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Monetary Policy Statement for October 2022

At the Monetary Policy Committee (MPC) meeting held on 6 October 2022, the Bank of Uganda (BoU) increased the Central Bank Rate (CBR) by one percentage point to 10 percent.

A combination of global factors, the recent drought and a weaker shilling to U.S. dollar exchange rate have driven inflation to the highest level recorded since 2012 and deteriorated the inflation outlook.

The annual headline inflation rose to 10 percent in September 2022 from 9 percent in August 2022. Annual core inflation, which excludes the volatile food and energy prices, rose to 8.1 percent in September 2022 from 7.2 percent in August 2022. Annual electricity, fuel and utilities inflation, which had been increasing since the beginning of the year, declined to 18.7 percent in September 2022 from 19.6 percent in August 2022, offering some relief against the price pressures.

In the coming months, headline inflation is forecast to rise and average around 7.3 percent in 2022, and between 8 percent to 10 percent in 2023, before declining back to around 5 percent in 2024.

The outlook for inflation is highly uncertain as several risks lie ahead. The balance of risks is tilted upwards. The upside risks include:

- the entrenchment of higher inflation expectations
- escalation of geopolitical tensions and the associated supply chain disruptions
- stronger monetary policy tightening by major central banks further weakening the exchange rate, and
- the impact of adverse weather conditions on food production.

Nonetheless, there are downside risks to the inflation outlook including:

- a global recession resulting from the fight against inflation
- faster decline in commodity prices, and
- lower domestic demand due to declining real incomes.

The domestic economy, which has weathered several shocks, is showing signs of recovery. The Composite Index of Economic Activity (CIEA) grew slightly by 1.2 percent in the quarter to August from 1.1 percent in the quarter to May 2022, supported by increased industrial activity. Also, business sentiments have improved since the previous forecast round. Nevertheless, economic growth is expected to remain below its long-run trend until FY2025/26. The risks of global recession and tighter financial conditions will likely weigh on domestic economic growth. Moreover, the potential for a sustained weakening of the shilling exchange rate coupled with lower foreign exchange reserves and constrained demand for Uganda's exports could add to the external financing strains. In addition, higher domestic interest rates, declining private sector credit and tight fiscal policy could further weigh down economic growth.

Inflation pressures are projected to peak in the first half of 2023, as COVID-19 effects wane, supply chain pressures ease and as a result of the impact of recent policy actions. The recent increases in the CBR coupled with fiscal tightening have had somewhat an indirect effect in stabilising the shilling exchange rate, which is expected to cushion the inflationary pressures. Indeed, growth in private sector credit and monetary aggregates have moderated, signalling the eventual impact on aggregate demand. Nonetheless, inflationary pressures remain elevated.

In light of the outlook of higher inflation, the MPC has increased the CBR by one percentage point to 10 percent. The band on the CBR remains at +/-2 percentage points. The margins 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 percent and 14 percent, respectively.

The BoU remains determined to rein in on inflation and will continue to undertake the necessary measures to restore inflation to the target of 5 percent in the medium-term.

Michael Atingi-Ego
<u>DEPUTY GOVERNOR</u>
6 October 2022