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Monetary Policy Statement for June 2023

At its meeting on 13 June 2023, the Monetary Policy Committee (MPC) maintained the Central Bank Rate (CBR) at 10%.

Uganda's economy has demonstrated notable strength and resilience amidst unpredictable global economic dynamics. Inflationary pressures are easing, and economic recovery is underway, despite ongoing uncertainty and evolving risks in the global economy.

The Uganda Bureau of Statistics (UBoS) data for October 2022 to May 2023 shows that inflation has declined on account of steadfast and prudent monetary and fiscal policies, stability in the exchange rate, and due to falling food, energy, fuel, and utility prices.

Annual headline and core inflation decreased to 6.2% and 5.6% in May 2023 from 8.0% and 6.8% in April 2023, respectively. Annual inflation for electricity, fuel, and utilities receded to 0.9% in May from 2.1% in April 2023. Similarly, food crops inflation eased to 15.7% in May 2023 from 25.3% over the same period. Inflation for goods, including imported items, declined to 7.4% in May from 8.8% in April 2023. Also, services inflation has remained low, averaging 4.2%, since January 2023.

The contractionary monetary policy stance since June 2022 to date, coupled with the decreasing global inflation, is expected to reduce inflation further in the upcoming months. As a result, headline and core inflation are forecast to reach 5% in the third quarter of 2023 and remain stable around the target over the medium term (2 to 3 years ahead). Despite the improvement in the near-term inflation outlook relative to the assessment at the MPC meeting of April 2023, the current inflation projections remain sensitive to elevated risks.

The downside risks to the inflation outlook include potentially lower global cost and commodity price pressures, minimisation of global supply constraints, favourable weather conditions, and sustained unused economic capacity. The upside risks to the inflation outlook include potentially higher demand pressures from a more substantial economic recovery; elevated import price inflation; and tighter global financial conditions, which could weaken the shilling exchange rate that, in turn, would exert pressure on consumer prices. Also, domestic food prices remain highly susceptible to unpredictable weather patterns that would turn out drier in the coming months. Currently, the MPC assesses the risks to the near-to-medium-term inflation outlook as trending downwards, albeit subject to elevated uncertainty.

Turning to the economic recovery, the UBoS estimated economic growth at 5.3% for the fiscal year 2022/23 up from 4.6% in 2021/22. The agricultural sector recovery, resilience of the services sector, and considerable household consumption propped up economic activity, countering a less supportive external environment. Furthermore, high-frequency indicators signalled accelerated economic activity in recent months. Also, consumer and business sentiments have exhibited positive momentum.

The MPC projects economic growth in the 6.0% to 6.5% range for fiscal year 2023/24. Economic growth is anticipated to return to its sustainable long-term trend in 2024/25, bolstered by investments in oil-related infrastructure, the energy sector, transportation, and a recovery in the manufacturing and construction sectors. In addition, potentially more robust external demand for Uganda's exports and supportive Government expenditure are expected to elevate annual economic growth above 7% in the medium to long term.

Nevertheless, the economic growth outlook remains highly uncertain, with the balance of risks leaning towards the downside. The potential downside risks include:

- protracted weak global growth and lower commodity prices, constraining Uganda's export earnings and widening the current account deficit;
- a resurgence of supply chain distortions due to geopolitical tensions and fragmentation;
- potentially lower external concessional financing could restrict government expenditure;
- higher public debt burden could weaken the local currency, limit Government's borrowing capacity and slow foreign investor inflows;
- a combination of moderate private sector credit growth, rising domestic interest rates, fiscal consolidation, and the shilling depreciation could weigh down growth; and
- higher frequency and intensity of climate shocks, including droughts and floods, may undermine agricultural activity and worsen food insecurity.

On the upside, the slowdown in global economic growth in the near term may be less severe than anticipated, and faster regional trade integration could bolster potential growth in the medium term. Also, domestic economic growth could surpass expectations aided by supportive Government expenditure and private sector investments in the extractive industry.

Heeding caution, mainly because of the elevated uncertainty in the global financial markets amidst slow global growth coupled with the dominant impact of the vagaries of weather on agricultural production, the MPC views the downside risks dominating the economic outlook.

The dominance of downward risks to the economic outlook coupled with growth remaining below its long-run average poses challenges to the sustainable restoration of price stability without urgent measures to boost productivity and enhance the economy's supply side. Therefore, it is imperative to consolidate the gains made by tight monetary policy, helped by fiscal consolidation, in restraining the recent inflationary pressures while undertaking commensurate interventions to upscale the production and productivity of the economy.

In other words, the fight against inflation can sustainably be won in the long run by boosting the economy's supply side to meet the growing needs of a dynamic economy undergoing structural transformation. This will require boosting economic production and productivity to foster sustainable macroeconomic stability for economic growth and development.

After careful deliberation, the MPC recognised that significant risks persist in the economy, and that the current monetary policy stance remains appropriate to consolidate the gains made and restore price stability while supporting economic growth.

As a result, the MPC has decided to maintain the CBR at 10%. The CBR's operational bands will remain at +/-2 percentage points, while the margin on the CBR for the rediscount and bank rates will be maintained at 3 and 4 percentage points, respectively. Consequently, the rediscount and bank rates will remain at 13% and 14%, respectively.

Despite the recent challenges experienced in the US and European banking sectors, the domestic financial system remains resilient and on track to meet the revised regulatory requirements, including those related to higher minimum paid-up capital.

The future adjustments to the monetary policy stance will be contingent upon new information regarding inflation and growth.

Michael Atingi-Ego
Deputy Governor
13 June 2023