countries and stringent containment measures against new Covid-19 virus strains in Asia are worsening the disruptions to global supply chains.

The downside risks include:

- Much weaker domestic demand as higher inflation squeezes consumers' real incomes together with tighter financial conditions, which will constrain investment.
- Bumper food crop harvests could lead to lower food prices.

The adverse global economic developments and higher inflation have diminished the prospects for domestic economic growth. The optimism for economic recovery from the removal of pandemic restrictions in January 2022 has been dampened by the effects of the Russia-Ukraine conflict. The Composite Index of Economic Activity (CIEA), a high-frequency indicator of economic activity, is signalling a slowdown in the pace of economic recovery. The growth of the CIEA declined to 0.8 percent in the three months to April 2022 from 2.4 percent in the three months to January 2022.

Economic growth is now projected in the range of 4.5 - 5.0 percent in 2022, which is lower than the previous projection of 5.5 - 6.0 percent as of April 2022. Weaker external demand coupled with surging commodity prices, and the resultant high domestic inflation will lead to tighter monetary conditions, thereby constraining aggregate demand.

The risks to the growth outlook, which are tilted to the downside, include weaker global growth, escalation of geopolitical conflicts, persistent global supply chain disruptions, heightened global economic uncertainty, and higher inflation. These downside risks are dampening consumer confidence, heightening exchange rate volatility, and prolonging weak growth in private sector credit. Nonetheless, in the medium-term, the economy will grow at 6 - 7 percent supported by public and private investments in the oil sector.

While the inflationary pressures are likely to be temporary, the worsening economic outlook, uncertainty, and risks ahead motivated the MPC to tighten monetary policy to contain demand pressures until supply catches up. Accordingly, the MPC has raised the CBR to 7.5 percent and maintained the band on the CBR at +/- 2 percentage points. The margins on the CBR for the rediscount and bank rates remain at 3 percentage points and 4 percentage points, respectively. Consequently, the rediscount and bank rates are now 10.5 percent and 11.5 percent, respectively.

The BoU will continue to raise the CBR until inflation is firmly contained around the medium-term target. Also, the BoU will phase out the remaining targeted credit relief measures for the education and hospitality sectors on 30 September 2022. Similarly, the Covid-19 Liquidity Assistance Program (CLAP) for managing potential liquidity risks arising from the pandemic as well as the restriction on payment of dividends and other discretionary distributions of Supervised Financial Institutions expired on 31 May 2022.

Michael Atingi-Ego
Deputy Governor
02 June 2022