Uganda's Economic Performance and Outlook

Inflation and Outlook

1. The recent readings show that inflationary pressures are losing momentum, driven mainly by the declining crude oil prices, easing supply-side challenges, a stable exchange rate on account of the prudent monetary policy actions by the Bank of Uganda (BoU), softening domestic demand, and diminishing base effects associated with higher prices of imported commodities. On a month-on-month basis, headline and core inflation was 0.1% and 0.2%, respectively, in December 2022, down from a peak of 1.5% and 1.2% in September 2022. On an annual basis, headline and core inflation was 10.2% and 8.4% in December 2022, down from 10.7% and 8.9% in October 2022.

2. Our recent forecasts show that inflation will average between 6-8% in 2023, down from averages of 7.2% and 6% for annual headline and core inflation in 2022. Inflation is expected to revert to the medium-term target of 5% by end-2023. The expected decline in inflation is due to declining global energy and non-energy prices as global demand pressures wane, continued easing of supply-side challenges, lower exchange rate depreciation, the current tightening of monetary and fiscal policies, and a rebound in agricultural production.

3. The inflation outlook is subject to significant risks. Nonetheless, in our assessment, the risks are tilted to the downside, including a sharper-than-anticipated slowdown in global growth affecting Uganda's external demand, a sharper-than-expected decline in oil prices, and faster reductions in domestic food crop prices due to bumper harvest. On the upside, however, inflation could be higher than currently projected if the international energy prices increase because of further OPEC+ supply cuts, further European bans on Russian crude imports, and the easing of the zero Covid-19 policy by China, spurring increased demand for commodities. In addition, a more depreciated shilling than envisioned due to tighter global financial conditions could make imported goods more costly, resulting in higher inflation.

Economic Activity and Outlook

4. The Ugandan economy remains resilient to shocks. However, the economy continues to suffer from adverse spillovers from the Russia-Ukraine war-induced high global commodity prices, tight global and domestic financial conditions, and adverse weather conditions. Furthermore, the high and persistent inflation has inevitably affected consumer and business demand and negatively affected business and consumer confidence. In addition, the slow

global growth, especially for Sub-Saharan African economies, which are the leading destinations for Uganda's exports, has negatively affected external demand.

5. The high-frequency indicators show that economic growth has weakened in recent months. The Composite Index of Economic Activity (CIEA) grew by 1.0% in the three months to October 2022 from 1.3% in the three months to July 2022. These growth rates are lower than the 2.2% observed in the three months to January 2022. The year-on-year monthly growth in the CIEA averaged 4.4% in the twelve months to October 2022, a significant deceleration from the 5.9% in a similar period the previous year. Nevetheless, the Stanbic Bank Uganda Purchasing Managers' Index (PMI) increased to 52.0 in December 2022, up from 50.9 in November and above the 50.0 no-change mark for the second month running, signaling a recovery in economic conditions.

6. Our forecasts show that economic growth for FY22/23 will be in the 5-5.3% range, driven by increased investments in the oil sector, a rebound in agricultural production owing to good weather, the government's interventions, and a rebound industrial activity.

7. There are, however, substantial risks to the growth outlook, with the balance of risks tilted to the downside, including delayed implementation of oil-related projects, tighter financial conditions coupled with fiscal consolidation, and a potential global recession weighing down external demand and financing. On the upside, growth could surprise if foreign direct investment (FDI) associated with oil-related projects is higher than anticipated.

External Sector Developments and Outlook

8. Uganda's external position weakened in the 12 months to November 2022, reflecting adverse spillover effects associated with the Russia-Ukraine conflict, particularly on the commodities terms of trade, which exerted pressure on the trade balance, keeping the current account in deficits.

9. The current account deficit widened to US$3,968.6 million, reflecting high private sector oil and non-oil imports, which grew by 60.9% and 15.6%, more than offsetting the improving exports of goods and services. The growth in imports overwhelmed the 19% growth in exports.

10. The financial account surplus recorded a steep contraction due to an upsurge in short-term capital outflows and shrinkage of loan disbursements to the government. Portfolio

capital recorded a net outflow of US$583.1 million in the twelve months to November 2022. On the other hand, Foreign Direct Investment (FDI), which grew by 37.9% to US$1,475.7 million, was a major source of financing. The combination of a widening current account deficit and reduced financing resulted in an overall balance of payments (BoP) deficit, amounting to US$676.5 million in the twelve months to November 2022 from overall BoP surpluses of US$510.5 million and US$240.4 million recorded in the twelve months to November in 2021 and 2020, respectively.

11. The overall BoP deficit resulted in a drawdown of the international reserves to US$3,570.1 million (or 3.6 months of imports of goods and services) as of end-November 2022 relative to US$4,346.0 million (or 4.8 months of imports of goods and services) as of end-November 2021.

12. Headwinds from extended global geopolitical tensions, tightening global financial conditions, subdued external demand, heightened foreign investor risk aversion, high cost of external borrowing, weakening global growth, and the negative effect of the recent Ebola outbreak on tourism inflows will continue to favour an elevated current account deficit in the region of 9% of GDP and muted financial inflows going forward. Financing is majorly anticipated to come from FDI inflows to the oil sector. Still, the expected high government expenditure on imports and debt service obligations will likely constrain the building of international reserves, further weakening Uganda's BoP position and external buffer.

Public Debt and Outlook

13. As at end-November 2022, total public debt stock increased to Shs.79,775.9 billion (appx. 49.1% of GDP), up from Shs.73,223.0 billion as at end-November 2021. The increase was due to a 5.2% increase in external debt and a 14.9% increase in domestic debt. External debt maintained the dominant share of 60.4% of the total public debt.

14. Public debt to GDP ratio is projected to rise further in the medium term, peaking at about 53% before gradually declining to the Government target of 50% by the end of FY2024/25.

15. Most risk indicators were within the 2018 Public Debt Management Framework (PDMF) thresholds. The annual time to maturity (ATM) for domestic debt increased to 6.5 years in November 2022 from 5.7 years in November 2021, and 4.9 years in November 2020. This is

consistent with the government's strategy to lengthen the maturity structure of the domestic debt to subdue refinancing risks. The share of debt maturing in one year improved from 28.3% in November 2021 to 24.5% in November 2022.

16. However, public debt service continues to exert pressure on domestic revenues. Total debt service (domestic & external) as a percentage of domestic revenues averaged 37% in the first four months of FY2022/23. Moreover, external debt service, which is projected to average about US$900 million per year between FY2022/23-2025/26, remains a significant strain on international reserves.

Monetary Policy

17. Inflation is showing signs of moderating, although food crops inflation remains elevated, edging up slightly in December 2022 to 29.4% from 27.8% in November 2022 because of the effects of the drought. Nonetheless, our assessment shows that food crop price increases are temporary and expected to fade in the coming months.

18. With many uncertainties surrounding the inflation outlook, the BoU will take a cautionary monetary policy stance. Accordingly, in December 2022, we kept the central bank rate (CBR) unchanged at 10%. Any future adjustment to the CBR will depend on the incoming inflation and economic growth data but will be measured and gradual to maintain support for sustainable economic growth in an environment of price stability.

19. Interest rates stayed on an upward trajectory in the three months to November 2022 reflecting the tight financial conditions. Both Treasury yields and lending rates rose. The growth in ptivate sector credit remained below historical averages owing to the tightening of monetary conditions. Total private sector credit growth averaged about 10.5 percent, year-on-year, in the three months to October 2022. Excluding the exchange rate changes and capitalized interest, private sector credit grew by 8.2 percent in the three months to October 2022 compared to the growth of 8.6 percent in the three months to July 2022. The growth in the Shilling loans, nonetheless, increased to 12.2 percent from 9.6 percent over the same period.

20. Loan approval rate increased in the three months to October 2022 to 59.8 percent from 50.4 percent observed in the three months to July 2022. The approval rates were higher in the

agriculture (66.5 percent), and mortgage sectors (62.2 percent) and lowest in the household loans (6.6 percent).

Exchange Rate

21. The exchange rate has continued to be stable, gaining by 1.6% in the three months to December 2022, supported by the prudent monetary policy and the recent declines in the global crude oil prices, which somewhat eased the pressure on the deteriorating terms of trade, increased personal remittances, and foreign direct investment inflows to the oil sector.

22. However, short-term capital flight from the domestic debt market that was triggered by investor nervousness over the sanctions on Russia and aggressive monetary tightening to curtail surging inflation in advanced economies weakened the shilling during the second and third quarters of 2022, leading to a 3.1% year-on-year depreciation in 2022.

23. In the near- (1 month) to short-term (6 months), the exchange rate movement will depend on global developments, particularly the pace of monetary tightening in the advanced economies. The medium-term (1 year) outlook is for the shilling to depreciate, reflecting the elevated current account deficit and the tightening of global financial conditions. Overall, the exchange rate movement will depend largely on global developments, particularly the pace of monetary tightening in advanced economies and the overall balance of payments position.

Table: Uganda's Domestic Debt Profile (Aggregate Government Treasury Instruments Issued by Tenure, UGX billions)

Instrument	FY2020/21	FY2021/22	FY2022/23* (Half Year to Dec 2022)
Total Treasury bond Issues (Cost value)	**7,718.4**	**8,246.4**	**2,277.7**
2-year	848.3	1,203.6	261.2
3-year	985.1	973.3	351.0
5-year	1,155.5	1,008.7	-
10-year	2,134.4	1,232.3	432.6
15-year	1,560.6	1,205.5	502.4
20-year	1,034.5	2,623.0	730.5
Total Treasury bill Issues (Cost value)	**6,495.4**	**5,357.7**	**3,201.3**
91-day	365.4	407.2	169.9
182-day	876.3	745.4	394.3
364-day	5,253.7	4,205.1	2,637.1
A. Total Gross Issues (Cost value)	**14,213.8**	**13,604.1**	**5,479.0**
B. Total Redemptions	**7,419.6**	**8,376.0**	**3,110.3**
C. Total Net Flows (A-B)	**6,794.2**	**5,228.1**	**2,368.8**
Total Interest Payments	**2,942.3**	**3,863.4**	**1,878.9**
Interest	610.6	736.8	211.9
Coupon Payments	2,331.7	3,126.6	1,667.0
D. Net Domestic Financing for the year (NDF)	**6,793.7**	**5,228.1**	**2,368.8**