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Monetary Policy Statement for August 2024

On 7 August 2024, the Bank of Uganda's Monetary Policy Committee (MPC) reduced the Central Bank Rate (CBR) by 25 basis points to 10.0%.

In the twelve months to July 2024, domestic inflation continued to moderate, with annual headline and core inflation averaging 3.2% and 3.0%, respectively, below the medium-term policy target of 5%. This is due to the fading impacts of global shocks like the war in Ukraine and COVID-19, the tightening of monetary policy early this year and the exchange rate that has stabilised with a bias towards appreciation since March 2024. The relative stability of the shilling against the US dollar has benefited from the recent CBR increases and inflows from coffee exports owing to favourable international coffee prices. Nonetheless, both annual headline and core inflation edged up slightly to 4.0% in July 2024 from 3.9% and 3.8% in June 2024, respectively. The increase in inflation was largely driven by services inflation which increased to 6.5% in July 2024 from 6.1% in June 2024, due to the increases in passenger transport, accommodation, recreation, sports, and culture services' inflation.

Looking forward, the Bank of Uganda (BOU) expects inflation to be below the 5% target in FY 2024/25, broadly reflecting stable demand conditions, lower imported inflation and exchange rate stability. The inflation projection has been revised slightly downwards relative to the June 2024 forecast round, largely due to a lesser depreciated shilling exchange rate. However, we expect inflation to continue rising moderately in the next four months due to seasonal factors but stabilise around the target of 5% by the first quarter of 2025. There are, however, persistent uncertainties around the inflation projection, including the effects of a possible escalation of the ongoing geopolitical tensions in the Middle East, potential energy price hikes, unfavourable weather patterns affecting food production, and a stronger-than-expected path for domestic demand. In addition, the signs of lingering inflation in other parts of the world and heightened volatility in both capital flows and the exchange rate could result in stronger depreciation of the shilling exchange rate and, therefore, higher inflation than currently assumed. Conversely, the continued unwinding of the past shocks to energy and other imported goods prices may moderate inflation. The risks around the projection for inflation are judged to be balanced.

Economic growth has recovered from the recent slowdown which had been occasioned by several external shocks. GDP growth picked up in the last two quarters of FY 2023/24, with an average growth of 6.7% year-on-year compared to a growth of 5.3% in the first two quarters of the financial year. The pickup in growth was broad-based across all sectors. There are signs that the continued recovery in real incomes and rising confidence are beginning to pass through to stronger consumption despite the tight monetary policy. Indeed, the high-frequency indicators of economic activity indicate improvement in business conditions, as shown by the sustained expansions in output and new orders. Economic growth for FY 2024/25 is projected between 6.0% and 6.5%. Over the medium term, economic growth is projected to be above 7%, supported by stronger private sector investment and government intervention, especially in agriculture and global economic growth recovery.

However, there are vulnerabilities to the growth outlook. Internationally, there remains the continuing risk of higher commodity prices and disruption to trade flows associated with developments in the Middle East and other significant geopolitical uncertainties, which could lead to weaker global economic activity and stronger inflationary pressures. In addition, the re-emergence of protectionist policies could add pressure on the international trading system and weigh on domestic growth through lower exports of goods and services. Economic growth could also be lower if the growth in private sector credit slows further due to higher costs of borrowing and higher domestic borrowing by the Government. Additionally, a stronger shilling depreciation could weigh down on domestic demand since capital and other intermediate goods account for about 75% of imports. On a positive note, more favourable weather conditions leading to good food crop harvests, higher government and private sector investment in the extractive industry, and effective government intervention programs could boost economic activity. Furthermore, if the world economy grows more strongly than currently projected, rising net exports, would boost domestic growth than expected. The risks to this forecast are assessed as broadly balanced.

The MPC noted that although risks of higher inflation remain, the adverse impact from past external shocks has abated and there has been some progress in moderating risks of inflation persistence. Therefore, it was appropriate to reduce slightly the degree of monetary policy restrictiveness. As a result, the MPC reduced the CBR by 25 basis points to 10.0%. The bands on the CBR remain at +/-2 percentage points, and the margins on the CBR for the rediscount and bank rates at 3 and 4 percentage points, respectively. As a result, the rediscount and bank rates will reduce to 13.0% and 14.0%, respectively.

Given the balance of risks, the MPC noted that a cautious easing of monetary policy is warranted in support of the objectives of containing inflation around the 5% policy target and economic growth to levels consistent with socio-economic transformation. Going forward, BOU will adjust its policy stance informed by incoming economic data, with a view to maintaining a low and stable inflation environment, which is necessary for sustainable economic growth.

Michael Atingi-Ego
Deputy Governor
7 August 2024