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Monetary Policy Statement for October 2018

Bank of Uganda's (BoU) Monetary Policy Committee (MPC) has raised the Central Bank Rate (CBR) by 1 percentage point to 10 percent. Inflation is on an upward trajectory and core inflation is projected to rise above the target of 5 percent within the next 12 months. In the recent months, rapidly rising oil prices coupled with a weaker shilling exchange rate and indirect tax increases have pushed up inflation. The strong rebound in economic growth in financial year (FY) 2017/18 has closed the negative output gap, and with growth projected to remain robust in FY2018/19, core inflation could rise higher in the remaining part of the fiscal year.

The economic outlook in the medium-term (2 to 3 years ahead) remains largely unchanged since the August 2018 MPC Meeting. Economic growth has been solid since the second-half of 2017 supported by the global economy upturn and the easing of domestic financial conditions. The economy is expected to remain on a steady growth path supported by robust domestic demand growth, public infrastructure investments, improving agricultural productivity, and recovery in Foreign Direct Investment (FDI). The BoU's Composite Index of Economic Activity (CIEA) shows that in the first eight months of 2018, annualised growth was about 7 percent, which would suggest economic growth of about 6.5 percent in FY 2018/19.

The Consumer Price Index (CPI) data released by the Uganda Bureau of Statistics (UBOS) indicates that inflation has risen since June 2018. Core inflation rose from 0.8 percent in June 2018 to 3.9 percent in September 2018, which is below the target of 5 percent. Headline inflation rose from 2.1 percent in June 2018 to 3.8 percent in August 2018 but eased slightly to 3.7 percent in September 2018 largely because of a decline in food prices.

The increase in core inflation was partly due to higher services prices, which rose sharply at the beginning of the financial year reflecting the effect of the Over-The-Top (OTT) tax. Services inflation rose from 1.7 percent in June 2018 to 5.3 percent in August 2018 before easing slightly to 4.5 percent in September 2018. Higher fuel prices and strong domestic demand could push services inflation higher in the remaining part of 2018.

In view of the recent global and domestic developments, the BoU estimates that inflationary pressures are higher than in the previous round of forecasts. Our forecasts indicate higher inflation compared to the August 2018 forecast round largely because the exchange rate is weaker and international oil prices are higher. Consequently, core inflation is projected to rise further in the coming months and peak in the range of 6.5-7.5 percent in the second half of 2019, if the current monetary policy stance is maintained. Core inflation is expected to fall back and stabilise at around 5 percent in the first half of 2020. The positive output gap will continue to be a key driver of inflation going forward.

A key risk to the inflation outlook is the shilling exchange rate, which remains vulnerable to the possibility of tighter global financial conditions as well as stronger domestic demand. The weaker shilling exchange rate combined with higher oil prices could result in a more elevated inflation trajectory. In addition, although food prices are projected to remain low in the forecast horizon and are not seen as a major risk to the inflation outlook, the path for food prices is uncertain as they are dependent on the weather.

Given the objective of keeping inflation close to the target of 5 percent and the need to maintain economic growth, a modest tightening of monetary policy stance is warranted. The BoU has therefore raised the CBR by 1 percentage point to 10 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 14 percent and 15 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile
<u>GOVERNOR</u>

3rd October 2018