BANK OF UGANDA

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Monetary Policy Statement for February 2023

The Monetary Policy Committee (MPC), at its meeting of February 6, 2023, maintained the Central Bank Rate (CBR) at 10%.

Annual headline and core inflation increased to 10.4% and 9.0% in January 2023 from 10.2% and 8.4%, respectively in December 2022. The increase in inflation was largely driven by base effects arising from a significant drop in public transport fares in January 2022 after the Government allowed full-capacity carriage following the reopening of the economy. The increase in inflation is therefore expected to be short-lived. Indeed, the average month-on-month headline inflation was zero percent in the three months to January 2023 compared to an average monthly increase of 1.1% in the three months to October 2022. Similarly, month-on-month core inflation averaged 0.1% in the three months to January 2023, a decline from an average of 0.9% in the three months to October 2022.

Inflation is expected to continue declining in the months ahead due to lower energy prices, improved global supply chains, exchange rate stability supported by tight monetary conditions, and moderate demand pressures due to tight monetary and fiscal policies. The headline and core inflation are expected to average 6.5% and 5.6%, respectively in 2023. Core inflation is projected to return to the 5% target by end of 2023.

Nevertheless, the inflation outlook is surrounded with some risks. The upside risks include:

- the impact of international financial conditions on the shilling exchange rate,
- slower adjustment in domestic demand due to tight monetary and fiscal policies,
- higher food crop prices due to unfavourable weather,
- faster global economic recovery and a possible increase in global energy prices, and
- a resurgence of supply chain distortions due to heightening geopolitical tensions.

The downside risks to the inflation outlook include:

- bumper food crop harvests due to good weather,
- lower than expected global growth due high interest rates,
- faster decline in international commodity prices,
- lower domestic demand due to declining real incomes.

Overall, the balance of risks to the inflation outlook is tilted downwards.

The latest quarterly GDP data from the Uganda Bureau of Statistics (UBoS) revealed stronger than expected economic growth in the three quarters of 2022, averaging 6%. Strong industrial and service output growth more than offset a decline in growth of the agricultural output. Similarly, the Composite Index of Economic Activity (CIEA), a high-frequency indicator of activity, points to a 1.5% growth in the second quarter of the FY 2022/23, up from 0.3% in the previous quarter. Also, business sentiments have improved since the MPC meeting of December 2022.

The Bank of Uganda (BoU) projects economic growth in the range of 5.0 - 5.6% in FY 2022/23. Increased external demand for exports, a significant rebound in foreign direct and private investment, which is reflected in strong growth in the quarterly industry and services output, and better supply-chain conditions, are expected to support modestly higher economic growth in the near term, firming further in the outer years.

However, economic growth is projected to remain below its long term trend until FY 2025/26. Moreover, the growth outlook is subject to downside risks, including lower-than-expected global growth, lower commodity prices, unfavourable weather conditions, a resurgence of supply chain distortions due to potential escalation of geopolitical tensions, and the risk of higher domestic inflation, which would necessitate further monetary policy tightening.

Based on the uncertainty surrounding the economic outlook, the MPC assessed that the current CBR would contain domestic demand pressures, while accommodating and supporting economic recovery. The MPC, therefore, maintained the CBR at 10%. 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 BoU will continuously review the monetary policy stance against new information and stands ready to respond appropriately to ensure that inflation is brought back sustainably to the 5% medium term target.

Michael Atingi-Ego
Deputy Governor
February 6, 2023