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Monetary Policy Statement for August 2018

The Consumer Price Index (CPI) data released by the Uganda Bureau of Statistics (UBOS) indicates that inflation edged up in July 2018. The increase in inflation was largely a result of the global oil price increases, the shilling depreciation and one-off price changes from communication taxes, and fuel excise tax rises. Annual headline inflation rose to 3.1 percent in July 2018 from 2.1 percent in June 2018. Annual core inflation also rose to 2.5 percent in July 2018 from 0.8 percent in June 2018. Annual food crops inflation however declined to *minus 2.0* percent in July 2018 from 2.3 percent in June 2018, while Energy Fuel and Utilities (EFU) inflation rose to 16.0 percent in July 2018 from 15.1 percent in June 2018.

Economic growth continues to strengthen. The real Gross Domestic Product (GDP) growth for FY 2017/18 is estimated at 5.8 percent compared to 3.9 percent in FY 2016/17. Economic growth is projected to strengthen further in FY 2018/19 to 6 percent and to an average of about 6.3 percent over the medium-term supported by public infrastructure investments, improving agricultural productivity, recovery in Foreign Direct Investment (FDI), and strengthening private sector credit (PSC) growth partly as a consequence of the monetary policy easing. Indeed, weighted average lending rates fell to 17.7 percent in June 2018 from 25.2 percent in February 2016 when Bank of Uganda (BoU) started easing monetary policy. The BoU's Composite Index of Economic Activity (CIEA) projects robust growth in the first half of 2018, with annualised growth of about 6-6.5 percent.

There are nonetheless downside risks to this growth outlook including challenges relating to financing of public investment programmes and the weak external balance position coupled with escalation of global trade tensions. Although public investment programs 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 investment and consumption, thus delaying the growth benefits of public investment.

The current account balance was relatively weaker in FY 2017/18, with the current account deficit as a ratio of GDP widening to 5.8 percent from 3.4 percent in FY 2016/17. This deficit was partly funded by inflows in the financial account driven by FDI and other related inflows. The heightened depreciation pressures experienced during the last quarter of FY 2017/18 were in part driven by speculative activity in the foreign exchange market, which resulted in the exchange rate overshooting its long-run equilibrium. The foreign exchange market has, however, stabilised with only intermittent demand surges. The BoU international reserve levels remain adequate to maintain stability in the foreign exchange market.

Core inflation is forecast to continue rising and peak in the range of 6-7 percent in the second half of FY 2018/19 but will stabilise around the medium-term target of 5 percent by end of 2019. The rise is a result of a combination of several factors: increase in fuel prices, the closure of the negative output gap and the increased taxes. A key risk to the inflation outlook is the shilling exchange rate which remains vulnerable to domestic market conditions and the possibility of tighter global financial conditions. The weaker shilling exchange rate combined with higher oil price assumptions could result in a more elevated inflation trajectory. Food prices are projected to remain low in the forecast horizon and are not seen as a major risk to the inflation outlook, but this can quickly change depending on the weather conditions.

Given the objective of keeping inflation close to the target and the need to contribute to attaining sustainable economic growth, a neutral monetary policy stance is warranted. The BoU will therefore maintain the Central Bank Rate (CBR) at 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 set at 13.0 percent and 14.0 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile
Governor
August 13, 2018