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Monetary Policy Statement for February 2021

The Bank of Uganda, at the Monetary Policy Committee (MPC) meeting of February 2021, has maintained the Central Bank Rate (CBR) at 7 percent.

Since the beginning of the financial year (FY)2020/21, the economic upturn is proceeding at an uneven pace as social distancing measures continue to weigh heavily on certain activities in the service sector, particularly education, hospitality, and tourism. The MPC noted that since the last meeting in December 2020, the economic recovery has somewhat lost momentum, as Covid-19 infection rates surged. Indeed, the Bank of Uganda's (BoU) high frequency indicators of economic activity indicate a growth of about 2.6 percent in the quarter to December 2020, down from a growth of 9.2 percent in the quarter to September 2020. In addition, both the BoU Business Confidence Index and the IHS Markit Purchasing Managers' Index (PMI) indicate that business conditions deteriorated in the quarter to January 2021, after improving in the quarter to October 2020. Nonetheless, economic indicators still suggest some recovery from the sharp contractions of 6 percent and 2.2 percent in the quarters to June 2020 and September 2020, respectively.

As the vaccine becomes readily available in Uganda and the spread of Covid-19 is contained, tourism is expected to rebound. In addition, exports should benefit from strengthening foreign demand, reduced pandemic-related uncertainty and improving global investment. Economic growth of 3.0-3.5 percent is therefore projected in Financial Year (FY) 2020/21, increasing to 4.0-4.5 percent and 6.0-7.0 percent in FY2021/22, and in the outer years, respectively.

The medium-term economic outlook continues to be highly conditional on the timeline of the world-wide vaccines rollout and the course of the virus and its new variants. For example, most of Uganda's exports are destined to the Common Market for Eastern and Southern Africa (COMESA) region, where the vaccine rollout is likely to be sluggish. Thus, whereas advanced economies are expecting a rapid vaccine-fuelled recovery, the damaging effects of the pandemic could persist in the region, which could be detrimental to domestic economic growth prospects in the medium to long-term. Therefore, while the output gap is projected to close in FY2023/24, the adverse impact of the pandemic on potential GDP growth could be more profound if it turns out to be longer or harsher than is currently assumed. Furthermore, adverse weather-related shocks, feeble private sector credit growth, increasing non-performing loans that could result in higher lending interest rates, public investment financing challenges that could slow implementation of public investments, global trade frictions and the still repressed global demand pose significant downside risks to the domestic economic growth outlook. On the upside however, economic activity could be stronger than is currently projected if Covid-19 scarring effects become more limited in scope. A successful

and faster rollout of mass vaccinations globally could allow a quicker unwinding of social distancing measures and result in more robust increase in economic activity.

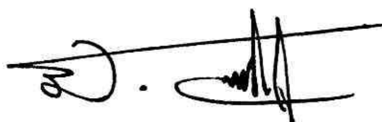
Inflation remains benign reflecting a combination of both global and domestic developments. Annual headline inflation in January 2021 edged up slightly to 3.7 percent from 3.6 percent in December in part due to increase in food crop and energy prices. Annual core inflation however declined to 5.5 percent from 5.9 percent.

As the effects of public transport measures to contain Covid-19 dissipate over the coming four months, and in combination with considerable spare capacity in the economy, core inflation is projected to decline to about 4.5 percent in 2021. Inflation is expected to return sustainably to the 5 percent target as excess capacity is absorbed in the medium-term.

There are however risks to these forecasts that make the timing of convergence to the medium-term target of 5 percent highly uncertain. On the upside, fiscal challenges, a more depreciated exchange rate, adverse weather related shocks, gains in international commodity prices, and a faster than anticipated global economic recovery could put upward pressure on domestic inflation. On the downside however, lower than anticipated domestic demand and sustained global lethargy could exert downward pressure on domestic inflation.

Given the inflation outlook and the heightened uncertainties surrounding the economic growth path, the MPC decided to maintain the current policy stance until the economy normalises sustainably. 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.

In addition, BoU will extend for six months effective from 1st April 2021 the Credit Relief Measures (CRM) and also maintain the Covid-19 Liquidity Assistance Program (CLAP) to supervised financial institutions. BoU will review CLAP from time to time as the pandemic evolves to ensure viability of solvent supervised financial institutions that may come under liquidity stress during the pandemic and to support credit extension.



Michael Atingi-Ego
DEPUTY GOVERNOR
February 15, 2021