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Monetary Policy Statement for August 2023

On 15 August 2023, the Monetary Policy Committee (MPC) lowered the Central Bank Rate (CBR) to 9.5%.

After peaking at 10.7% in October 2022, inflation has steadily decreased to below 5%, faster than expected. Annual headline and core inflation dropped to 3.9% and 3.8% in July 2023 from 4.9% and 4.8% in June 2023, respectively. Similarly, food crops inflation declined to 9.3% in July from 12.3% in June 2023. The deflation of energy, fuel, and utility costs was -1.6% in July from -3.1% in June 2023 and services inflation averaged 3.1% from April to July 2023.

The decline in inflation was due to tighter monetary and fiscal policies, strengthening of the shilling exchange rate, lower energy and food prices, improved global supply chains, and reduced domestic demand. Also, the drop in inflation was driven by base effects as the prices are now lower than they were at the same time last year.

This downward inflation trend is predicted to continue in the coming months due to lower international food and fuel prices, better agricultural supply, and decreasing inflation expectations. Although global inflation remains relatively high, it's getting closer to the targets set by central banks in advanced economies. This international trend could help reduce domestic inflation pressures.

However, advanced economies will likely maintain tight monetary policies, which might cause currency volatility as foreign investors in local markets seek high returns abroad. Nevertheless, the exchange rate is expected to remain stable.

There are still risks despite improvements in near-term inflation projections compared to June 2023. On the downside, global inflation might continue to decrease, potentially affecting domestic inflation. A significant global economic slowdown could also impact inflation by reducing global demand, leading to lower prices for goods and commodities.

On the upside, external risks could drive inflation higher. Factors like ongoing geopolitical conflicts, rising commodity prices, or disruptions in global trade could push up inflation. Sticky inflation in advanced economies might also mean higher interest rates, which could affect economies needing foreign capital as well as their exchange rates. Also, adverse weather could keep food prices elevated.

On balance, the MPC assesses the risks to the inflation outlook could result in lower inflation.

Uganda's economy has demonstrated resilience and has been recovering well despite the uneven global growth environment with estimated annual growth of 5.3% in 2022/23. However, economic growth seems to be slowing due to weak domestic demand. The Uganda Bureau of Statistics (UBoS) data showed quarter-on-quarter average economic growth of -6.5% in the second and third quarters of 2022/23. The agriculture, industry and services sectors posted -21.6%, -2.3%, and -1.3% growth in activity. Private sector credit growth was moderate amidst tightening bank lending standards. In addition, the high-frequency economic indicators pointed to weakening growth momentum during April to June 2023.

Looking ahead, economic growth is expected to recover gradually, ranging from 5.0% to 6.0% in fiscal year 2023/24. Private sector consumption, investments in extractive industries, and improved exports are anticipated to drive this recovery. The outlook for the domestic economy is subject to a range of uncertainties:

- economic growth in advanced economies posing a risk to domestic growth. It is possible that higher policy rates in these economies could interact with long-standing global financial vulnerabilities, such as elevated levels of debt, to significantly slow global growth;
- weaker foreign demand could restrain export growth resulting in a deteriorating current account deficit and higher external financing needs;
- a resurgence of supply chain distortions due to geopolitical factors;
- a tighter fiscal policy in part due to unfavourable global financial markets could restrict government development expenditure; and
- stronger moderation of household expenditure in part due to lagged effects of decline in real incomes, weakening of prices for commodity exports and reduction in agricultural output as a result of unfavourable weather conditions.

MPC noted that the materialisation of the downside risks to economic growth could lead to a sharper decline in GDP growth. The current economic forecast suggests that economic activity remaining below capacity over the next two years will exert downward pressure on inflation.

In light of this outlook, the MPC decided to lower the CBR to 9.5% aiming to stimulate economic activity while maintaining inflation around the target. The CBR bands remain at +/-2 percentage points, and the margins on the CBR for rediscount and bank rates stay at 3 and 4 percentage points, respectively. As a result, the rediscount and bank rates are now 12.5% and 13.5%. In addition, the Cash Reserve Requirement (CRR) has been lowered by 50 basis points to 9.5%.

The Bank of Uganda will closely monitor economic developments and inflation prospects to take appropriate actions for sustainable macroeconomic stability.

The MPC also noted Uganda's progress in strengthening Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT). In February 2020, the Financial Action Task Force (FATF) placed Uganda among jurisdictions under increased monitoring referred to as the "Grey List" due to the strategic deficiencies in the AML/CFT. Accordingly, the Ugandan Authorities agreed with the FATF to implement an action plan to address the deficiencies. Specifically, BOU was required to address 6 deficiencies relating to Immediate Outcomes (IO) 3 & 4 of the FATF Standards. Following continuous engagement with the FATF since May 2020, as at 30 June 2023, Uganda had largely addressed 20 out of the 22 FATF agreed actions. The remaining 2 action points are being addressed.

Michael Atingi-Ego
Deputy Governor
15 August 2023