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 2021

The Bank of Uganda, at the Monetary Policy Committee (MPC) meeting of June 2021, has decided to reduce the Central Bank Rate (CBR) by 0.5 percentage point to 6.5 percent.

The MPC noted that economic developments have been broadly in line with the outlook in the April Monetary Policy Report (MPR). High frequency indicators of economic activity indicate that the momentum of economic activity for the quarter to May 2021 was moderate. Indeed, the Uganda Bureau of Statistics (UBoS) in its June 2021 real GDP estimates indicate economic growth of 3.3 percent in Financial Year (FY) 2020/21, slightly higher than initial projections of 3.1 percent, owing primarily to stronger household consumption. However, contraction in private sector investment is persisting, partly reflecting heightened Covid-19 induced uncertainties. The real GDP growth outlook remains unchanged at 4.0-4.5 percent in FY2021/22. Nonetheless, the recovery is expected to strengthen, with above-trend economic growth in the outer years as vaccine effectiveness increases, which should allow relaxing the current public health measures and a stronger rebound in domestic demand.

A high degree of uncertainty surrounds the economic outlook, with many possible upside and downside risks. On the upside, moderate growth in domestic demand is expected over the forecast horizon and the strengthening global recovery is generally supportive of economic growth. Moreover, the vaccination process is expected to gather steam in the coming months, which should help to normalise economic activity quickly.

On the downside, the main risk is a resurgence of the Covid-19 pandemic and conceivably more contagious variants. In the near-term (12 months ahead), domestic demand could be dented by still emerging second Covid-19 wave, especially in the sectors that are contact intensive. In addition, there is little space for a fiscal stimulus package to respond to the fragile economic growth and the rising public debt necessitates fiscal consolidation to keep public debt on a firm downward path. Furthermore, a sizable share of domestic debt held by non-resident investors makes the domestic financial market an important transmitter of external financial shocks to economic growth in the event of intensified global financial volatility. Additionally, private sector credit growth slackened in March-April 2021, and in the months ahead the growth of private sector credit could be unduly deterred by higher non-performing loans (NPLs), as forbearance periods come to an end and the real impact of the Covid-19 pandemic on businesses and individuals becomes clearer. If these developments were to materialise, they would substantially slow economic recovery.

Inflation remains subdued. UBoS rebased and re-weighted the Consumer Price Index (CPI) basket to 2016/17 from 2009/10. The rebased CPI resulted in inflation being lower than earlier outturns. With the rebased CPI, annual headline and core inflation averaged 2.7 percent and 3.4 percent, respectively, in the 12 months to March 2021, lower by 1.2 and 1.6 percentage points, compared to inflation based on the CPI rebased to 2009/10. The rebased CPI indicates that annual headline edged lower to 1.9 percent in May 2021 from 2.1 percent in April 2021, in part due to a decrease in food crop, and energy, fuel and utilities (EFU) prices. However, annual core inflation rose slightly to 3.1 percent from 2.9 percent, primarily due to increases in prices for services. While inflation will likely remain below the 5 percent target in near-term, as excess capacity continues to exert downward pressure, it is forecast to stabilise around the 5 percent target by the end of 2022.

Going forward, the inflation path is likely to be shaped by uncertainties impinging on the upside and the downside. On the upside, if the upward surge of international commodity prices becomes another commodity super-cycle, it would pose upside risks to the inflation outlook. This compounded with a more depreciated exchange rate, one-off effects of increases in some taxes, adverse weather-related shocks, and a more robust than anticipated global economic recovery could put considerable upward pressure on domestic inflation. On the downside, a projected bumper harvest in 2021 could keep food prices low. In addition, renewed lockdown to combat rising Covid-19 infections and lower than anticipated domestic demand could exert downward pressure on domestic inflation. Nonetheless, the balance of risks is currently assessed to be balanced.

The MPC assessed that the risks to the economic growth outlook are still on the downside, that there remains considerable excess capacity in the economy, sectoral unevenness of economic recovery, and a weak level of business investment. Therefore, the economic recovery continues to require monetary policy support until economic slack is absorbed so that the 5 percent inflation target is sustainably achieved. Against this backdrop, the MPC decided to reduce the CBR to 6.5 percent and maintained the band on the CBR at +/-2 percentage points on the CBR. The margin on the rediscount rate and bank rate has been kept unchanged at 3 and 4 percentage points on the CBR, respectively. Consequently, the rediscount rate and the bank rate have been reduced to 9.5 percent and 10.5 percent, respectively.

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