

# BANK OF UGANDA



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## Monetary Policy Statement for April 2021

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At the Monetary Policy Committee (MPC) meeting of April 14<sup>th</sup> 2021, the Bank of Uganda maintained the Central Bank Rate (CBR) at 7 percent.

The MPC noted that economic recovery is proceeding and is stronger than was projected at its last meeting in February 2021. The Uganda Bureau of Statistics (UBoS) in its updated quarterly GDP estimated the contraction in real GDP at 1.1 percent in 2020, lower than initial projections of about 2 percent. Economic growth in the quarter to December 2020 is estimated to have picked up 1.6 percent from a year earlier, a significant improvement compared to the revised contractions of 6.1 percent and 0.1 percent, respectively in the quarters to June 2020 and September 2020. The economic upturn is, however, less sanguine in certain activities of service sector, particularly education, hospitality, and tourism. Indeed, the services sector is estimated to have contracted by 2.6 percent in the quarter to December 2020.

High frequency economic indicators for the first quarter of 2021 indicate a gradual strengthening of economic activity but still at a subdued pace. Therefore, the GDP growth outlook remains unchanged at 4.0-4.5 percent in FY2021/22. Nonetheless, the recovery is expected to strengthen, with above-trend growth in outer years as vaccine effectiveness increases, which should allow for reduced social distancing and a rebound in consumption.

A high degree of uncertainty surrounds economic outlook, with many possible downside and upside risks, but with balance of risks tilted to the downside. On the downside, the main risk is still the virus and possible variants. Infection could take off again despite the ongoing Covid-19 inoculations and this would dampen the economic upbeat, especially in the near term (12 months ahead) as it would diminish the improvement in demand conditions and delay the return of normalcy. In addition, there is a limited fiscal policy space to respond to fragile economic growth. With the rising public debt, fiscal adjustments through higher taxes, lower expenditure or both might be required in the coming years to avoid a persistent increase in indebtedness and this could constrain demand. Public investments, which is key for infrastructure development could be curtailed by paucity of funding, yet it would have revived the broader economy by directly enhancing capital stock and productivity, and by attracting private investment. Furthermore, although growth of private sector credit gathered pace in February 2021, banks could see rising non-performing loans (NPLs) this year, as forbearance periods sputter out and the real impact of the Covid-19 pandemic on businesses and individuals becomes clearer. Moreover, there is a

possibility of monetary policy tapering in advanced economies to deal with emerging inflationary pressures, which could result in capital flight and the associated exchange rate depreciation, and this combined with rising international commodity prices accentuates the downside risks. On the upside, a rapid bounce back of the global economy, would stimulate growth through recovery of exports, foreign direct investment, personal transfers, and tourism. The final investment decision (FID) on the oil pipeline, which puts Uganda on the path to exporting oil by 2025, could trigger higher foreign direct investments and private sector investments.

Inflation remains favourable reflecting a combination of both global and domestic developments. Annual headline inflation in March 2021 edged up slightly to 4.1 percent from 3.7 percent in February 2021 in part due to increase in food crop and energy prices. Annual core inflation, however, declined to 5.3 percent from 5.6 percent.

Going forward, inflation could rise temporarily in the near term because of the rising food crop prices, which could outweigh the correction of services inflation as the effects of SOPs on public transport fade out. Projected rise in some taxes combined with rising international oil prices, if the recent increase is sustained, may push up input price pressures across all sectors of the economy. Looking through this, with the economy still operating with considerable spare capacity, inflation is projected to fluctuate around the 5 percent target in the remaining part of 2021 and in the medium-term.

There are, however, risks to these forecasts. On the upside, fiscal challenges, a more depreciated exchange rate, adverse weather-related shocks, stronger gains in international commodity prices, and a more robust than anticipated global economic recovery could put upward pressure on domestic inflation. On the downside however, lower than anticipated domestic demand and sustained global economic weakness could exert downward pressure on domestic inflation. Nonetheless, the balance of risks is currently assessed to be balanced.

In consideration of the current and expected macroeconomic developments, the MPC assessed the uncertainties and risks facing the economy to warrant keeping the monetary conditions accommodative. Against this backdrop, the MPC maintained the CBR at 7 percent and the band on the CBR at +/-2 percentage points on the CBR. The margin on the rediscount rate and bank rate has also been kept 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.



**GOVERNOR**

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