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Monetary Policy Statement for February 2018

The inflation data released by the Uganda Bureau of Statistics (UBOS) indicates that inflation remains subdued. Annual headline and core inflation declined to 3.0 percent and 2.6 percent in January 2018 from 3.3 percent and 3.0 percent, respectively in December 2017. The decline in inflation is partly attributable to low food prices, as annual food inflation declined to 2.7 percent in January 2018 from 3.5 percent in December 2017. For Electricity, Fuels and Utilities (EFU) the annual inflation rate also declined to 9.8 percent from 12.5 percent in December 2017.

The pace of economic activity strengthened in 2017. Indeed, the high frequency indicator of real economic activity, Bank of Uganda's Composite Index of Economic Activity (CIEA), projects economic growth for 2017 to be in the range of 5.0-6.0 percent compared to 2.5 percent in 2016. In addition, there are indications of a revival in private investment activity; as reflected by the recovery of Foreign Direct Investment, which grew by 18.5 percent in 2017 compared to a decline of 30.5 percent in 2016; improving shilling credit extension by 10.8 percent in December 2017 compared to 7.9 percent in December 2016; and an increase of imports of raw materials and capital goods, which grew by 17.4 percent in 2017 compared to a decline of 21.1 percent in 2016. These developments, coupled with an improving global economic outlook, could strengthen domestic economic activity. Economic growth for Financial Year 2017/18 is now projected in the range of 5.0-5.5 percent, a positive payoff for the current stimulatory monetary policy.

Over the next five years, economic growth is projected to average 6.3 percent, boosted by public investments, increasing growth in consumption, and improved agricultural productivity. There are nonetheless downside risks to this outlook. The growth of private sector credit remains below historic levels and the cost of credit remains relatively high for micro and small loans while the cost to corporates have declined.

However, non-performing loans as a percentage of gross loans have declined from a peak of 10.5 percent in December 2016 to 5.6 percent in December 2017, which should support credit extension. In addition, although public investment programmes could substantially raise output and be self-financing in the long run, transitional challenges of funding these investments can be formidable, and may crowd out private sector borrowing, thus delaying the growth benefits of public investment.

The near-term inflation forecasts are similar to those of the MPC meeting in December 2017. However, forecasts for the 12-months horizon are lower by about 1 percentage point, in large part due to lower food inflation. Inflation is forecast to increase gradually, as the economy strengthens with both the headline and core inflation converging to 5 percent by the second half of 2019. There are nonetheless, upside risks to this outlook, including the path of the exchange rate which in part is contingent on external economic environment, the future direction of food crops prices and the evolution of international crude oil prices. The Bank of Uganda (BoU) estimates that there is still spare capacity in the economy that will dampen inflationary pressures.

Given the objective of keeping inflation close to the target and the estimated spare capacity in the economy, a cautious easing of monetary policy is warranted to further boost private sector credit growth and to strengthen the economic growth momentum. The BoU will therefore reduce the Central Bank Rate (CBR) by 50 basis points to 9.0 percent. The band on the CBR will be maintained at +/-3 percentage points and the margin on the rediscount rate at 4 percentage points on the CBR. Consequently, the rediscount rate and the bank rate have been reduced to 13.0 percent and 14.0 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

February 13, 2018