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Monetary Policy Statement for April 2023

At its meeting on 6 April 2023, the Monetary Policy Committee (MPC) maintained the Central Bank Rate (CBR) at 10%.

The economy has broadly evolved in line with our expectations at the February 2023 MPC meeting. The March 2023 data from the Uganda Bureau of Statistics indicated that annual headline and core inflation dropped to 9.0% and 7.6% in March 2023 from 9.2% and 7.8% in February 2023, respectively. The annual electricity, fuel, and utilities, as well as food crops inflation also dropped to 4.4% and 26.7% in March 2023 from 5.2% and 27.4%, respectively, in February 2023. The decline in inflation is on account of a reduction in international commodity prices, improved global supply chains, and relative exchange rate stability due to tight monetary and fiscal policies. Although the shilling has weakened marginally against the US dollar since the beginning of the year, in part due to seasonal factors, it has strengthened when compared to the currencies of Uganda's major trading partners.

In the MPC's current assessment, absent new shocks, inflation will continue decelerating and converge to the 5% target by the end of 2023. The factors favouring the continued decline of inflation are lower energy prices, improved global supply chains, lower food crop prices due to favourable weather, the existing spare capacity in the economy, and the exchange rate stability owing to tight monetary and fiscal policies. Fiscal restraint has dampened demand thereby limiting inflationary pressures, while at the same time putting the economy on a sounder long-term footing through reducing public debt and investing in infrastructure.

The inflation outlook is subject to several risks. The upside risks include i) persistence of high domestic food prices despite the good rains in the second half of 2022; ii) tighter global financial conditions, which could exert pressure on the shilling exchange rate; and iii) higher oil prices following production cuts by the Organization of the Petroleum Exporting Countries and Russia.

The downside risks include: i) a considerable slowdown of the world economy, ii) a reduction of geopolitical risks and better functioning of supply chains, and iii) a stronger shilling if global financial volatility dissipates and the external financing gap declines. The balance of risks to the inflation outlook remains biased to the upside.

Economic growth remains on a recovery path, averaging 6.8% in the first two quarters of the Financial Year (FY)2022/23, supported by a stronger recovery in services and agriculture output. However, the quarterly economic growth for Q2 FY2022/23 dropped to 4.4% from 9.2% for Q1 FY 2022/23, due to a decline in industrial output and a moderation in services output growth. Moreover, growth in economic activity, measured by high-frequency indicators points to a moderation in recent months. The Composite Index of Economic Activity (CIEA) grew by 0.9 percent in the three months to

February 2023, lower than 1.2% in the quarter to November 2022. The moderation in growth partly reflects the tight monetary and fiscal policies, as the increase in domestic interest rates and tight credit standards by banks affected the growth in private sector credit.

The MPC projects economic growth in the 5.5 - 6.0% range for FY2022/23, remaining below its long-term trend until FY2025/26 partly because of the tight domestic and external financial conditions. Moreover, growing external financing needs are expected to put pressure on the shilling. With lower export-to-import prices and slower growth in export volumes, the current account balance is forecast to deteriorate to a deficit of 7.4% of GDP for the next three years, keeping some drag on economic growth.

Additional downside risks to economic growth include:

- lower-than-expected global growth affecting the demand for exports,
- a combination of uncertainty, higher interest rates, cost-of-living pressures, and the government's fiscal consolidation, though necessary, could weigh heavily on household consumption and private sector investment decisions,
- lower commodity prices affecting our primary commodity exports,
- unfavourable weather conditions affecting agricultural production,
- the resurgence of supply chain distortions due to geopolitical tensions,
- weaker-than-expected global economic growth outturns or much tighter and more volatile global financial conditions.

The MPC assesses that the near-term risks to the inflation outlook remain elevated, with considerable uncertainty surrounding the economic outlook. The MPC, therefore, maintained the CBR at 10% to contain inflationary pressures sustainably. The bands on the CBR will remain at +/-2 percentage points. The margin on the CBR for the rediscount and bank rates will remain at 3 and 4 percentage points. Consequently, the rediscount and bank rates will be 13% and 14%, respectively. The MPC assesses that the current policy stance remains appropriate to contain domestic demand pressures while supporting economic recovery. Looking ahead, the MPC's policy decisions will be guided by the inflation outlook in light of the incoming economic data.

The MPC also noted the heightened volatility in the global financial markets, due to challenges in the USA & Swiss banking systems partly on account of valuation losses resulting from interest rate increases. However, the Ugandan banking system is well capitalised, highly liquid, and well-placed to absorb emerging interest rate shocks and to continue providing credit to the economy.

Michael Atingi-Ego
Deputy Governor
6 April 2023