Bank of Uganda

State of the Economy

December 2017

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Acronyms and Abbreviations

AEs	Advanced Economies
BoP	Balance of Payments
BoU	Bank of Uganda
CA	Current Account
CAD	Current Account deficit
CBR	Central Bank Rate
CPI	Consumer Price Index
EU	European Union
EFU	Energy, Fuel and Utilities
EMDEs	Emerging Market and Developing Economies
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFEM	Interbank Foreign Exchange Market
IMF	International Monetary Fund
M-o-M	Month-on-Month
NEER	Nominal Effective Exchange Rate
NPL	Non- Performing Loans
OPEC	Organization of Petroleum Exporting Countries
PDMF	Public Debt Management Framework
PPs	Percentage Points
PSC	Private Sector Credit
PSI	Policy Support Instrument
q-o-q	Quarter on Quarter
REER	Real Effective Exchange Rate
REPOs	Repurchase Agreements
SMEs	Small and Medium Enterprises
SSA	Sub- Saharan Africa
T-Bills	Treasury bills
T-Bonds	Treasury bonds
UK	United Kingdom
US	United States
USD	United States Dollar
WAI	Weighted Average Interest rate
WEO	World Economic Outlook
WALR	Weighted Average Lending Rate
Y-o-Y	Year-on-Year

Executive Summary

1) Global economic activity continues to firm up, with global output now estimated at 3.7 per cent in 2017, which is 0.1 percentage point (PP) higher than had been projected in October and 0.5 PP higher than in 2016. The pickup in growth has been broad based, with upside surprises for both Advanced Economies (AEs) - particularly in Europe and Asia and the Emerging Market and Developing Economies (EMDEs), broadly driven by monetary and fiscal policy stimulus, increased investment and productivity. While global economic activity is projected to strengthen in 2017 and 2018 and short-term risks are broadly balanced, medium-term risks are still tilted to the downside. The risks stem mainly from likely reduction in global trade owing to a shift to protectionism in a number of leading economies, possible tightening of global financial conditions with a faster-than-expected increase in interest rates in the U.S, lower commodity prices and potential disruption to consumer and business confidence arising from non-economic factors such as geo-political tensions, domestic political strife and terrorism concerns.

2) Global financial market conditions remain relatively easy, supported by continued gains in equity markets in both Advanced and Emerging Market Economies. In AEs, longer-term bond yields in key global markets continued to rally, buoyed by generally strong company earnings, solid economic growth, and expectations of a very gradual normalization path for monetary policy in a weak inflation environment and low expected volatility in underlying fundamentals.

3) On the domestic scene, in line with the continued easing of monetary policy stance, money market rates have continued to decline. The weighted average 7-day money market rate declined to 10 per cent during the quarter under review, down from 10.2 per cent in the quarter to October 2017 and 13.8 per cent over a corresponding period in 2016. Average yields on the 91-day, 182-day and 364-day Treasury bills (T-bills) declined to 9.3, 9.2 and 9.7 per cent, respectively, relative to 10.2, 10.9 and 12.1 per cent respectively in the quarter to August 2017 and 14.1, 15.1 and 15.5 per cent respectively in the quarter to November 2016. Yields on the longer term bonds also declined, with the average yields on the 2-year, 3-year and 5-year Treasury bonds (T-bonds) declining to 12.2, 12.3 and 12.4 per cent, respectively, from 13.4, 14.4 and 14.6 per cent, respectively in the preceding quarter. Average yields on the 10-year and 15-year T-bonds also declined to 15 and 14.9 per cent from 16 and 16.4 per cent, respectively, over the same period.

4) Commercial bank interest rates have continued to ease, in response to the accommodative monetary policy stance albeit sluggishly and with a lag. The weighted average lending rate on shilling denominated loans declined to 20.4 per cent in the quarter ended November 2017, from 21.4 per cent in the preceding quarter and 23.2 per cent in the corresponding quarter of the previous year. However, growth in Private Sector Credit (PSC) continued to decelerate. Average annual growth in PSC stood at 5.1 per cent in the quarter ended November 2017, down from 5.8 per cent in the preceding quarter ended August 2017. Modest PSC growth in an environment of sustained monetary policy easing in part reflects a raft of supply side constraints and implies that monetary policy alone cannot generate the much needed boost to economic growth.

5) Growth in monetary aggregates remains broadly robust supported, in part, by monetary policy easing, although it decelerated during the quarter under review. On average, M2 and M3 grew in annual terms by 14.4 and 13.1 per cent, respectively, in the quarter ended November 2017, lower than the respective growth rates of 15.5 and 13.4 per cent in the quarter to August 2017. Similarly, M1 annual average growth moderated to 13.7 per cent, from 14.5 per cent recorded in the quarter ended August 2017. Annual average growth in CIC softened to 12 per cent, from 15 per cent in the preceding quarter ended August 2017, while annual average growth in demand deposits strengthened to 14.8 per cent, from 14.1 per cent over the same period.

6) Preliminary fiscal data for the five months of FY 2017/18 indicates that fiscal operations were less expansionary compared to the approved budget. Total Government revenue (including grants) during the first five months of FY 2017/18 amounted to Shs. 5,687.8 billion, which was Shs. 893.5 billion lower than the amount programmed in the approved budget, mainly due to underperformances in both domestic revenue and grants. Total government expenditure and net lending in the period to November 2017 amounted to Shs. 8,177.9 billion, which was Shs. 1,228.5 billion lower than the approved budget, largely due to a shortfall in externally financed investment expenditure.

7) The balance of payments (BoP) continued to improve, although only slightly, during the quarter ended November 2017, recording an overall surplus of USD 0.1 million, following surpluses of USD 181.4 million and USD 77.3 million recorded in the last two immediate quarters. This relative deceleration in the performance of the BoP

was largely on account of a widening of the current account deficit (CAD), which almost doubled to USD 467.1 million, from a deficit of USD 243.3 million recorded in the quarter ended August 2017. The goods account deficit deteriorated by 39.5 per cent to USD 548.7 million during the three months to November 2017, as export earnings improved only slightly while the import bill increased significantly, driven by an increase in both government and private sector imports.

8) During the quarter ended November 2017, the Uganda Shilling stood at an average midrate of Shs. 3,625.5 per US Dollar, a depreciation of 0.7 per cent and 4.8 per cent on quarterly and annual basis, respectively. Notably the weakening of the Uganda Shilling during the quarter ended November 2017 was concentrated in the month of October when the currency recorded heightened pressures arising from elevated uncertainty surrounding the political environment both locally and in neighbouring Kenya. The Nominal Effective Exchange Rate (NEER) also depreciated by 0.8 per cent and 3.0 per cent on quarterly and annual basis, respectively. The Real Effective Exchange Rate (REER), which takes into account the inflation differential between Uganda and its trading partners depreciated too by 0.6 per cent on quarterly basis, during the period under review. The depreciation of the REER is a pointer to increased competitiveness of Uganda's exports.

9) Real GDP estimates for the domestic economy for FY 2016/17 were revised upwards to 4.0 per cent from 3.9 per cent, on account of stronger activity in the agriculture sector, specifically in the coffee sub sector and higher than expected activity in the services sector, especially trade and repairs and commercial banks activity. There was some improvement by 2.9 per cent in final consumption expenditure during FY 2016/17, relative to the decline of 0.3 per cent recorded in FY 2015/16, mainly on account of recovery in household expenditure, although government expenditure declined further by 10.9 per cent from the decline of 5.1 per cent recorded in FY 2015/16.

10) Inflation continued to moderate further, with annual average core and headline inflation falling to 3.7 per cent and 4.7 per cent during the quarter ended November 2017, from 4.5 per cent and 5.8 per cent respectively recorded in the quarter ended August 2017. On monthly basis, annual average core and headline inflation dropped to 3.3 per cent and 4 per cent respectively in November 2017, down from 3.5 per cent and 4.8 per cent respectively in October 2017. Overall decline in inflation was mainly driven by the fall in annual food inflation, which moderated to an average of

6.6 per cent in the quarter ended November 2017, down from 14.2 per cent in the quarter ended August 2017 and the peak of 21.9 per cent in the quarter ended May 2017.

11) Inflation forecast indicates that in the near term, inflation outlook is slightly lower than the previous forecasts, mainly on account of lower food prices. Both headline and core inflation are forecast to converge to the 5 per cent target in the medium term. Nonetheless, there are both upside and downside risks to this outlook, which if they were to materialize, could alter the inflation path. The upside risks include the future direction of food crops prices and the path of the exchange rate, with the latter contingent on the external economic environment. On the downside; is subdued aggregate demand, which could suppress domestic prices. Based on the outlook for inflation and economic activity, together with an expansionary fiscal policy in FY 2017/18, and the evolution of the risks and uncertainties, the Bank of Uganda (BoU) judged that the current stance of monetary policy remained appropriate and therefore maintained the Central Bank Rate (CBR) at 9.5 per cent.

1 Back ground

This report presents domestic and external economic developments in the period to October 2017, extending into November 2017 where data is available. It also assesses the future prospects and outlook for both the domestic and global economy, including projected domestic output and inflation. In addition, it discusses the risks to the domestic economic outlook and identifies policy challenges in the short- to- medium term. Finally, it discusses the implications of the outlook and risks on the future direction of monetary policy in Uganda.

2 Global Economic Environment

2.1 Global Economic Activity

The global pickup in activity that started in H2-2016 gained further momentum in H1-2017. Global economic growth, which in 2016 was the weakest since the global financial crisis at 3.2 per cent, is projected to itch up to 3.6 per cent in 2017 and to 3.7 per cent in 2018, some 0.1 percentage point (PP) higher than the April 2017 World Economic Outlook (WEO) forecast. Growth projections for 2017 and 2018 are supported by firmer domestic demand in Advanced Economies (AEs) and China and improved performance in other large Emerging Market and Developing Economies (EMDEs) – on account of improved external factors, notably a benign global financial environment. Global growth is forecast to increase marginally beyond 2018, reaching 3.8 per cent by 2021.

Growth in AEs for 2017 is projected 0.2 PP stronger than the April forecast, at 2.2 per cent, driven by stronger growth in the Euro area, Japan, and Canada — which more than offset downward revisions for the United States (U.S) and the United Kingdom (U.K). The Euro area recovery is expected to further strength, with growth projected to rise by 0.4 and 0.3 PP to 2.1 per cent in 2017 and 1.9 per cent in 2018, relative to April. The increase in growth in 2017 mostly reflects acceleration in exports in the context of the broader pickup in global trade and continued strength in domestic demand, supported by accommodative financial conditions amid diminished political risk and policy uncertainty. The medium-term outlook for the Euro area remains subdued because projected potential growth is held back by weak productivity, adverse demographics and in some countries, a public and private debt overhang.

Growth in the U.S is projected to expand at 2.2 per cent in 2017 and 2.3 per cent in 2018, on account of very supportive financial conditions and strong business and consumer confidence. The downward revision by 0.1 and 0.2 PP for 2017 and 2018, respectively relative to the April reflects significant policy uncertainty. Over the medium term, US growth is expected to moderate at 1.8 per cent, on account of continued sluggish growth in total factor productivity and diminished growth of the workforce due to population aging. In the U.K, growth is projected to subside to 1.7 per cent in 2017 and further to 1.5 per cent in 2018, driven by weaker-than-expected growth outturns for H1-2017 due to softer growth in private consumption as the pound's depreciation weighs on household real income. The medium-term growth outlook is highly uncertain and will depend in part on the new economic relationship with the European Union (EU) and the extent of the increase in barriers to trade, migration, and cross-border financial activity. Overall, recovery in AEs is not complete as growth remains weak and inflation is below target in many countries. Commodity exporters, especially of fuel, are particularly hard hit as their adjustment to a sharp stepdown in foreign earnings continues.

In EMDEs, growth is forecast to rise strongly from 4.3 per cent in 2016 to 4.6 and 4.9 per cent in 2017 and 2018, respectively, which is 0.1 PP higher for both 2017 and 2018 relative to April. The upward revisions reflect stronger projected activity in China and other parts of emerging Asia and Europe for 2017 and 2018. China's growth is projected to notch up to 6.8 per cent in 2017 and to slow to 6.5 per cent in 2018. The upward revision to the 2017 forecast, i.e. 0.2 PP relative to the April 2017 WEO reflects the stronger-than-expected outturn in H1-2017 underpinned by previous policy easing and supply-side reforms. The upward revision for 2018 of 0.3 PP mainly reflects an expectation that the authorities will maintain a sufficiently expansionary policy mix (especially through high public investment) to meet their target of doubling real GDP between 2010 and 2020. Over the medium term, growth has similarly been revised upward by 0.2 PP, on average, reflecting the assumed delay in withdrawing stimulus. In India, growth projection for 2017 has been revised down to 6.7 per cent (from 7.2 per cent in April WEO), reflecting the lingering impact of the authorities' currency exchange initiative as well as uncertainty related to the launch of the national Goods and Services Tax in July 2017. In Brazil, strong export performance and a diminished pace of contraction in domestic demand allowed the economy to return to positive growth in Q1-2017, after eight quarters of decline.

Growth in sub-Saharan Africa (SSA) is projected to remain broadly in line with the April forecast, at 2.6 per cent in 2017 and 3.4 per cent in 2018, with sizable differences across countries. Downside risks have risen because of idiosyncratic factors in the region's largest economies and delays in implementing policy adjustments. Beyond the near term, growth is expected to rise gradually, but barely above population growth, as large consolidation needs weigh on public spending. Nigeria is expected to emerge from the 2016 recession caused by low oil prices and the disruption of oil production. Growth in 2017 is projected at 0.8 per cent, owing to recovering oil production and ongoing strength in the agricultural sector. However, concerns about policy implementation, market segmentation in a foreign exchange market that remains dependent on central bank interventions, and banking-system fragilities are expected to weigh on economic activity in the medium term. In South Africa, growth is projected to remain subdued at 0.7 per cent in 2017 and 1.1 per cent in 2018, despite more favourable commodity export prices and strong agricultural production, as heightened political uncertainty saps consumer and business confidence. The outlook for fuel-importing countries is generally brighter, with an aggregate growth rate of 3.9 per cent in 2017, rising to 4.4 per cent in 2018. Global growth projections are presented in **Table 1**.

Table 1: Global Growth Projections

	Outturn	Projections		Diff. from April 2017 WEO	
	2016	**2017**	**2018**	**2017**	**2018**
World	**3.2**	**3.6**	**3.7**	**0.1**	**0.1**
Advanced Economies	**1.7**	**2.2**	**2.0**	**0.2**	**0.0**
United States	1.5	2.2	2.3	-0.1	-0.2
Euro Area	1.8	2.1	1.9	0.4	0.3
Japan	1.0	1.5	0.7	0.3	0.1
United Kingdom	1.8	1.7	1.5	-0.3	0.0
Emerging Market & Developing Economies	**4.3**	**4.6**	**4.9**	**0.1**	**0.1**
Russia	-0.2	1.8	1.6	0.4	0.2
Brazil	-3.6	0.7	1.5	0.5	-0.2
China	6.7	6.8	6.5	0.2	0.3
India	7.1	6.7	7.4	-0.5	-0.3
Sub-Saharan Africa	**1.4**	**2.6**	**3.4**	**0.0**	**-0.1**
Nigeria	-1.6	0.8	1.9	0.0	0.0
South Africa	0.3	0.7	1.1	-0.1	-0.5

Source: IMF, WEO Update October 2017

While global economic activity is projected to strengthen in 2017 and 2018 and short-term risks are broadly balanced, medium-term risks are still tilted to the downside. The risks stem mainly from likely reduction in global trade owing to a shift to protectionism in a number of leading economies, possible tightening of global financial conditions with a faster-than-expected increase in interest rates in the U.S, lower commodity prices and potential disruption to consumer and business confidence arising from non-economic factors such as geo-political tensions, domestic political strife and terrorism concerns.

2.2 Global Inflation

Global inflation remains relatively subdued although there was an uptick in the first two months of Q3-2017. During the quarter ended September 2017, inflation in key AEs, except the U.K, declined compared to Q1-2017, as the boost to prices from the oil price recovery of 2016 has faded and the decline in oil prices has started to exert downward pressure. In the U.S and the Euro Area, headline inflation declined to 2.0 and 1.5 per cent, respectively in Q3-2017, from 2.5 and 1.8 per cent respectively in Q1-2017. However, in the U.K, headline inflation rose to 2.8 per cent from 2.1 per cent over the same period, mainly on account of the pass-through of the country's currency depreciation to consumer prices.

Save for the U.K, where the strong depreciation of the pound has passed through into higher consumer prices, core inflation has been generally soft in most AEs and remains below most central bank targets, even as domestic demand has gathered pace. In the Euro area, core inflation has been stuck at about 1.2 per cent since April, while in Japan it remained slightly negative for six months through July. In the U.S, where core inflation is higher—the annual change in the core personal consumption expenditure deflator declined from just below 2 per cent in early 2017 to 1.4 per cent in August.

In many EMDEs, the waning of pass-through effects from earlier exchange rate depreciations and, in some cases, recent appreciations against the US dollar have helped moderate core inflation rates, with exceptional decelerations in India and Brazil. In China, core inflation remained broadly stable at 2 per cent in July. Global inflation developments are shown in **Table 2**.

In terms of the outlook, headline inflation is projected to rise to 1.7 per cent in 2017, from 0.8 per cent in 2016 in AEs and to remain relatively stable at around 4.2 per cent in 2017 before rising to 4.4 per cent in 2018 in EMDEs. The projections are downward revisions from the early year forecasts, owing to weaker than expected rise in average crude oil prices.

Table 2: Global Inflation Developments

	Quarterly			Monthly		
	2017			2017		
	Q1	Q2	Q3	Jul	Aug	Sep
Euro Area	1.8	1.5	1.5	1.3	1.5	1.5
Japan	0.3	0.4	..	0.4	0.7	..
UK	2.1	2.7	2.8	2.6	2.9	3.0
US	2.5	1.9	2.0	1.7	1.9	2.2
Brazil	4.9	3.6	2.6	2.7	2.5	2.5
China	1.4	1.4	1.6	1.4	1.8	1.6
India	2.4	1.5	..	1.8	2.5	..
Russia	4.6	4.2	3.4	3.9	3.3	3.0
South Africa	6.5	5.2	4.6	4.4	4.6	4.9

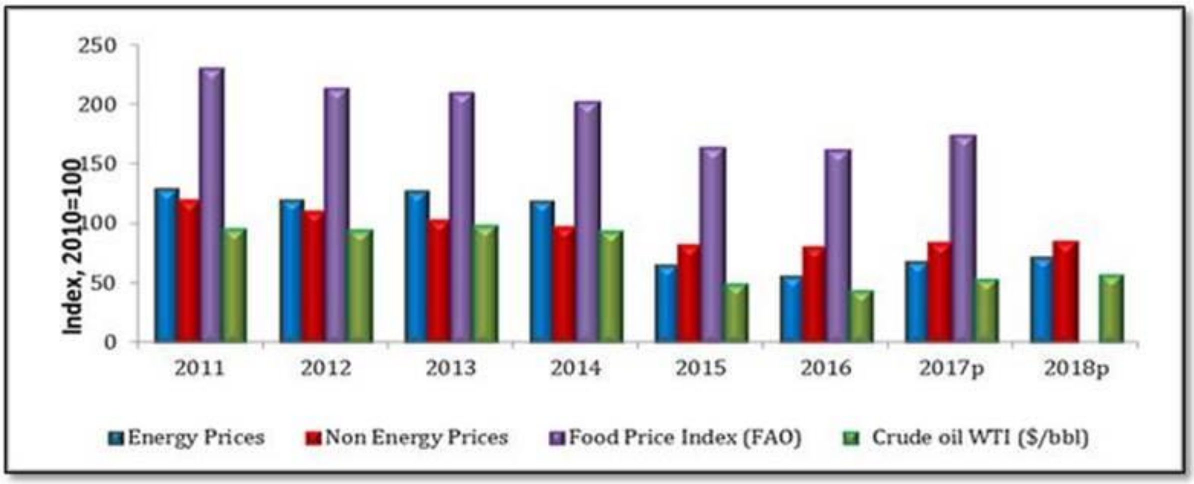
Source: Organization for Economic Cooperation and Development (OECD), September 2017.

2.3 International Commodity Prices

Global commodity prices softened between February and August 2017 by 5 per cent, despite expectations of more robust global demand going forward. Average crude oil prices fell by 8.1 per cent between February and August, even as the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC oil exporters announced in May that they would extend oil production cuts through Q1-2018. The main drivers of lower prices were higher-than-expected U.S shale production and stronger-than-expected production recoveries in Libya and Nigeria. In addition, exports from OPEC countries remained at relatively high levels, even with lower production. Following some strengthening most recently, oil prices stood at about USD 50 a barrel as of late August 2017.

Among the non-fuel commodities, prices of metals rose modestly but agricultural commodity prices declined between February and August 2017. Metal prices increased by 0.8 per cent while the IMF's agricultural price index declined by 5 per cent. Despite the recent decline in commodity prices, the IMF's commodity price index is expected to increase by 12.3 per cent in 2017 from its average in 2016, and then fall slightly again in 2018, by 0.1 per cent. After averaging USD 43 a barrel in 2016, oil prices are expected to average USD 50.3 a barrel in 2017 (down from USD 55.2 a barrel in the April 2017 WEO), and stay at about that level in 2018. Nonfuel commodity prices are expected to strengthen in 2017–18 from their 2016 averages because of stronger demand for metals from China, tight supply conditions for food, and a general pickup in global demand. Developments in international commodity prices are shown in **Figure 1**.

Figure 1: Global Commodity Price Developments



Source: World Bank, Food and Agriculture Organization of the UN
P = Projection

2.4 Global Financial Markets

Global financial market sentiments have remained strong and market volatility indicators remain low, with continued gains in equity markets in both Advanced and Emerging market Economies. The U.S Federal Reserve raised short-term interest rates in June to 1–1.25 per cent, and markets have since priced in a 70 per cent probability of one additional rate increase by the end of 2017. In most other advanced economies, the monetary policy stance remained broadly unchanged. With markets pricing in a slightly more gradual normalization of U.S monetary policy coupled with diminished expectations about fiscal stimulus, nominal yields on 10-year U.S Treasury bonds have declined by about 20 bps from their March 2017 average, but rose in the U.K by 10 bps.

Equity markets in AEs have continued to rise in recent months amid strong earnings, improvements in consumer and business confidence, and favorable macroeconomic data. With narrowing interest differentials, the U.S dollar has depreciated by more than 5 per cent in real effective terms, with a commensurate real appreciation of the Euro on stronger growth prospects.

In EMDEs, financial conditions have generally been supportive of a pickup in economic activity. Equity markets have strengthened and long-term interest rates on localcurrency bonds have generally declined, China being the exception, and spreads on the Global Emerging Markets Bond Index have fallen slightly. As search for yield continues, emerging market currencies have generally strengthened relative to the U.S dollar. The Mexican peso appreciated by 10 per cent on tighter monetary policy and declining concerns about trade-related frictions with the U.S. However, the South African rand depreciated by 7 per cent on domestic political uncertainty. Capital flows to EMEs have remained resilient in recent months, continuing their recovery after a sharp decline in late 2015 and early 2016.

Going forward, monetary policy is projected to be moderately more accommodative in the U.S than previously expected, given weaker projected demand and diminished inflation pressure. The U.S policy interest rate is projected to remain broadly unchanged for the rest of 2017, but may rise by about 75 bps in 2018. In the Euro area, monetary policy is expected to remain very accommodative and short-term rates are projected to remain negative through 2018. The assumed monetary policy stances across EMEs vary, reflecting diverse cyclical positions of these economies'. Overall, global financial conditions are expected to remain accommodative as an easing of lending conditions in major economies is expected to offset the anticipated gradual rise in long-term interest rates, while the normalization of monetary policy in the U.S and the U.K is expected to proceed smoothly, without triggering large and protracted increases in financial market volatility. Except for several vulnerable economies, most emerging markets are expected to face generally accommodative financial conditions, with higher policy rates partially offset by a recovery in risk appetite.

2.5 Implications for the Uganda Economy

The external economic environment will continue to influence Uganda's economic performance given her integration into the global economy. As such, risks to the global economic outlook have the potential to affect consumer and investor confidence and curtail growth in the Ugandan economy. The risks stem mainly from likely reduction in global trade owing to a shift to protectionism in a number of leading economies, possible tightening of global financial conditions with a faster-than-expected increase of interest rates in the U.S, lower commodity prices and potential disruption to consumer and business confidence arising from non-economic factors such as geo-political tensions, domestic political strife and terrorism concerns.

A shift to protectionism in a number of leading economies and a rising belief in the need for greater state intervention in the economy and reversal of accommodative policies in the U.S could in general disrupt and reduce trade and cross – border investment flows - affecting both commodity importers and exporters especially the EMDE's of which Uganda is part. This however could be moderated by the recovery in the Euro zone, which is a major trading partner for Uganda and a pick-up in SSA, which is a destination to more than 60 per cent of Uganda's exports. The recovery in the Euro zone is expected to have a positive impact on Uganda's export earnings, remittances and as well as FDI inflows.

Furthermore, there is a possibility of tightening of global financial conditions should a faster-than-expected increase in interest rates in the U.S materialize. This could trigger renewed financial markets volatility and sporadic portfolio adjustments – and could heighten exchange rate depreciation pressures in vulnerable economies, including Uganda with a potential to drive up domestic inflation and run down foreign exchange reserves.

Crude oil prices continue rally at low levels compared to historical patterns, in part reflecting important supply-side developments and could fall further, especially if major oil producers continue to expand supply in the current circumstances. This, on a positive side, will support global activity and help offset some of the headwinds to growth, including keeping domestic inflation in check in oil-importing developing economies. Uganda, being an oil-importer, benefits from this scenario through the reduction in oil imports bill. However, the persistently low oil prices could depress oil related Foreign Direct Investment (FDI) inflows to Uganda. And while low global inflation and declining commodity prices will keep domestic inflation in check, at least in the short-term, low commodity prices may worsen Uganda's trade deficit by keeping export revenues at bay, which may more than offset its impact on the oil import bill.

The geopolitical tensions and the threat of terrorism also remain elevated. This has negative implications on consumer and business confidence as economic agents could hold back on spending, which may lead to a fall in aggregate demand, thereby constraining global growth with adverse implications for Ugandan exports. On a positive side, the pick-up in global economic activity could lead to higher export receipts and increased investments, both of which are favourable for growth.

3 Domestic Economic Developments

3.1 Reflections on Monetary Policy Stance and Implementation

3.1.1 Monetary Policy Stance

Bank of Uganda (BoU) maintained a neutral monetary policy stance in December 2017. The Central Bank Rate (CBR) was maintained at 9.5 per cent, same level as in October 2017, to further boost growth in private sector credit (PSC) and to strengthen economic growth momentum.

At the time of the Monetary policy (MPC) committee meeting of December, 2017, the near-term inflation outlook remained subdued but core inflation was projected to pick-up in FY 2018/19 to around 5 per cent, as spare capacity in the economy is reduced. Nonetheless, there were both upside and downside risks to this outlook, which if they were to materialize, could potentially alter the inflation path. The upside risks included the future direction of food crops prices and the path of the exchange rate, with the latter contingent on the external economic environment. On the downside, was subdued aggregate demand, which could suppress domestic prices.

Based on the outlook for inflation and economic activity, together with an expansionary fiscal policy in FY 2017/18, and the evolution of the risks and uncertainties, the BoU judged that the prevailing monetary policy stance remained appropriate. The BoU therefore maintained the Central Bank Rate (CBR) at 9.5 per cent, as in October 2017. The band on the CBR was maintained at +/-3 PPs and the margin on the rediscount rate at 4 PPs on the CBR. Consequently, the rediscount rate and the bank rate remained at 13.5 per cent and 14.5 per cent, respectively.

3.1.2 Monetary Policy Operations and Challenges

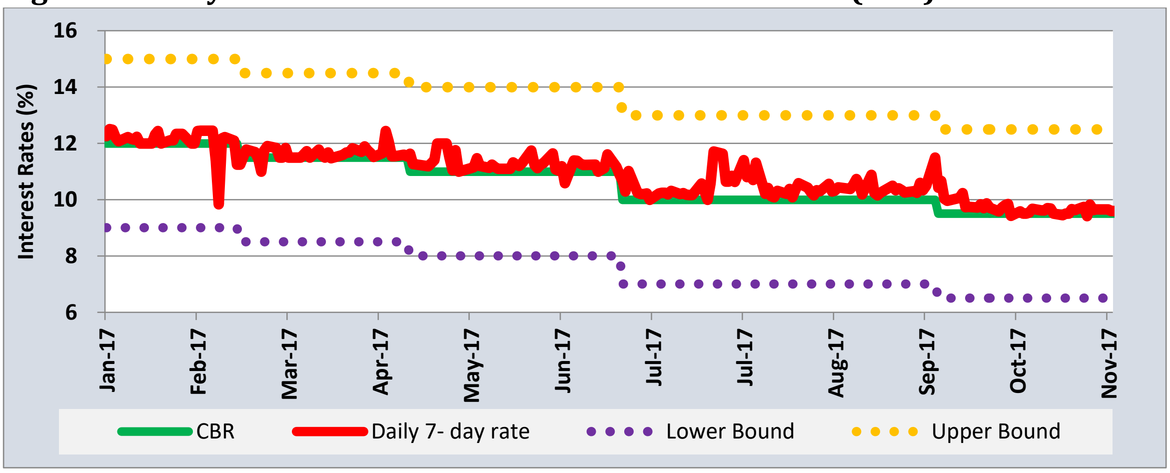
Bank of Uganda continued to use Repurchase Agreements (REPOs), deposit auctions and sales of recapitalization securities in the secondary market to align domestic liquidity conditions with the desired monetary policy stance. As at end November 2017, the outstanding stock of REPOs and Deposit auctions stood at Shs. 377.4 billion and Shs 1.76 trillion, respectively, while the available stock of recapitalization securities, used to restrain the persistent build-up of structural liquidity, stood at Shs. 19 billion.

Optimal management of structural liquidity remains a challenge as it requires a substantial amount of a wide range of longer dated marketable instruments. BoU remains aggressive in issuing short term REPOs to dampen disruptive volatility in money market rates, and will continue to engage MoFPED for additional instruments.

3.1.3 Interbank Money Market Rates

In line with the cautious easing of monetary policy, money market rates declined during the quarter ended November 2017. The weighted average 7-day money market rate declined to 10.0 per cent during the quarter under review, down from 10.2 per cent in the quarter to October 2017 and 13.8 per cent over a corresponding period in 2016 (Figure 2).

Figure 2: 7-day Interbank Rate and the Central Bank Rate (CBR)



Source: Bank of Uganda

3.2 Other Interest rates and Private Sector Credit

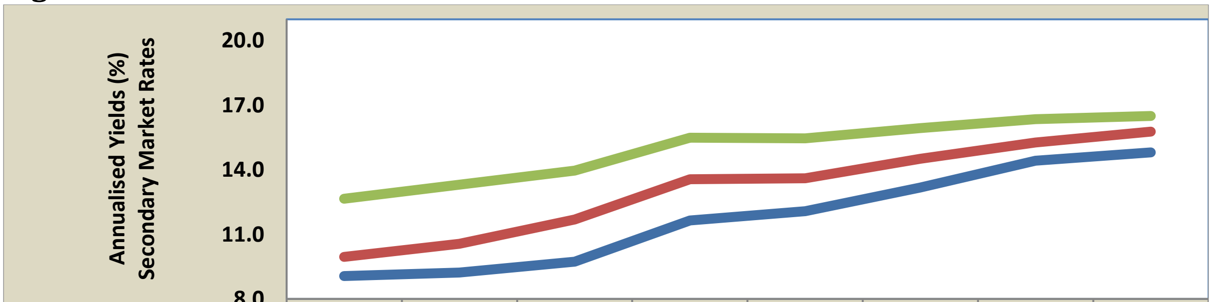
3.2.1 Yields on Government Securities

Yields on government securities also continued to decline, during the quarter ended November 2017, in line with the sustained easing of monetary policy and lower inflation expectations. Average yields on the 91-day, 182-day and 364-day Treasury bills (T-bills) declined to 9.3, 9.2 and 9.7 per cent, respectively in the quarter to November 2017, relative to 10.2, 10.9 and 12.1 per cent respectively in the quarter to

August 2017 and 14.1, 15.1 and 15.5 per cent respectively in the quarter to November 2016.

Yields on the longer term bonds also declined, with the average yields on the 2-year, 3-year and 5-year Treasury bonds (T-bonds) declining to 12.2, 12.3 and 12.4 per cent, respectively in the quarter ended November 2017, from 13.4, 14.4 and 14.6 per cent respectively in the preceding quarter. Average yields on the 10-year and 15-year T-bonds also declined to 15.0 and 14.9 per cent respectively from 16.0 and 16.4 per cent, respectively over the same period. **Figure 3** shows developments in yields on government securities.

Figure 3: Yields on T-bills and T-bonds



	91-days	182-days	364-days	2-years	3-years	5-years	10-years	15-years
Ave Jan-Mar 2017	12.7	13.3	14.0	15.5	15.5	15.9	16.4	16.5
Ave Jun-Aug2017	10.0	10.6	11.7	13.6	13.6	14.5	15.3	15.8
Ave Sep-Nov2017	9.1	9.2	9.7	11.7	12.1	13.2	14.4	14.8

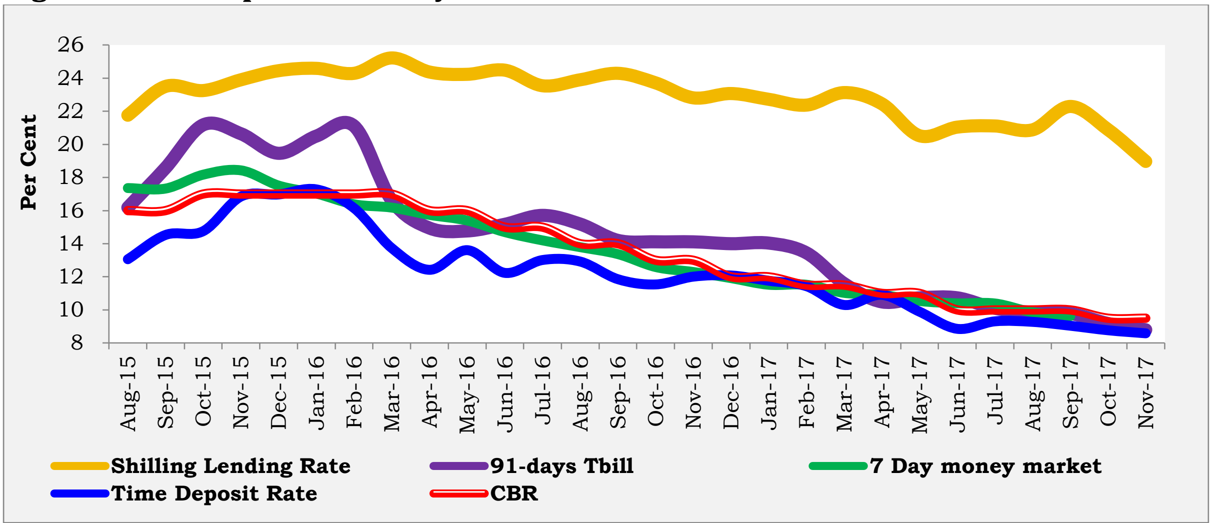
Source: Bank of Uganda

3.2.2 Lending and deposit interest rates

Commercial bank interest rates have continued to ease, in response to the accommodative monetary policy stance albeit sluggishly and with a lag. The weighted average lending rate on shilling denominated loans declined to 20.4 per cent in the quarter ended November 2017, from 21.4 per cent in the preceding quarter and 23.2 per cent in the corresponding quarter of the previous year. The decline in the average lending rate was driven by lower rates on loans to the trade, business services, personal and household sectors. Similarly, the average lending rate on the United States (US) dollar denominated loans also fell to 7.6 per cent in the quarter ended November 2017, from 8.0 per cent in the preceding quarter and 9.7 percent recorded in the corresponding quarter of the previous year.

Shilling-denominated weighted average time deposit rates also fell to 8.8 per cent in the quarter ended November 2017, from 9.2 per cent in the quarter ended August 2017 and 11.8 per cent recorded in November 2016. Similarly, weighted average rates on foreign currency-denominated time deposits declined to 2.6 per cent in the quarter ended November 2017, from 3.0 and 3.9 per cent, respectively recorded in the quarters ended August 2017 and November 2016. Consequently, the spread for both Shilling and foreign denominated loans lowered to 11.6 per cent and 4.97 per cent, respectively, in the quarter ended November 2017, from 12.3 and 5.0 per cent respectively in the preceding quarter. Developments in key interest rates are shown in **Figure 4**.

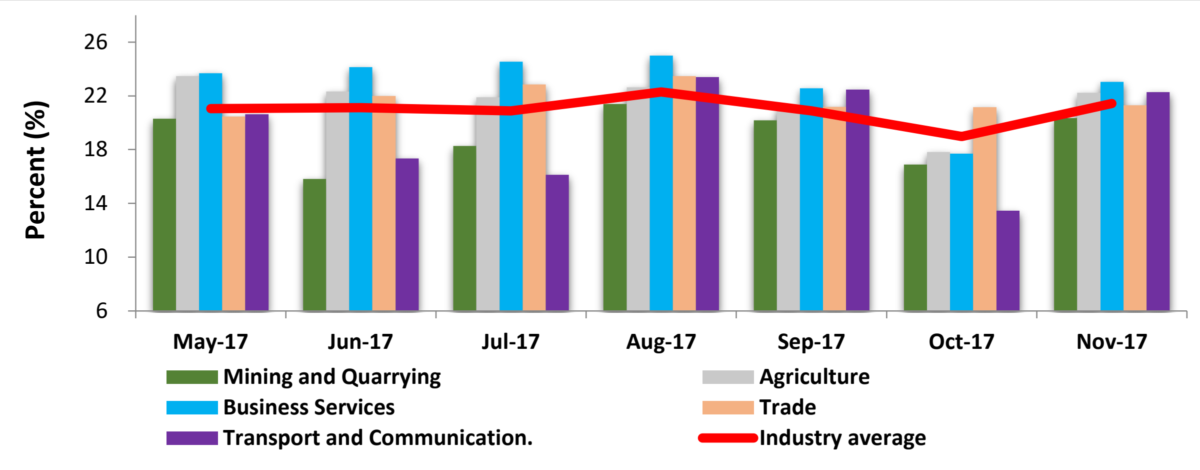
Figure 4: Developments in Key Interest Rates



Source: Bank of Uganda

In terms of sectoral interest rates, Business Services, Agriculture, Transport and Communication posted the highest average lending rates in the quarter ended November 2017, at 24.6, 23.4, 22.8 and 22.1 per cent, respectively. Sectoral developments in interest rates are shown in **Figure 5.**

Figure 5: Interest rates by Sector



Source: Bank of Uganda

3.2.3 Monetary Aggregates and Private Sector Credit

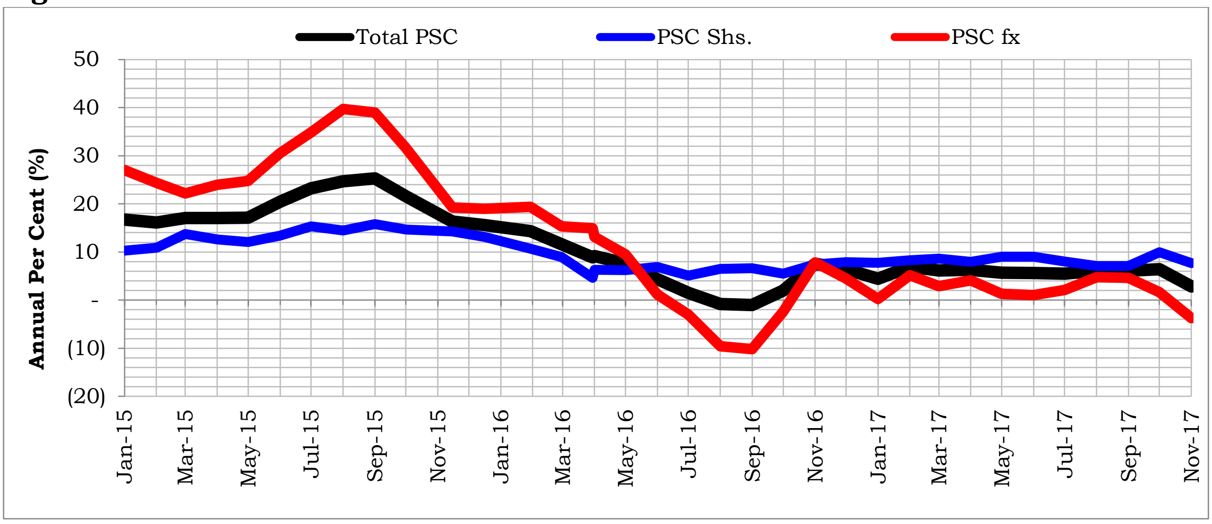
Growth in monetary aggregates remains robust although it decelerated during the quarter under review. M2 and M3 annual average growth stood at 14.4 and 13.1 per cent, respectively, in the quarter ended November 2017, lower than the respective growth rates of 15.5 and 13.4 per cent in the quarter to August 2017. Growth in M3 remains positive, largely on account of growth in Net Foreign Assets (NFA), supported by BOU's purchases of US dollars, from the Interbank Foreign Exchange Market (IFEM), for reserve build-up.

Similarly, M1 annual average growth moderated to 13.7 per cent in the quarter ended November 2017, from 14.5 per cent recorded in the quarter ended August 2017, largely driven by a slowdown in growth in currency in circulation (CIC), although growth in demand deposits strengthened over the period. Annual average growth in CIC softened to 12 per cent during the quarter ended November 2017 from 15 per cent in the preceding quarter ended August 2017, while annual average growth in demand deposits strengthened to 14.8 per cent, from 14.1 per cent over the same period.

On the asset side, net foreign assets (NFA) continued to drive growth in M3, contributing on average 8.2 per cent, compared to 1.4 per cent in net domestic assets (NDA), in November 2017. On the liability side, growth in M3 was mainly driven by shilling deposits, which contributed 8.0 per cent during the same period. Foreign currency deposits and CIC contributed 2.4 and 1.7 per cent, respectively. On monthly basis, M1, M2 and M3 grew by 3.5, 3.2 and 2.4 per cent, respectively in November 2017, as in August 2017.

Growth in Private Sector Credit (PSC) remains relatively subdued, despite the protracted monetary policy easing. Annual average growth in PSC stood at 5.1 per cent in the quarter ended November 2017, down from 5.8 per cent in the preceding quarter ended August 2017. The deceleration in PSC growth was mainly driven by foreign currency-denominated loans, which grew at a slower pace of 0.8 per cent during the quarter under review, down from 2.7 per cent in the quarter ended August 2017. Over the same period, annual growth in Shilling-denominated loans remained relatively unchanged at around 8 per cent. Net of valuation changes on account of the foreign exchange rate, annual average growth in total private sector credit strengthened to 3.7 per cent in the quarter ended November 2017, up from 3.2 per cent in the preceding quarter ended August 2017 (**Figure 6)**.

Figure 6: Annual Growth in Private Sector Credit

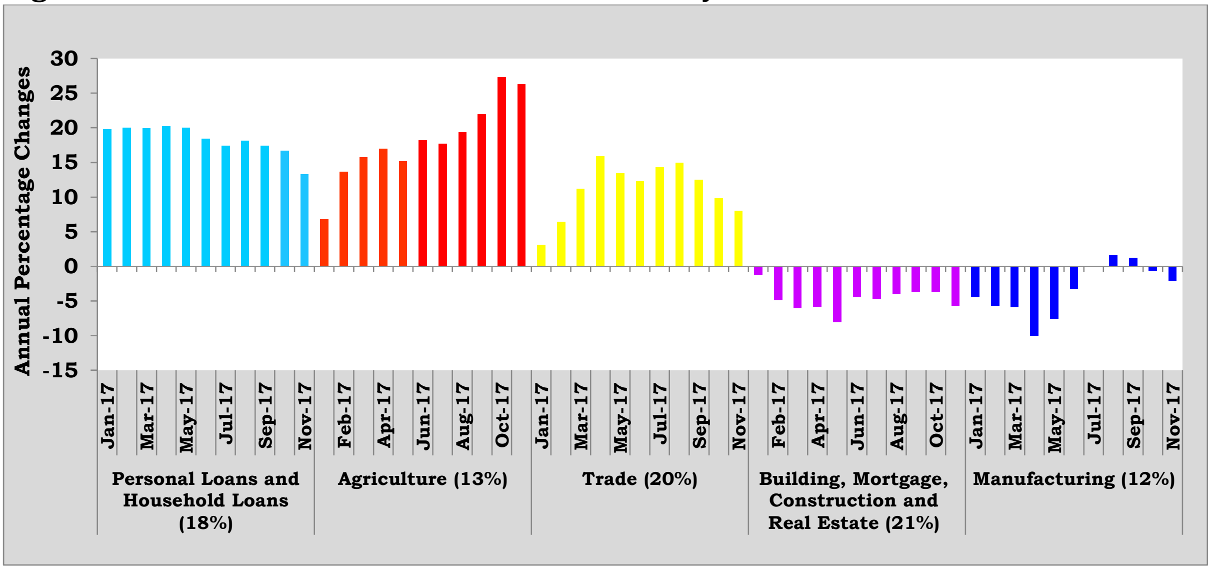


Source: Bank of Uganda

Modest PSC growth in an environment of sustained monetary policy easing in part reflects a raft of supply side constraints and implies that monetary policy alone cannot boost economic growth. Increase in Non-Performing loans (NPLs) remains the biggest risk to PSC growth, following the rise of the ratio of NPLs to 7.2 per cent in the quarter ended September 2017, from 6.2 per cent in the preceding quarter ended June 2017. Nonetheless, PSC is expected to grow moderately in the short-term. On the one hand, credit may continue to recover on account of increased lending to enterprises given the need for commercial banks to grow their loan portfolio, competition within the sector and a promising macro-economic environment, in addition to higher consumer demand supported by easier lending standards for households during the quarter ended December 2017. On the other hand, however, there are limitations to the optimism regarding future lending on account of a persistence of risk aversion of commercial banks and higher risk of default on the largely unsecured personal and household loans.

Demand for credit (as proxied by value of loan applications) remains robust while supply of credit (proxied by value of loan approvals) remains weak. During the quarter ended November 2017, the value of loan applications totalled about Shs. 4,607.5 billion, down from Shs. 4,787 billion in the quarter ended August 2017, while the value of approvals summed up to about Shs. 2,939.1 billion, up from Shs. 2,434.6 billion. The disparity between value of loan applications and approvals partly reflects supply-side constraints to growth in PSC. Growth in the supply of credit continues to be driven by robust extensions to individuals and households, agriculture and trade sectors (**Figure 7**).

Figure 7: Annual Private Sector Credit Growth by Sector



Percentage share of credit to sector to total credit indicated in parenthesis in legend
Source: Bank of Uganda

3.3 Fiscal Policy and Operations

Preliminary data for the first five months of FY 2017/18 indicates that fiscal operations were less expansionary compared to the approved budget. Government revenue and expenditure both registered shortfalls relative to the programed amounts.

Total Government revenue (including grants) during the first five months of FY 2017/18 amounted to Shs. 5,687.8 billion, which was Shs. 893.5 billion lower than the amount programmed in the approved budget, mainly due to underperformances in both domestic revenue and grants (**Table 3**). Grant receipts during the period underperformed by Shs. 700.2 billion, mainly due to an underperformance in project support grants arising from uncertainty in the timing of grant disbursements. Domestic revenues amounted to Shs. 5,404.9 billion, which was less than the approved budget amount by Shs. 193.2 billion. .

Total government expenditure and net lending in the period July 2017 to November 2017 amounted to Shs. 8,177.9 billion, which was lower than the approved budget amount by Shs. 1,228.5 billion, largely due to a shortfall in externally financed investment expenditure. Government net lending was Shs. 389.0 billion higher than programmed due to payments made by China Exim bank for submitted payment certificates for earlier work done on the Karuma and Isimba Hydro Power Projects (HPPs). Current expenditure fell short of the program by Shs. 114.6 due to lower than programmed interest payments on external debt.

The developments in government revenue and expenditure resulted in a fiscal deficit of Shs. 2,490.1 billion, which was lower than the anticipated deficit by Shs. 335 billion. Financing of the fiscal deficit amounted to Shs. 2,140.9 billion, out of which about 56 per cent was externally sourced. Nevertheless, external financing, which amounted to Shs. 1,396.8 billion, was Shs. 44.6 billion lower than the programmed amount, mainly due to an underperformance in project loan receipts. Domestic financing amounted to Shs. 744.1 billion, which was Shs. 639.6 billion lower than programmed mainly due to improvement in government's financial position with the central bank, which outweighed the net borrowing from the domestic market.

In the first five months of FY 2017/18 the roads and works sector took up the bulk of government development expenditure (31.2 per cent) compared to 28.7 per cent recorded in the same period of the previous year. Security had the highest share of the total current expenditure at 32.0 per cent, followed by interest payments and the education sector which had shares of 16.2 per cent15.3 per cent, respectively. Fiscal developments are shown in Table 3.

Table 3: Fiscal Operations (Shs. Billion)

	Jul'16 – Nov'16	Prel. July'17– Nov'17	Approved Budget Jul'17– Nov'17
Revenue & Grants	5,187.1	5,687.8	6,581.3
Revenue	4,733.8	5,404.7	5,598.0
Grants	453.4	283.1	983.3
Expenditure & Lending	7,500.5	8,177.9	9,406.4
Deficit (including grants)	-2,313.4	-2,490.1	-2,825.2
Financing (net)	2,313.4	2,490.1	2,825.2
External Financing (net)	1,206.4	1,396.8	1,441.5
Domestic	510.8	744.1	1,383.7

Source: Ministry of Finance, Planning and Economic Development (MFPED)

3.3.2 Public Debt Stock

The provisional total public debt stock (at nominal value) as at end November 2017 stood at Shs. 37.2 trillion, representing an increase of 7.6 per cent relative to June 2017. This increase in the stock of public debt was mainly on account of a 9.5 per cent growth in public external debt (in Shillings terms), which continues to have the dominant share of 65.8 per cent of total public debt. In November 2017, external and domestic debts amounted to Shs. 24.9 trillion and Shs. 12.7 trillion respectively, which is an increase of 9.5 per cent and 4.1 per cent, respectively compared to June 2017.

The provisional stock of public external debt disbursed and outstanding stood at USD 6,736.9 million as at end November 2017, representing an increase of 8.2 per cent from June 2017 compared to an increase of 1.8 per cent in the corresponding period a year ago. The total external debt exposure (debt disbursed and outstanding and debt committed but undisbursed) amounted to USD11,674.3 million as at end November 2017. **Table 4** indicates that all the domestic debt cost and risk indicators, with the exception of the ratio of the stock of government securities to PSC was within the Public Debt Medium Framework (PDMF, 2013) benchmarks.

Table 4: Public Debt Developments

	PDMF	Nov-16	Jun-17	Nov-17
% maturing in 1 year	<40%	42.9	38.4	35.8
% maturing in any year after year 1	< 20%	11.6%; 10.4%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years	11.2%; 11.4%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years	13.6%; 11.5%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years
T-bonds/T-bills (at face value)	70/30	66/34	70/30	74/26
Average Time to Maturity (Years)	>3Yrs	3.4	3.7	3.9
Total Stock/PSC	<75%	102.2	101.4	101.8

Source: Bank of Uganda

In terms of outlook, there is an expected shortfall in tax revenues in FY 2017/18, amounting to Shs. 659 billion, which is equivalent to 0.7 per cent of GDP), driven by unapproved tax measures and tax exemptions as well as slow recovery in economic activity. Supplementary expenditure is estimated at Shs. 392 billion, equivalent to 0.3 per cent of GDP. Government is also expected to run an expansionary budget in FY 2018/19 following her pledge to raise salaries for public servants in different sectors and also to cater for oil infrastructure projects. Debt indicators could further be affected by additional borrowing amounting to Shs. 300 billion for construction of the oil pipeline.

3.4 Balance of Payments and Exchange rates

3.4.1 Balance of Payments

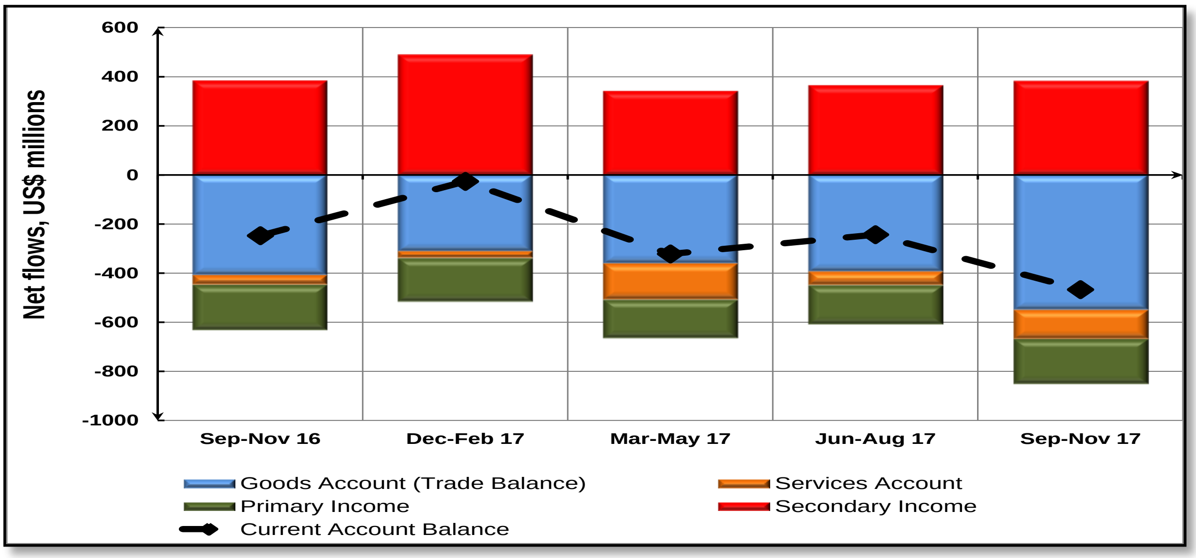
The balance of payments (BoP) continued to improve, although only slightly, during the quarter ended November 2017, recording an overall surplus of USD 0.1 million, following surpluses of USD 181.4 million and USD 77.3 million recorded in the last two immediate quarters. This deceleration in the performance of the BoP was largely on account of a widening of the current account deficit (CAD).

During the quarter ended November 2017, the current account deficit almost doubled to USD 467.1 million, from a deficit of USD 243.3 million recorded in the quarter ended August 2017, mainly driven by deterioration of the deficit on the goods account. The deficit on the goods account worsened by 39.5 per cent to USD 548.7 million during the three months to November 2017, as export earnings improved only slightly while the import bill increased significantly, driven by an increase in both government and private sector imports.

During the quarter ended November 2017, receipts from exports increased by 1.5 per cent to USD 825.2 million, mainly on account of an increase in non-coffee export receipts. Total non-coffee export receipts (excluding non-monetary gold) increased by 6.2 per cent to USD 502.4 million, compared to USD 473.1 million received in the previous quarter. Conversely, earnings from coffee exports decreased by 9.9 per cent to USD 131.7 million, as a result of a reduction in both the volume and price of coffee exported. The volume of coffee exported during the quarter under review decreased by 109,534 (60Kg) bags to 1,166,575 (60 Kg) bags, while the price reduced to USD USD 1.88 per kg from USD 1.91 per kg recorded in the three months to August 2017. Net exports of non-monetary gold increased marginally to USD 17.9 million from USD 17.7 million in the previous quarter.

The import bill increased notably by 13.9 per cent to USD 1,373.9 million during the three months to November 2017, mainly on account of an increase in private sector imports, which rose by 13.5 per cent to USD 1,188 million. The increase in private sector imports during the quarter under review was largely driven by non-oil imports which rose by 14.2 per cent to USD 972.9 million, mainly on account of increases in imports of machinery, vehicles and accessories, petroleum products, vegetable products, beverages, fats and oils. Over the same period, private sector oil imports also increased by 10.7 per cent, to USD 215.1 million. The government import bill also increased by 35.7 per cent to USD 105.6 million in the three months period to November 2017, mainly due to an increase in project imports by 43.8 per cent to USD 103.7 million. Trends in the Current Account Balance and its components are shown in **Figure 8**.

Figure 8: Quarterly Developments in the Current Account



Source: Bank of Uganda

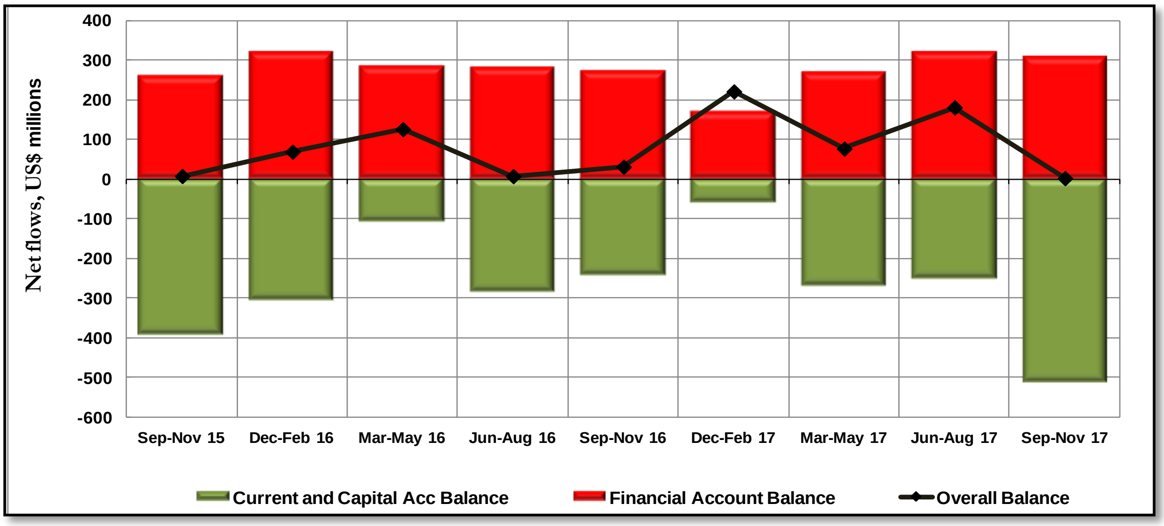
The balance on the services account deteriorated by USD 61.8 million to a deficit of USD 117.5 million during the quarter under review, largely due to higher transport services payments coupled with reduced government goods and services receipts during the quarter. Similarly, the deficit on the primary income account increased by 15 per cent to USD 182.9 million during the quarter ended November 2017, from a deficit of USD159.1 million during the quarter ended August 2017, on account of higher direct investment income payments made during the quarter. The secondary income balance improved by 4.1 per cent to a surplus of USD 382.1 million during the quarter, supported by higher receipts of transfers to both government and non-governmental organizations (NGOs). Notably personal transfers declined by 1.7 per cent, to USD 280.9 million, during the period under review.

During the three months to November 2017, net inflows (liabilities) through the financial account increased, by 1.2 per cent to USD 287.1 million, mainly driven by developments in direct and other investments. Foreign direct investment (FDI) inflows increased by over 50 per cent to USD 189.6 million during the quarter ended November 2017, compared to USD 120.9 million in the previous quarter, driven mainly by increased investments in equities by non-residents.

Compared to the previous quarter, the overall trend in portfolio investment barely changed over the period under review. Portfolio investments recorded a net outflow of USD 115.9 million in the quarter ended November 2017, relatively unchanged from the outflow of USD 116.6 million recorded in the preceding quarter. This is largely attributed to the continued exit by offshore investors from Uganda's debt securities market and investment in regional debt securities and equity markets by resident entities. Offshore investors reduced their stock of government securities by USD 83.1 million, and resident entities invested USD 32.8 million in regional debt securities and equity markets in the three months to November 2017. The capital account balance increased to a surplus of USD 34.1 million during the quarter ended November 2017, mainly due to increased official grants received for capital projects.

The overall BoP surplus of USD 0.1 million recorded during the quarter ended November 2017 resulted in a net build-up in reserves assets of USD 0.4 million excluding valuation changes. Developments in the overall BoP and its components on a quarterly basis are shown in **Figure 9**.

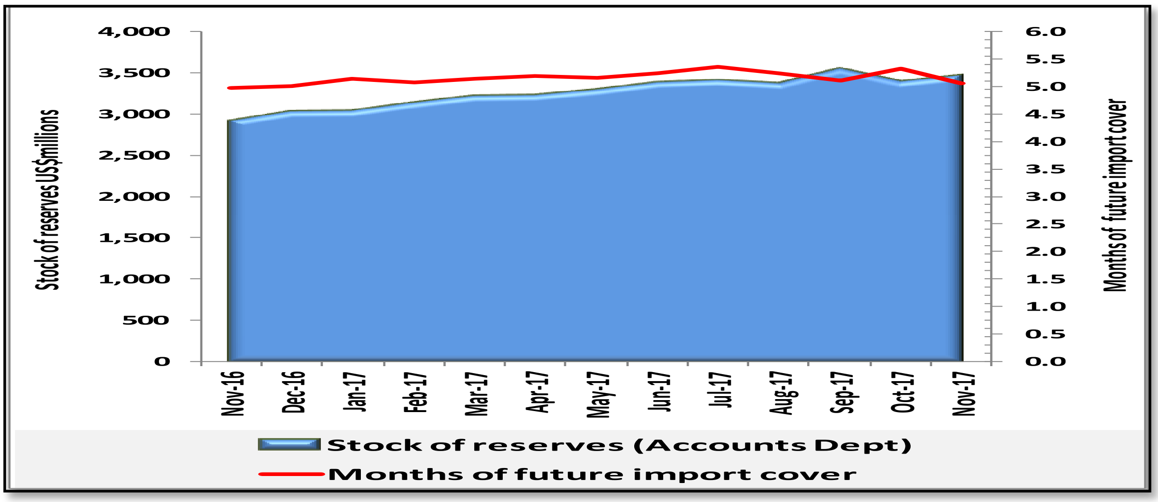
Figure 9: Development in Overall Balance of Payments and Main Components



Source: Bank of Uganda

The stock of reserves at the end of November 2017 was estimated at USD 3,472.3 million (including valuation changes), equivalent to 5.2 months of future imports of goods and services. Developments in the stock of reserves and months of import cover are shown in **Figure 10**. Going forward, in the short run, the current account deficit is expected to worsen on account of a rise in the import bill associated with the festive season, although this could be moderated by increased personal transfers over the same period. Over the medium-term, the current account deficit is expected to widen further as the import bill rises largely on account of the continued pickup in economic activity.

Figure 10: Stock of Reserves and Months of Import cover



Source: Bank of Uganda

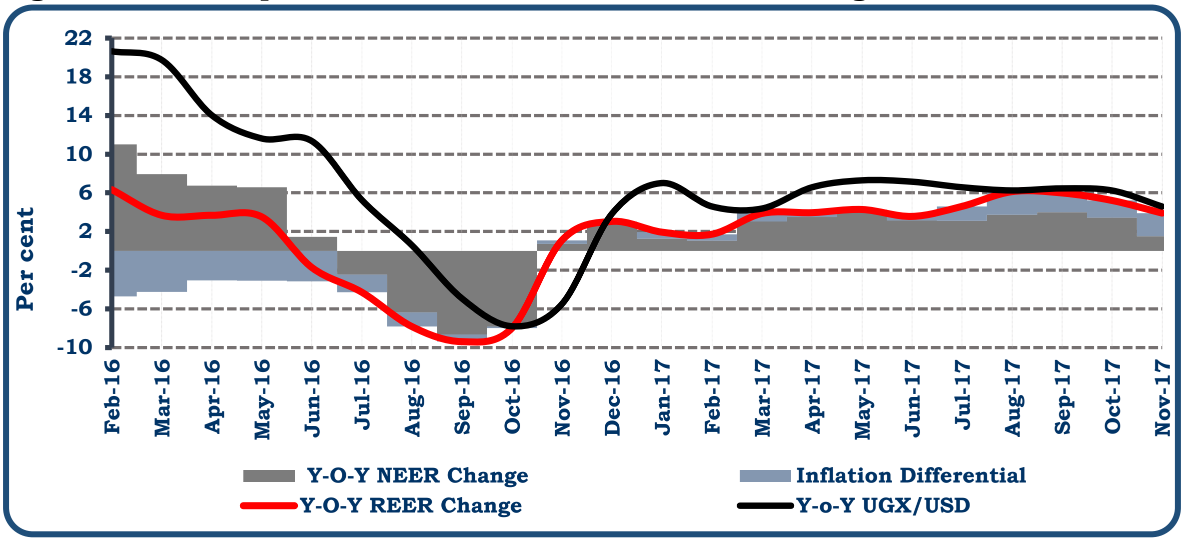
3.4.2 Exchange Rate Developments

During the quarter ended November 2017, the Uganda Shilling stood at an average midrate of Shs. 3,625.5 per US Dollar, a depreciation of 0.7 per cent and 4.8 per cent on quarterly and annual basis, respectively Notably the weakening of the Uganda Shilling during the quarter was concentrated in the month of October when the currency recorded heightened pressures arising from elevated uncertainty surrounding the political environment both locally and in neighbouring Kenya.

The Nominal Effective Exchange Rate (NEER) also depreciated by 0.8 per cent and 3.0 per cent on quarterly and annual basis, respectively. The Real Effective Exchange Rate (REER), which takes into account the inflation differential between Uganda and its trading partners depreciated by 0.6 per cent during the quarter under review. Exchange rate developments are shown in **Figure 11**.

Conditions in the interbank foreign exchange market (IFEM) enabled the BoU to purchase USD 131.9 million in the quarter ended November 2017 for reserve build up. Altogether, the total amount purchased for reserve build-up, in the first five months of 2017/18, amounted to USD 264.6 million. However, with USD 12.6 million sold in a market intervention and USD 46.3 million sold in targeted interventions, the net BOU action in the IFEM amounted to a net foreign exchange purchase of USD 72.97 million.

Figure 11: Developments in Effective and Bilateral Exchange Rates



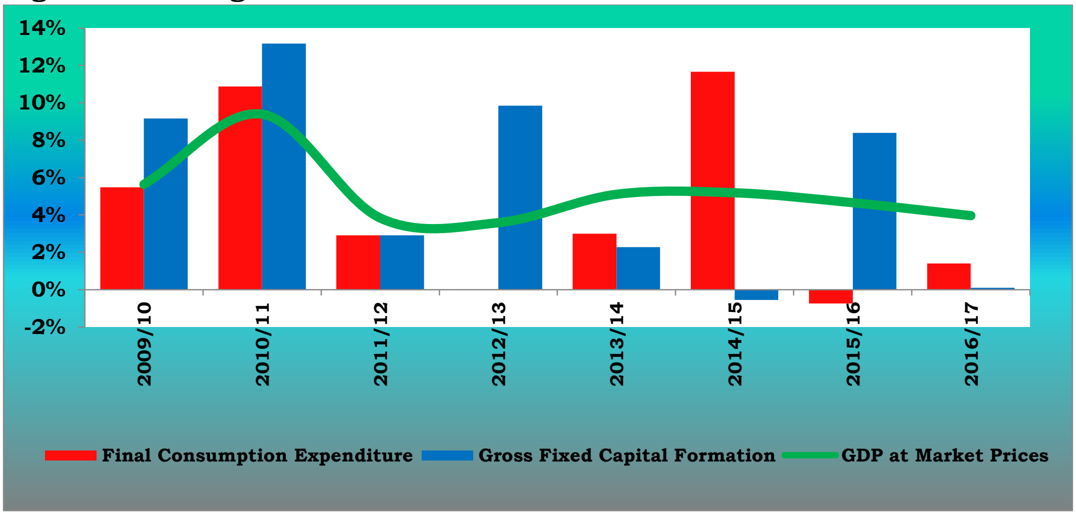
Source: Bank of Uganda

Going forward, the shilling may weaken further on account of recovery in aggregate demand, tapering of accommodative monetary policies in some of the AEs, uncertainty in global financial markets conditions stemming from an inward focus in policies, particularly protectionism leading to reduced trade and cross-border investment in AEs and rising geopolitical tensions.

3.5 Domestic Economic Activity

Real GDP estimates for FY 2016/17 were revised upwards to 4.0 per cent from 3.9 per cent, on account of stronger activity in the agriculture sector, specifically in the coffee sub sector and higher than expected activity in the services sector, especially trade and repairs and commercial banks activity. There was some improvement by 2.9 per cent in final consumption expenditure during FY 2016/17, relative to the decline of 0.3 per cent recorded in FY 2015/16, mainly on account of recovery in household expenditure, although government expenditure declined further by 10.9 per cent from the decline of 5.1 per cent recorded in FY 2015/16. Further, as highlighted in **Figure 12**, growth in gross capital formation decelerated significantly to 0.1 per cent in FY 2016/17 from 8.4 per cent posted in FY 2015/16, largely due to declines in expenditure on ICT and transport equipment as well as research and development.

Figure 12: GDP growth

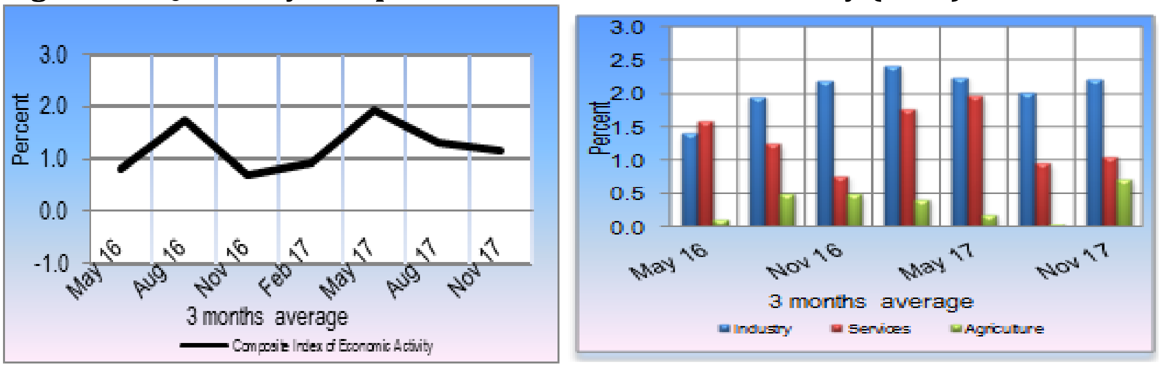


Source: Uganda Bureau of Statistics, UBOS

According to Bank of Uganda's early warning indicator, the composite index of economic activity (CIEA), shown in **Figure 13**, Uganda's economic activity is estimated to have remained stable in the quarter ended November 2017. The CIEA grew by 1.2 per cent in the quarter to November 2017 compared to 1.3 per cent in the quarter to August 2017, but higher than the 0.8 per cent in the quarter to November 2016.

Agricultural production is estimated to have increased by 0.7 per cent in the quarter to November 2017, compared to no growth at all and 0.5 per cent in the quarters to August 2017 and November 2016, respectively. Industrial activity remained stable at around 2 per cent in the quarter to November 2017, the same rate as in the quarters to August 2017 and November 2016, supported by growth in the manufacturing sub-sector. Month on month growth rates, however, point to lower growth in industrial activities. In the services sector, activity grew at a higher rate of 1.1 per cent compared to 1.0 per cent and 0.8 per cent, respectively over the same period, mainly on account of growth in Transport, Communication, Wholesale and Retail trade subsectors. Consumer perceptions were more pessimistic during the quarter to November 2017, suggesting deteriorating economic conditions, while businesses confidence in the economy was more optimistic, for all sectors save for the agricultural sector, during the same period.

Figure 13: Quarterly Composite Index of Economic Activity (CIEA)



Source: Bank of Uganda

Going forward, the economy is projected to grow at an annual rate of 5.0 - 5.5 per cent in FY2017/18 and is projected to accelerate further to 6.0 - 6.5 per cent over the medium-term, supported by accommodative monetary policy, improvements in public investment management and an improvement in the global economy.

3.6 Consumer Price Inflation

3.6.1 Recent Inflation Developments

Inflation continued to moderate further, with annual average core and headline inflation falling to 3.7 per cent and 4.7 per cent respectively during the quarter ended November 2017, from 4.5 per cent and 5.8 per cent respectively recorded in the quarter ended August 2017. On a monthly basis, annual average core and headline inflation dropped to 3.3 per cent and 4 per cent respectively in November 2017, down from 3.5 per cent and 4.8 per cent respectively in October 2017. Overall decline in inflation was mainly driven by the fall in food inflation especially in November 2017. Developments in domestic inflation are shown in **Table 5**.

Annual food crop inflation decelerated to an average of 6.6 per cent in the quarter ended November 2017, down from 14.2 per cent in the quarter ended August 2017 and the peak of 21.9 per cent in the quarter ended May 2017. Annual services inflation also eased to 3.1 per cent in the quarter to November 2017, from 3.8 per cent in the quarter to August 2017, but increased on a monthly basis to 0.6 per cent in November 2017, from 0.1 per cent in October 2017, largely driven by measures taken to collect more tax on airtime agents' commission. Annual average Energy, Fuel and Utilities (EFU) inflation increased to 12.8 per cent in the quarter ended November 2017 from 7.1 per cent in the quarter ended August 2017, largely on account of an increase in prices of solid fuels (charcoal and firewood). Annual non-food inflation remained stable at about 3 per cent during the quarter under review, while other goods inflation continued to decline to 4.1 per cent in the quarter ended November 2017 from 5.1 per cent in the preceding quarter ended August 2017.

Table 5: Developments in Domestic Inflation

	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17
	Annual Per cent change							
Headline	6.8	7.3	6.4	5.7	5.2	5.3	4.8	4.0
Core	4.9	5.1	5.0	4.5	4.1	4.2	3.5	3.3
Food crops And Related Items	21.6	23.1	18.1	12.9	11.7	9.6	7.9	2.3
Other Goods	5.1	5.6	5.6	4.9	4.7	4.3	4.3	3.7
Services	4.7	4.5	3.9	4.0	3.3	4.1	2.3	2.8
Energy Fuel And Utilities	5.3	7.1	5.7	7.8	7.8	10.6	14.1	13.7
	Quarterly moving average							
Headline	6.6	6.8	6.8	6.4	5.8	5.4	5.1	4.7
Core	5.1	4.9	5.0	4.9	4.5	4.3	3.9	3.7
Food crops And Related Items	20.4	21.9	21.0	18.0	14.2	11.4	9.7	6.6
Other Goods	5.2	5.2	5.4	5.4	5.1	4.6	4.4	4.1
Services	5.1	4.6	4.4	4.1	3.8	3.8	3.2	3.1
Energy Fuel And Utilities	3.4	5.4	6.0	6.9	7.1	8.8	10.8	12.8

Source: Uganda Bureau of Statistics (UBOS)

3.6.2 Inflation Outlook

The outlook for the external economic environment remains on a trajectory of broad-based improvement. Global growth is projected to pick up to 3.9 per cent both in 2018 and 2019, supported mainly by anticipated strong growth in AEs, where economic activity is now anticipated to expand at an annual rate exceeding 2 per cent over the two-year period. In addition, growth in EMDEs is also projected to firm further, supported by strong growth in China and India and steady recovery in Brazil, Russia and Nigeria. Growth in SSA, the destination to over half of Uganda's exports, is expected to increase although it is yet to match the previous trends. Risks to the outlook, while balanced in the near term, downside risks remain elevated in the medium term.

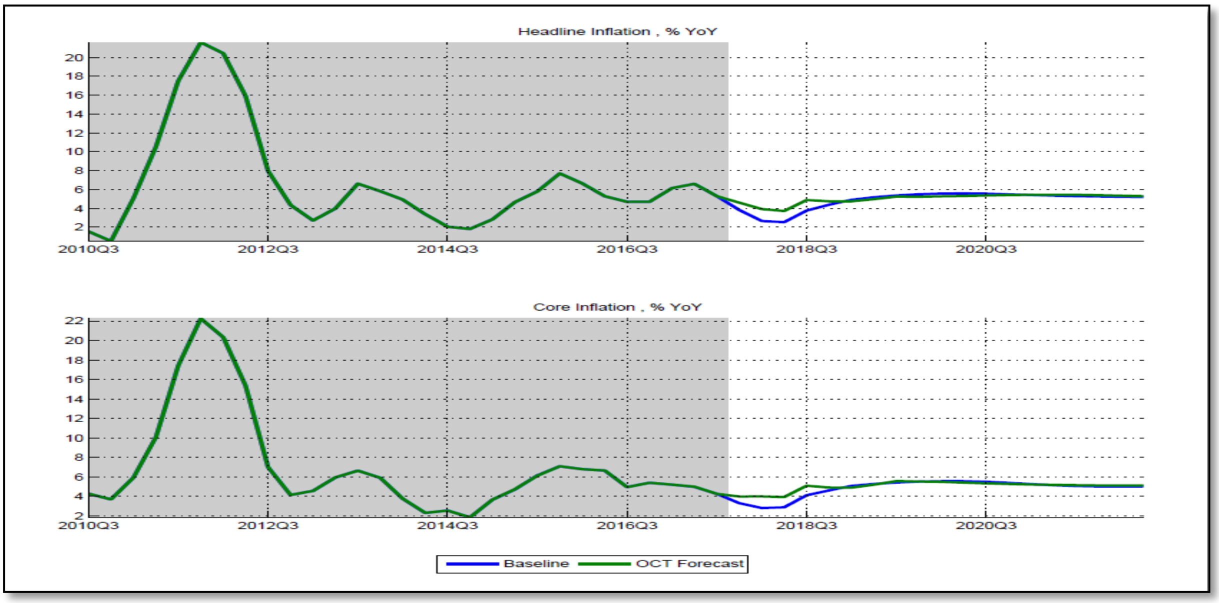
In the short term, global inflation expectations are generally stable. Deflationary concerns have eased even as economies show resilience; EU and U.S. inflation is expected to remain close to central bank target rates; and Japan has fewer deflationary concerns (although it remains a laggard). Nonetheless, looking outwards, global inflation is projected to rise in 2018 and 2019, largely supported by the sustained recovery in global oil prices, with headline inflation in AEs rising slightly above 2 per cent and to about 4.5 per cent in EMDEs. A healthier global economic environment may benefit the domestic economy through improved current account position.

The domestic economy is projected to grow at an annual rate of 5 per cent in FY2017/18, which is higher than the 4 per cent recorded in FY2016/17. Indeed the CIEA, which is the Bank of Uganda's high frequency indicator of economic activity, suggests a strengthening of economic activity in the first four months of FY2017/18. In the medium term, economic growth is projected to accelerate at a faster pace boosted by public investments, growth in consumption and the current stimulatory monetary policy. A considerable amount of public infrastructure works are planned or underway, particularly the oil related investments. There are however, several domestic factors that pose risks to the economic outlook. Growth has not been even across all sectors and growth in private investment and PSC remains subdued, and this is compounded by persistent delays in execution of public investments. Overall, domestic economic conditions have improved since early in the year, supported by easing of monetary policy, growth in public spending and continued strengthening in the global economy. In the medium term, the economy is expected to expand at a solid pace boosted by public investments, increasing growth in consumption and improved agricultural productivity.

In the near term, inflation outlook is slightly lower than the previous forecasts, mainly on account of lower food prices. Both headline and core inflation are forecast to converge to the 5 per cent target in the medium term. A reduction in spare capacity in economy is expected over the medium term, which will support a gradual increase in inflation to target. These inflation forecasts are depicted in **Figure 14**.

While inflation is projected to remain within the BoU medium target of 5 per cent, there are both upside and downside risks to this outlook. On the upside, are risks pertaining to the future direction of food crops prices and the path of the exchange rate, with the latter contingent on the external economic environment. On the downside, is subdued aggregate demand, which could suppress domestic prices.

Figure 14: Inflation forecast



Source: Bank of Uganda

4 Conclusion

Domestic inflation has continued to decline and remains subdued, hoovering within the lower band of the medium term target of 5.0 percent. Annual headline inflation declined further, from 4.8 per cent in October 2017, to 4.0 per cent in November 2017 – a decline driven by a fall in food crops price inflation, which continued to decline from a peak of 23.1 per cent in May 2017 to 2.3 per cent in November 2017. Annual core inflation also eased by 0.2 basis points to 3.3 per cent in November 2017, supported by the stability of the exchange rate in the last 12 months. Annual EFU inflation also declined to 13.7 per cent in November 2017 from 14.1 per cent in October 2017.

Domestic economic conditions have improved since early in the year, supported by easing of monetary policy, growth in public spending and continued strengthening of the global economy. In the medium term, the economy is expected to expand at a solid pace boosted by public investments, increasing growth in consumption and improved agricultural productivity. A considerable amount of public infrastructure work is planned or underway, particularly the oil related investments. GDP is projected to grow by 5.0 per cent in FY 2017/18. Indeed, the Composite Index of Economic Activity, which is the BoU's high frequency indicator of economic activity, points to a strengthening of economic activity in the first four months of FY 2017/18. There are however, several domestic factors that pose risks to the growth outlook. Growth has not been even across all sectors and growth in private investment and PSC remains subdued, and this is compounded by persistent delays in execution of public investments.

The near-term inflation outlook remains subdued but core inflation is projected to pick-up in FY 2018/19 to around 5 per cent as spare capacity in the economy is reduced. Nonetheless, there are both upside and downside risks to this outlook, which if they were to materialize, could alter the inflation path. The upside risks include the future direction of food crops prices and the path of the exchange rate, with the latter contingent on the external economic environment. On the downside, is subdued aggregate demand, which could suppress domestic prices. Based on the outlook for inflation and economic activity, together with an expansionary fiscal policy in FY 2017/18, and the evolution of the risks and uncertainties, the BoU judged that the prevailing monetary policy stance remained appropriate. The BoU therefore maintained the Central Bank Rate (CBR) at 9.5 per cent, as in October 2017. The band on the CBR was maintained at +/-3 PPs and the margin on the rediscount rate at 4 PPs on the CBR. Consequently, the rediscount rate and the bank rate remained at 13.5 per cent and 14.5 per cent, respectively. The Bank reiterates its commitment to conduct monetary policy with flexibility, so that medium term inflation converges to 5 per cent target over the policy horizon. If, however, the assumptions underpinning the projections prove to be inconsistent with incoming data, or if risks to the projections materialize, the policy may be revised accordingly.