

BANK OF UGANDA



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Monetary Policy Statement for June 2020

On the basis of an assessment of the current and evolving macroeconomic situation, Bank of Uganda (BoU) has reduced the Central Bank Rate (CBR) by 1 percentage point to 7 percent and reduced the band on the CBR by 1 percentage point to +/-2.

The COVID-19 pandemic continues to have adverse effects on the economy. Since the April 2020 Monetary Policy Committee (MPC) meeting, the pandemic continues to spread with wide-ranging social and economic effects. Indeed, the BoU's Composite Index of Economic Activity, contracted by 4.0 percent month-on-month in April 2020, indicating continuous shrinkage of economic activity heading into May 2020. Also, the Purchasing Managers' Index (PMI) remained below the 50 mark for the third consecutive month in May 2020 (PMI below 50 indicates a contraction in industrial production).

Although Uganda is gradually easing the lockdown measures instituted to contain the spread of the pandemic, the adverse consequences of the global and domestic supply chain disruptions could persist through the remaining part of 2020. While the economic slowdown will be severe in the second quarter of 2020, a gradual recovery is expected to set in during the third and fourth quarters. On the whole, household expenditure, investment, exports and imports are projected to decline in 2020. Accordingly, BoU has revised down its projection of economic growth to a range of 2.5 to 3.5 percent in 2020 from the April 2020 forecast of 3 to 4 percent. The strength of the economic recovery will depend in part on how Uganda will be able to open up for economic activity safely, and in particular how effectively the public will comply with social distancing rules. The World Health Organisation advocates caution going forward as the spread of the coronavirus is evolving in waves.

Resumption of pre-pandemic levels of economic activity will be gradual, partly due to dampened external demand amidst the deterioration in global economic sentiment. Although the risks to the outlook are currently extreme and tilted towards lower economic growth, economic growth is projected to recover to between 4 to 5 percent in 2021, rising further to between 6 and 6.5 percent in 2022. The output gap will thus remain negative over the entire forecast horizon and will close only gradually. The combination of the COVID-19 pandemic, extreme weather, and volatility in the global financial markets, could weigh-down Uganda's balance of payments,

potentially destabilizing the domestic foreign exchange market and dampening economic growth.

On the positive side, the BoU's decisive easing of liquidity conditions in the banking system influenced the decline of average lending rates to 17.7 percent in April 2020 from 19.9 percent in January 2020. The forthcoming fiscal stimulus together with accommodative monetary policy might offset the negative impact the COVID-19 pandemic has on the economy in a manner that is stronger than currently envisaged.

Consistent with the slowdown of economic activity, inflation has remained subdued. The headline and core inflation declined to 2.8 percent and 3.2 percent, respectively, in May 2020, from corresponding levels of 3.2 percent and 3.4 percent in April 2020. The public transport measures to contain the pandemic will temporally increase transport costs in months ahead but the overall risks to the inflation outlook appear to be to the downside. The economic slowdown and a gradual recovery will keep inflation below the medium-term target of 5 percent in the near term (12 months ahead). Moreover, external sources of inflation are likely to remain weak in the near term amid the global economic downturn and food crop inflation is also expected to remain contained. Risks to inflation from shilling depreciation are expected to stay low as pass-through of exchange rate depreciation to inflation is expected to remain slow due to subdued demand.

Although the measures taken by the BoU are yet to take full effect in mitigating the adverse impact of the pandemic on the economy, it is necessary to ease financial conditions further since inflation outlook remains benign. Accordingly, BoU has decided to further ease monetary policy by reducing the CBR by 1 percentage point to 7 percent. The band on the CBR has also been reduced by 1 percentage point to +/-2 percentage points, while the margin on the rediscount rate and bank rate have been set at 3 and 4 percentage points on the CBR, respectively. Consequently, the rediscount rate and the bank rate have been reduced to 10 percent and 11 percent, respectively.

Furthermore, BoU will maintain an adequate supply of liquidity in domestic markets, to encourage lending by financial institutions to households and businesses. Also, BoU expects financial institutions to reduce further their lending rates commensurate with our monetary policy stance.



Prof. Emmanuel Tumusiime-Mutebile

GOVERNOR

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