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Monetary Policy Statement for February 2019

Bank of Uganda (BoU) has in the February 2019 Monetary Policy Committee (MPC) meeting decided to maintain the Central Bank Rate (CBR) at 10 percent. Although the inflation outlook over a 12-months horizon has improved compared to the December 2018 forecast round, risks to the inflation outlook remain elevated.

The economy is projected to grow by about 6.3 percent in FY2018/19 and remain on a steady growth trajectory over the coming years, with output trending above potential. Indeed, high frequency real economy indicators project that domestic economic growth momentum continued into the first half of FY2018/19. The strong growth is in part supported by our accommodative monetary policy stance and the resultant favourable financial conditions, fiscal impetus and multiplier effects of public infrastructure investments, ensuing strong domestic demand conditions and improved agricultural performance.

There are nonetheless risks to the projected economic growth momentum including weather-related constraints to agricultural production and challenges relating to the financing of public investment programmes. In addition, the escalating global trade frictions and lower than anticipated global growth may not only subdue external demand thereby weakening Uganda's external position, but could also lead to volatility in the domestic foreign exchange market. Furthermore, although private sector credit growth has been on a recovery path since January 2018, it remains below its historical trend and its contribution to economic growth could be weighed down by the relatively weak performance of foreign currency-denominated loans.

The January 2019 Consumer Price Index (CPI) data released by the Uganda Bureau of Statistics (UBOS) indicates that inflation remains relatively subdued. Nonetheless, annual headline inflation rose from 2.2 percent in December 2018 to 2.7 percent in January 2019. Annual core inflation also rose from 2.8 percent to 3.4 percent during the same period. The low inflation environment continues to be supported by low food inflation which has averaged ***minus*** 2.2 percent since the beginning of FY 2018/19. The decline in international oil prices and a stable exchange rate have also been key drivers of the low inflation environment.

The medium-term (2-3 years) inflation outlook remains relatively unchanged from the December 2018 round of forecasts, with inflation projected to converge to the BoU's target of 5 percent. However, the inflation outlook in the intermediate period has improved, largely driven by a relatively stronger shilling and good crop harvest. Headline and Core inflation are forecast to peak at 5.5 percent and 5.3 percent in the first quarter of 2020, which are lower than the previous estimates by 0.6 and 1.1 percentage points, respectively. There are nonetheless upside risks to the outlook including the future direction of food crops prices; the path of the exchange rate, which in part is contingent on external economic environment; and the ensuing demand pressures on account of the positive output gap.

Overall, the MPC assesses that the risks to the projected inflation path are roughly balanced. Based on the assessment, the MPC decided to maintain the CBR at 10 percent. The band on the CBR will remain 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 14 percent and 15 percent, respectively.

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<u>GOVERNOR</u>
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