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Monetary Policy Statement for December 2020

The Bank of Uganda, at the Monetary Policy Committee (MPC) meeting of December 2020 has maintained the Central Bank Rate (CBR) at 7 percent.

The MPC noted that since the last meeting in October 2020, the economic recovery has gradually gained traction, in line with projection for economic growth of above 3 percent in FY2020/21. Indeed, the high frequency indicators of economic activity in the quarter to October 2020 indicate an annual growth of 3.3 percent in contrast to the sharp contraction of 6 percent in the quarter to June 2020. However, the recovery is proceeding at an uneven pace. Social distancing measures continue to weigh heavily on certain activities of services sector, particularly in hospitality and tourism, while other sectors are still feeling the lagged effects of the economic downturn. Economic activity is expected to take longer to recover and resource utilisation to return to normal given the sharp contraction experienced in the quarter to June 2020. Economic growth is therefore projected to remain below its potential until FY2023/24.

Risks to the economic outlook in the near term have eased as a result of signs of a rebound in both foreign and domestic demand which could be bolstered by optimism associated with Covid-19 vaccine development. Nevertheless, the rising Covid-19 cases in Uganda and many other countries, present considerable downside risks. In addition, weather-related natural disasters, pro-cyclical private sector credit growth, increasing non-performing loans and high lending interest rates, trade protectionism by Uganda's trading partners, still pent-up global demand, persistent geopolitical tensions, global trade policy uncertainty and technology fractions pose challenges to domestic economic growth. These coupled with the increasing fiscal financing pressures pose significant downside risks to the growth outlook. On the upside, while it could take some time to fully implement worldwide, the recent news on Covid-19 vaccine development is reassuring and presents positive prospects. Inflation remains benign reflecting a combination of both global and domestic developments. Falling food crop and energy prices pushed headline inflation down to 3.7 percent in November 2020 from 4.5 percent in October 2020. Core inflation also declined to 5.8 percent from 6.3 percent.

The inflation outlook has been revised downwards compared to the October 2020 forecast round owing largely to considerable spare capacity in the economy. Inflation is now projected in the range of 5-6.5 percent in 2020 before converging to its medium-term target of 5 percent. There are however risks to these forecasts. On the upside, a more depreciated exchange rate, increase in food prices due to weather related shocks, rebound in international commodity prices, and a faster than anticipated global economic recovery due to the discovery of Covid-19 vaccines could put upward pressure on domestic inflation. On the other hand, lower than anticipated fiscal spending and sustained global and domestic economic weakness would exert downward pressure on domestic inflation.

There is still considerable uncertainty surrounding economic developments and there is need for monetary policy to remain accommodative until the economy sustainably normalises since inflation is projected to be well contained over the medium-term. Against this backdrop, the MPC decided to keep CBR rate unchanged at 7 percent and maintain liquidity support to supervised financial institutions. The band on the CBR has also been maintained at +/-2 percentage points, while the margin on the rediscount rate and bank rate is unchanged at 3 and 4 percentage points on the CBR, respectively. Consequently, the rediscount rate and the bank rate have been maintained at 10 percent and 11 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

GOVERNOR

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