Bank of Uganda

State of the Economy

March 2019

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Acronyms and Abbreviations

AEs	Advanced Economies
BoP	Balance of Payments
BoU	Bank of Uganda
CA	Current Account
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
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
REPOs	Repurchase Agreements
SSA	Sub- Saharan Africa
T-Bills	Treasury bills
T-Bonds	Treasury bonds
UK	United Kingdom
US	United States
WEO	World Economic Outlook

Executive Summary

Global growth momentum is showing signs of moderation amid slowing growth in most major advanced and emerging economies. The outlook for the global economy has become more uncertain, partly because it is hard to predict how trade policies might evolve and how much support stimulatory policies will provide to domestic demand, especially in China.

Financial market conditions in most advanced economies tightened somewhat in late 2018, following a lengthy period when conditions were generally very accommodative. The cost of funding for corporations rose, issuance of new debt securities eased, equity prices declined and volatility across global financial markets rose slightly. However, these moves have since been partly reversed, and risk premiums generally remain low by historical standards. In addition, long- term government bond yields have declined, as market participants have scaled back their expectations for central bank policy rates and inflation expectations have declined alongside lower oil prices. As a result, the cost of funding for corporations and sovereigns in major markets remains low by historical standards. Going forward, unresolved trade tensions remain a key source of risk, affecting global trade and investment activities. Tighter global financial conditions and elevated political and policy uncertainty could lead to financial market adjustments, further weighing on the overall outlook.

The BoU gradually eased monetary policy by reducing CBR from 17 percent in March 2016 to 9 percent in February 2018, held it unchanged until September 2018 and slightly increased and maintained it at 10 percent since October 2018. This accommodative monetary policy has helped support growth and a gradual increase in inflation. Other interest rates followed similar trends with weighted average lending interest rates declining from 24 percent in March 2016 to 20 percent in March 2018 before edging up to 21 percent as of January 2019.

Although fiscal policy for FY2018/19 is expansionary as implied by a widening of the overall fiscal deficit to about 6.6 percent compared to 4.9 percent in FY2017/18, fiscal operations in the first seven months of FY 2018/19 were less expansionary when compared to the approved budget. Total government revenue (including grants) over the period July 2018 to January 2019 amounted to Shs. 10,049.3 billion, which was Shs. 265.0 billion lower than the amount programmed in the approved budget due to an underperformance in project grants. Grant receipts during the period amounted to Shs. 425.8 billion compared to the budget projection of Shs 1,120.1 billion while domestic revenue amounted to Shs. 9,623.5 billion, which was Shs. 429.3 billion higher than the programmed amount in the approved budget.

Total government expenditure and net lending over the same period under review amounted to Shs. 13,446.4 billion. This outturn was Shs.3,321.3 billion lower than the programmed expenditure, mainly due to an under performance of Shs.2,752.9 billion in development expenditure. The shortfall in development expenditure was largely on account of lower than programmed external financing for government projects which could be attributed to the slow absorption of fiscal spending by government projects.

The provisional stock of public debt as at end January 2019 stood at Shs. 44,349.2 billion, representing growth of 4.5 percent relative to June 2018. The growth in the stock of total public debt between June 2018 and January 2019 was mainly due to a 12.3 percent increase in the public domestic debt. However, the public external debt maintained a dominant share of 64.8 percent of the total public debt. With the increased deficit, government debt would reach 44 percent of GDP at the end of FY2018/19.

The external position continues to weaken. The current account deficit widened to 5.9 percent of GDP in FY17/18 and projected to widen further, with continued increases in imports related to public sector investment and FDI. In the 12 months to January 2019, the CAD worsened by 117.4 percent, to US$ 2667.5 million from US$1227 million during the previous period. Goods and services deficit worsened by 49.5 percent, from US$ 2112.1 million to US$3157.5 million while, the goods deficit increased from US$1699.7 million to US$2535.3 during the same period.

In the three months to February 2019, the shilling was relatively strong, appreciating by about 2 percent in the quarter to Shs.3,696.48/US$. The appreciation pressure during this period is largely attributed to increased dollar inflows reflecting seasonal factors coupled with a low demand for foreign currency for imports on account of low activity. In line with the developments in the nominal exchange rate, the trade weighted nominal effective exchange rate (NEER) appreciated by 2 percent in the quarter to January 2019.

Economic growth has recovered and is trending in the range of 6.5-7 percent in the medium term. The Bank of Uganda's composite index of economic activity (CIEA) indicates stronger performance although the momentum seems to have slackened in the quarter to January 2019 compared to the quarter ended October 2018. The CIEA trend suggests annualised growth rate of 7-8 percent in 2018 implying that that growth in FY2018/19 could be higher than the projected of 6.3 percent. Growth above 6 percent would be above estimates of potential growth, implying a positive output in the economy.

Looking ahead, growth is expected to be sustained in 2019 with continued support from private sector spending. Expansionary fiscal stance combined with accommodative monetary policy conditions and capacity expansion in key sectors will continue to drive household and capital spending. Support from the external sector is expected to soften, in tandem with the moderating global growth momentum. Global trade tensions, disruptions in the context of Brexit, rising global interest rates and a strengthening U.S. dollar could weigh on growth and put further pressure on the shilling. Ongoing trade tensions remain a source of uncertainty. These factors have contributed to volatility in international financial markets. Weather conditions remain a risk for agriculture sector. Furthermore, if the tensions between Rwanda and Uganda escalate, it could lead to a decline in exports resulting in lower growth. Looser fiscal policy is likely to have an impact on growth and inflation. On balance, the baseline forecast is for the Ugandan economy to remain on a steady growth path. However, materialisation of downside risks from unresolved trade tensions, heightened uncertainties in the global and domestic environment, and prolonged weakness in the commodity-related sectors could further weigh on growth.

Inflation continued rising in February 2019 with annual core inflation increasing to 3.7 percent from 3.4 percent in January 2019 while headline inflation rose to 3.0 percent from 2.7 percent over the same period. The inflation outlook remained relatively unchanged from the February 2019 forecast round. With growth expected to be slightly above trend, core inflation is expected to increase gradually, reaching 5 percent by the end of 2019. There are however risks to the inflation forecasts that are relatively well balanced. On the upside, there is a possibility of a more depreciated exchange rate given the volatile global market conditions resulting from heightened risk sentiment mainly arising from uncertainty surrounding trade policies and the Brexit negotiations. In addition, a higher fiscal deficit and domestic demand pressures as a result of a positive output gap could also put upward pressure on inflation. On the down side, the softening momentum in global growth may weaken oil demand further resulting in lower than anticipated increases in crude oil prices. Finally, lower global commodity prices could lead to lower domestic inflation.

At the current level of the CBR, the degree of monetary accommodativeness is consistent with the intended policy stance. Recognising that there are downside risks in the economic and financial environment, the BoU will continue to monitor and assess the balance of risks surrounding the outlook for domestic growth and inflation.

1 Background

This report presents domestic and external economic developments in the period to February 2019. It also assesses the future prospects for both the global and domestic economy, including the growth and inflation outlook. 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

Softening activity, heightened risks and uncertainty have clouded the global growth prospects. International trade and investment, which are the main drivers of global growth moderated, trade tensions are elevated and financing conditions have tightened. Indeed, economic growth projections for 2019 and 2020 were revised downwards to 3.5 percent and 3.6 percent, which are respectively 0.2 and 0.1 percentage points lower than the October 2018 forecasts, largely citing sustained negative effects of the US-China trade war, fragile growth prospects in the Euro area and some large emerging markets and developing economies. Economic growth for the advanced economies has been revised downward to 2.0 percent in January 2019, 0.1 percentage points lower than earlier predicted.

Headline economic growth rates for emerging market and developing economies, and sub-Saharan Africa masks significant variation among individual countries. Whereas growth for emerging market and developing economies has been revised downwards by 0.2 percentage points in January 2019 relative to earlier forecast, India and Brazil's growth are projected to remain robust in 2019. Growth for Sub-Saharan Africa is expected to be lower by 0.3 percent points relative to earlier projections, largely driven by softening oil prices which are expected to affected growth in major oil exporters. Over one-third of sub-Saharan economies however, are expected to grow above 5 percent in 2019–2020.

Downside risks to the global growth prospects have increased, including the possibility of escalating trade disputes, uncertainty surrounding the Brexit, and further deterioration in risk sentiments, given the high levels of public and private debt. Policymakers in developing countries should continue to build policy buffers, promote trade integration and remove barriers to investment. The global growth projections are presented in **Table 1**.

Table 1: Global Growth Projections

	IMF WEO Oct-18 Forecasts		IMF WEO Jan-19 Forecasts		
	2018	2019	2018	2019	2020
World (Real GDP Growth (PPP Ex Rates)	3.7	3.7	3.7	3.5	3.6
Advanced Economies	2.4	2.1	2.3	2.0	1.7
United States	2.9	2.5	2.9	2.5	1.8
Euro Area	2.0	1.9	1.8	1.6	1.7
Japan	1.1	0.9	0.9	1.1	0.5
United Kingdom	1.4	1.5	1.4	1.5	1.6
Emerging Market & Developing Economies	4.7	4.7	4.6	4.5	4.9
China	6.6	6.2	6.6	6.2	6.2
India	7.3	7.4	7.3	7.5	7.7
Brazil	1.4	2.4	1.3	2.5	2.2
Sub-Saharan Africa	3.1	3.8	2.9	3.5	3.6
World Trade Growth (%)	4.2	4.0	4.0	4.0	4.0

Source: IMF, WEO update January 2019

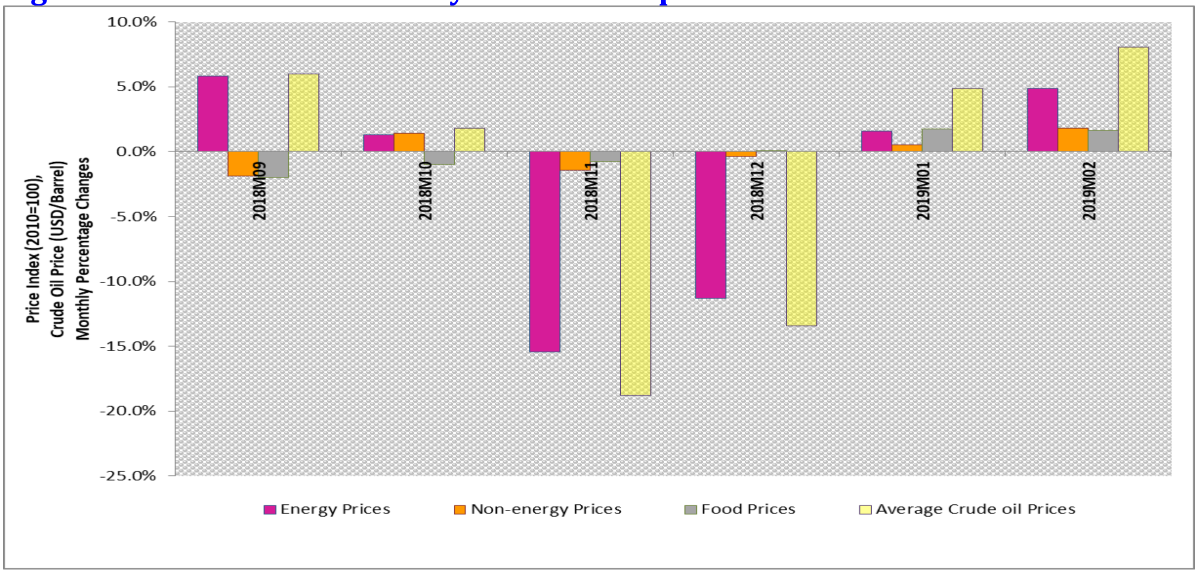
2.2 Global Commodity Prices and Inflation

2.2.1 Global Commodity Prices

The global commodity markets continued to be affected by the deteriorating global growth prospects, the appreciation of the U.S. dollar, increased sanctions and growing trade tensions. Nonetheless, prices for most commodities rose in February 2019 with energy and non-energy commodities increasing by 4.9 percent and 1.8 percent, respectively. Average crude oil prices rose by about 8 percent to US$ 61 per barrel in February 2019. However, the rise in oil prices is still below the US$ 75.9 average per barrel recorded in October 2018. The FAO food price index, a measure of global food prices edged up largely driven by increases in prices of dairy products.

The softening global growth prospects, increased sanctions and growing trade tensions are expected to have knock-on effects on the recovery of commodity prices. According to the World Bank, oil prices are projected to average US$74 dollars a barrel in 2019, up from a projected average of US$72 dollars in 2018. Although the global oil prices are projected to rise in 2019, they are expected to be below their historical medium-term averages. Metal prices are however expected to remain broadly stable over 2019, while prices of agricultural products are expected to soften in 2019 amidst ample supply and trade tensions. The global commodity price developments are depicted in **Figure 1**.

Figure 1: Global Commodity Price Developments



Source: World Bank Commodity Price Data and FAO

2.2.2 Global Inflation

Global inflation remained relatively subdued in recent months amidst rising commodity prices and weakening global demand on account of the moderating economic growth in major emerging market economies. Inflationary pressures which were observed in both advanced and emerging markets and developing economies in mid-2018 subsided in the quarter to December 2018. In the UK and U.S., although inflation declined to about 2.1 percent and 2.2 percent, respectively, they remained above the central banks' targets of 2 percent target. In the Euro area and Japan, inflation declined to 1.9 percent and 0.9 percent, respectively over the same period. Except Russia where it increased to 3.9 percent in the quarter ended December 2018 from 3 percent in the previous quarter, inflation broadly declined in most emerging markets & developing economies. Inflation developments in selected countries are shown in **Table 2**.

The outlook is for a relatively stable global inflationary environment in 2019 and 2020 in line with the projected softening in global commodity prices. In advanced economies, inflation is projected to drop to 1.7 percent in 2019 but rise to 2 percent in 2020. However, in emerging markets and developing economies, inflation is projected to slightly increase to 5.1 percent in 2019 largely driven by the lagged impact of previous exchange rate depreciations. The expected increase in inflation in most emerging markets and developing economies are however expected to remain below the central bank targets, but further tightening in global financial conditions and elevated financial risk sentiments may trigger exchange rate depreciation pressures, which may cause higher inflation in these economies.

Table 2: Inflation Developments in Selected Countries

	Quarterly Averages			Monthly				
	Quarter to Jun-18	Quarter to Sept-18	Quarter to Dec-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-18
Euro Area	1.7	2.1	1.9	2.1	2.3	1.9	1.5	1.4
Japan	0.6	1.1	0.9	1.2	1.4	0.8	0.3	0.2
UK	2.2	2.3	2.1	2.2	2.2	2.2	2.0	1.8
US	2.7	2.6	2.2	2.3	2.5	2.2	1.9	1.6
Brazil	3.3	4.4	4.1	4.5	4.6	4.0	3.7	3.8
China	1.8	2.3	2.2	2.5	2.5	2.2	1.9	1.7
India	4.0	5.6	5.1	5.6	5.2	4.9	5.2	6.6
Russia	2.4	3.0	3.9	3.4	3.5	3.8	4.3	5.0
South Africa	4.3	4.9	4.8	4.8	5.0	5.1	4.4	3.9

Source: OECD Statistics

2.3 Global Financial Markets

Global financial market conditions remained relatively volatile at the start of 2019 as a result of heightened risk sentiments mainly arising from uncertainty surrounding trade policies, Brexit negotiations, as well as expectations of slower global growth prospects. These conditions prompted major central banks in advanced economies to signal a cautious approach to further tightening monetary policy stance. The U.S. Fed in particular adopted a more gradual pace of rate hikes in 2019 and 2020 as a result of lower than expected inflation pressures and global financial conditions. The European central bank also announced an accommodative monetary policy stance with no rate hikes until the summer of 2019 and the Bank of England is not expected to undertake any policy changes on account of the uncertainty surrounding the Brexit negotiations. However, in emerging market and developing economies, several central banks, except India and China raised policy rates in light of the closing output gaps, risk of high oil prices and fear of the pass through from currency depreciation to inflation.

As a result of investors generally lowering exposure to riskier assets, emerging market economies experienced net capital outflows towards the end of 2018. In January 2019, the US dollar remained broadly unchanged in real effective terms relative to September 2018, the Euro weakened by about 2 percent amidst slower growth and concerns about Italy. The UK pound depreciated by about 2 percent as Brexit-related uncertainty increased. In contrast, the Japanese yen appreciated by about 3 percent.

Several emerging market currencies, including the Turkish lira, Argentine peso, Brazilian real, South African rand, Indian rupee, and Indonesian rupiah recorded recoveries from their 2018 lows. The outlook remains for continued volatility in global financial markets as a result of uncertainty surrounding the Brexit negotiations, escalation of global trade tensions, tightening financial conditions and heightened risk aversion due to rising public and private debt.

2.4 Implications for the Uganda Economy

The outlook for the global economic environment is weaker than earlier projected largely due to uncertainties related to the US-China trade war. The global economic growth prospects are expected to remain relatively subdued, while growth in Sub-Saharan Africa is expected to be robust. The moderation in global growth momentum if it outweighs the robust growth in over one-third of sub-Saharan economies, which are expected to grow above 5 percent in 2019–2020, may have a knock-on effect on Uganda's export demand and may somewhat dampen the domestic growth momentum.

Global commodity prices are also expected to remain relatively subdued despite the recent increase observed in February 2019. Lower commodity prices could therefore filter through to low domestic inflation. In addition, the reduced commodity prices could lead to a lower import bill and support the exchange rate. However, lower commodity prices may affect export earnings, which may somewhat offset the gains from lower oil import bill. Continued volatility in global financial markets and heightened tensions in the global financial markets may be a source of volatility in the domestic financial markets with implications for the exchange rate stability.

3 Domestic Economic Developments

3.1 Reflections on Previous Monetary Policy Stance and Implementation

3.1.1 Monetary Policy Stance

The Bank of Uganda (BoU) maintained the Central Bank Rate (CBR) at 10 percent in February 2019. The band on the CBR was maintained at +/-3 percentage points and the margin on the rediscount rate at 4 percentage points on the CBR. Consequently, the rediscount rate and the bank rate were set at 14 percent and 15 percent, respectively.

The neutral monetary policy stance was warranted by the expected inflation and output trajectory. The medium-term (2-3 years) inflation outlook remained relatively unchanged from the December 2018 round of forecasts, with core inflation projected to converge to the BoU's target of 5 percent. However, the inflation outlook in the intermediate period had improved, largely driven by a relatively stronger shilling and good crop harvest. However, there were upside risks to this forecast including the future direction of food crop prices, the exchange rate path, which is contingent on the external environment, the domestic demand pressures as a result of a positive output gap and the widening fiscal deficit.

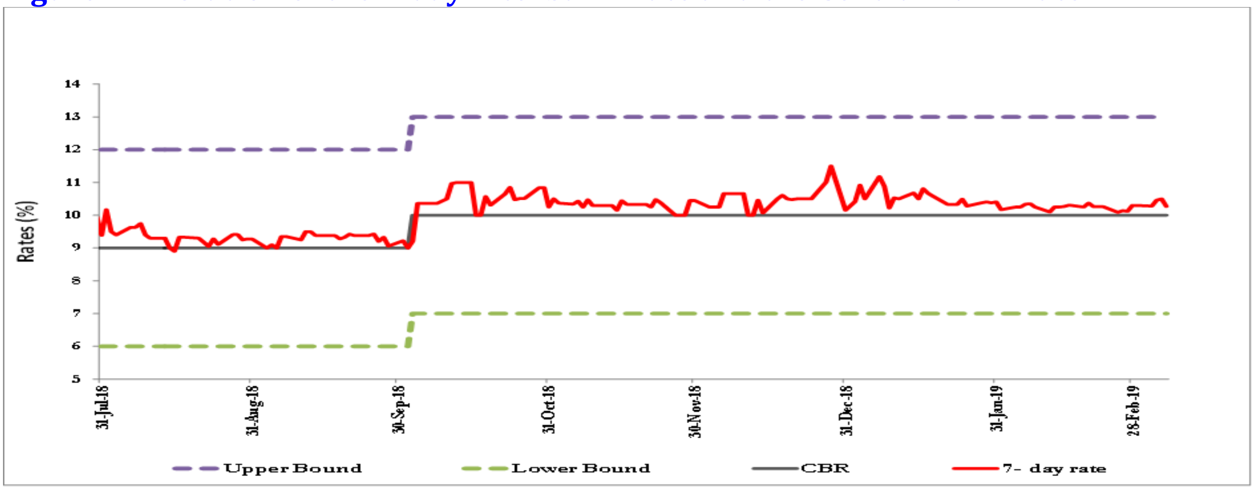
Economic growth was expected to remain robust at about 6.3 percent in FY 2018/19 in part supported by accommodative monetary policy stance, multiplier effects of public infrastructure development, improved agriculture performance and the pickup in private sector credit. However, the growth outlook was subject to uncertainty such as the weather related constraints to agricultural production and challenges relating to the financing of public investment programs. Furthermore, the lower than anticipated global growth prospects as a result of international trade tensions and volatility in the domestic foreign exchange market that was likely to strain growth going forward.

3.1.2 Monetary Policy Implementation and Challenges

Bank of Uganda continued to use Repurchase Agreements (REPOs)/reverse REPOs and deposit auctions to align domestic liquidity conditions in the domestic banking system with the desired monetary policy stance. The net outstanding stock of REPOs and deposit auctions at end February 2019 were Shs. 284.5 billion and Shs. 1,258.8 billion, respectively.

In line with the neutral monetary policy stance, average money market rates remained relatively stable in the three months to February 2019. The weighted average 7-day interbank money market rate remained close to the CBR, averaging 10.5 percent in the three months to February 2019, compared to 10.1 percent in the three months to November 2018. The CBR continued to anchor movements in the money market rates (**Figure 2**).

Figure 2: Evolution of the 7-day Interbank Rate and the Central Bank Rate



Source: Bank of Uganda

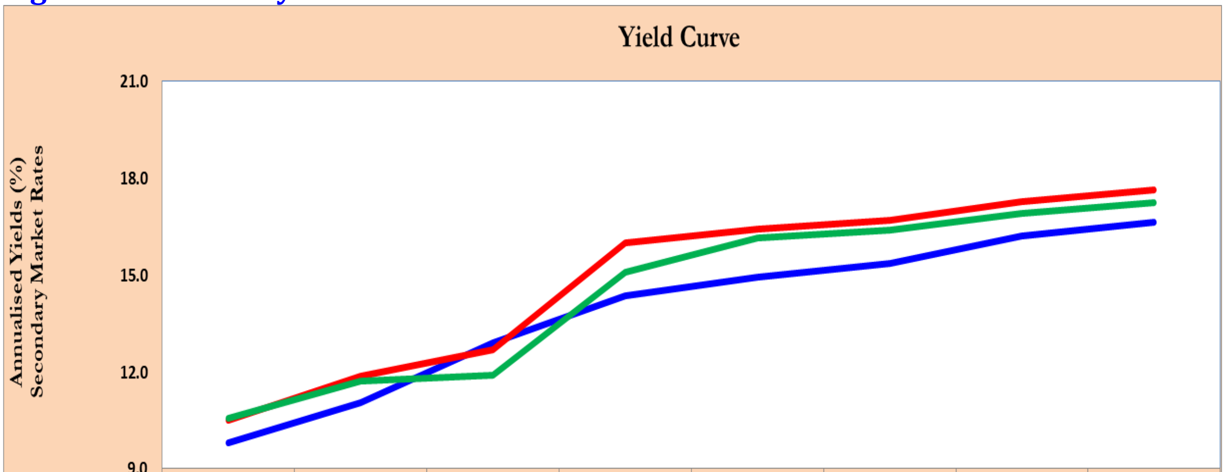
3.2 Interest Rate Developments

3.2.1 Yields on Government Securities

Average yields on government securities declined in the quarter to February 2019 in part reflecting increased demand for Government securities. In the three months to February 2019, yields on treasury bonds declined save for the 5-year Treasury bond, which on average registered a 0.5 percentage point increase to 16.8 percent compared to the three months to November 2019. The average yields on the 2-year, 3-year, 10-year and 15-year Treasury bonds (T-bonds) declined to 14.9, 16.1, 16.6 and 17.2 percent, respectively in the quarter ended February 2019, down from 15.6, 16.7, 17.2 and 17.6 percent in the preceding quarter. Similarly, yields on T-bills declined across the board, registering an average of 10.5, 11.8 and 12.5 percent in the quarter ended February 2019, compared to an average of 10.9, 12.5 and 13.1 percent in the quarter ended November 2018. The yields on Government securities are expected to remain relatively stable, but could increase if there are additional financing requirements by Government beyond the Shs. 380 billion.

The yields in the secondary market largely reflected developments in the primary market. Yields on Treasury securities for all tenors except the 91-day T-bill (which remained stable) declined in the quarter ended February 2019 compared to the previous quarter. Average yields on the 182-day and 364-day papers fell to 11.7 and 11.9 percent, respectively from 11.9 and 12.7 percent during the quarter ended November 2018. Similarly, average yields on the longer dated securities declined to 15.1, 16.1, 16.4, 16.9 and 17.2 percent respectively for the 2-year, 3-year, 5-year, 10-year and 15-year T-bonds during the quarter ended February 2019 compared to 16.0, 16.4, 16.7, 17.3, 17.6 percent, respectively in the quarter to November 2018. **Figure 3** shows the trend in the secondary market yields on government securities since three months to August 2018.

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



	91-days	182-days	364-days	2-years	3-years	5-years	10-years	15-years
Q-Aug	9.8	11.0	12.9	14.4	14.9	15.4	16.2	16.6
Q-Nov	10.5	11.9	12.7	16.0	16.4	16.7	17.3	17.6
Q-Feb	10.6	11.7	11.9	15.1	16.1	16.4	16.9	17.2

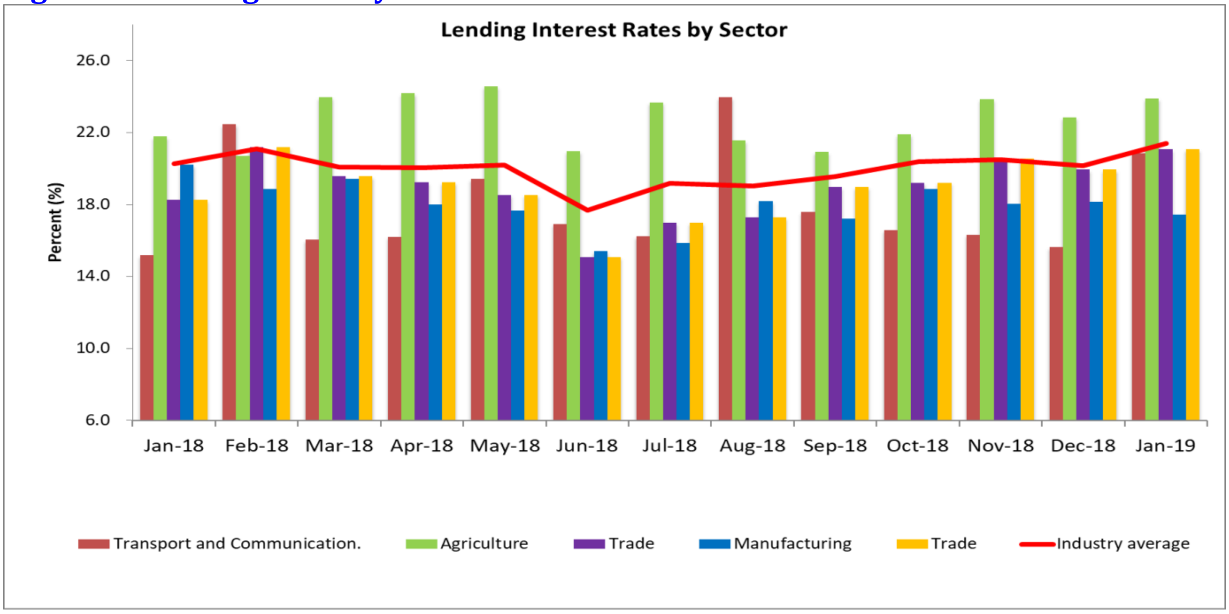
Source: Bank of Uganda

3.2.2 Lending and Deposit Rates

Although lending rates have remained relatively stable over the past 6 months, the weighted average shilling lending rate edged-up moderately by 1 percentage point to 20.7 percent in the quarter to January 2019 compared to the quarter to October 2018. On the contrary, the weighted average lending rate on foreign currency loans declined by 0.6 percent to 7.6 percent in the quarter to January 2019 compared October 2018. The weighted average deposit rate on the shilling and forex deposits remained relatively stable at 3.0 percent and 1.4 percent, respectively in the period under review.

A decomposition of lending rates by sector for the quarter ended January 2019 shows moderately higher lending rates for the agriculture, trade, mortgage & land purchase and business services sectors, which registered averages of 23.5, 20.5, 23.0 and 22.2 percent, respectively from 21.4, 18.5, 21.6 and 21.1 percent in the quarter to October 2018. Conversely, the lending rates for the manufacturing and transport and communication sectors recorded a decline in the period under review to 17.8 and 17.6 percent respectively from 18.1 and 19.4 percent. The agriculture and trade sectors were the largest contributors to the increase in lending rates in the quarter to January 2019. The lending rates by sector are depicted in **Figure 4**.

Figure 4: Lending Rates by Sector



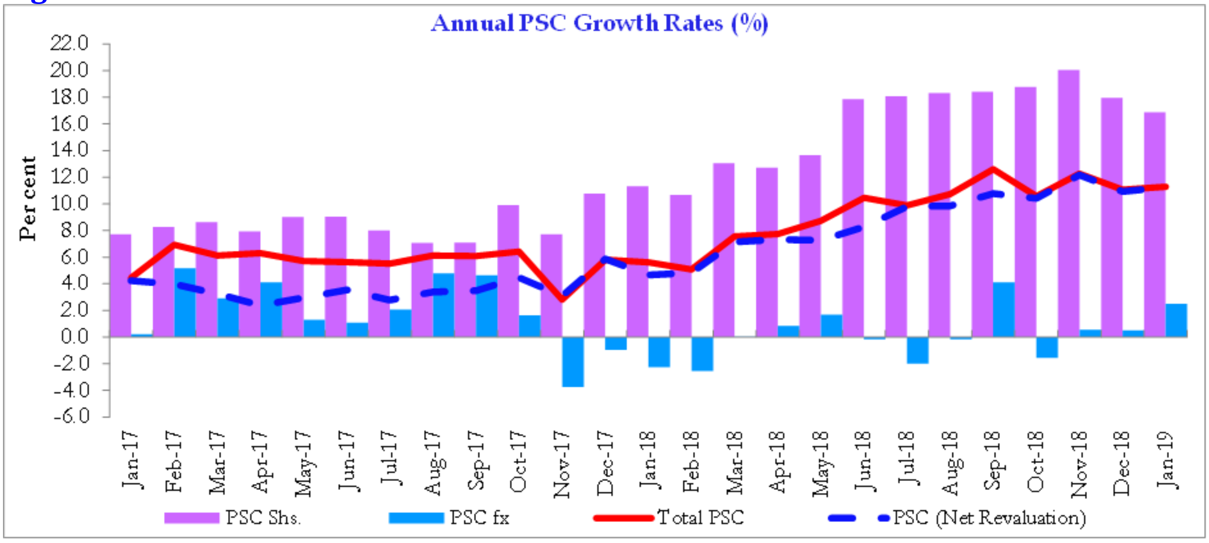
Source: Bank of Uganda

3.3 Private Sector Credit

Private sector credit (PSC) growth has continued on a gradual growth path, partly supported by a recovery in economic activity, improvement in asset quality evidenced by lower non-performing loans (NPLs) and the lagged impact of monetary policy easing. The average annual growth in PSC for the quarter ended January 2019 remained relatively stable at 11.5 percent compared to the previous quarter but was higher than 4.7 percent in the quarter to January 2018. In the three months to January 2019, the annual Shilling-denominated loans grew on average by 18.9 percent, slightly higher than the 18.3 percent recorded in the quarter to October 2018 and 9.9 percent in the quarter to January 2018. Over the same period, foreign currency denominated lending registered on average a contraction of minus 0.2 percent, a deterioration from the 0.6 percent growth registered in the previous quarter but an improvement compared to minus 2.3 percent in the quarter ended January 2018.

Net of valuation changes on account of exchange rate movements, the average annual PSC grew by 11.2 percent in the quarter to January 2019, higher than the 10.1 percent growth recorded in the quarter to October 2018 and 4.5 percent in the quarter to January 2018. Specifically, foreign currency denominated loans contracted by minus 2.8 percent, an improvement from the minus 3.7 percent recorded in the three months to October 2018 and minus 3.2 in the quarter to January 2018. Developments in private sector credit are shown in **Figure 5.**

Figure 5: Annual Growth and Contributions to Private Sector Credit

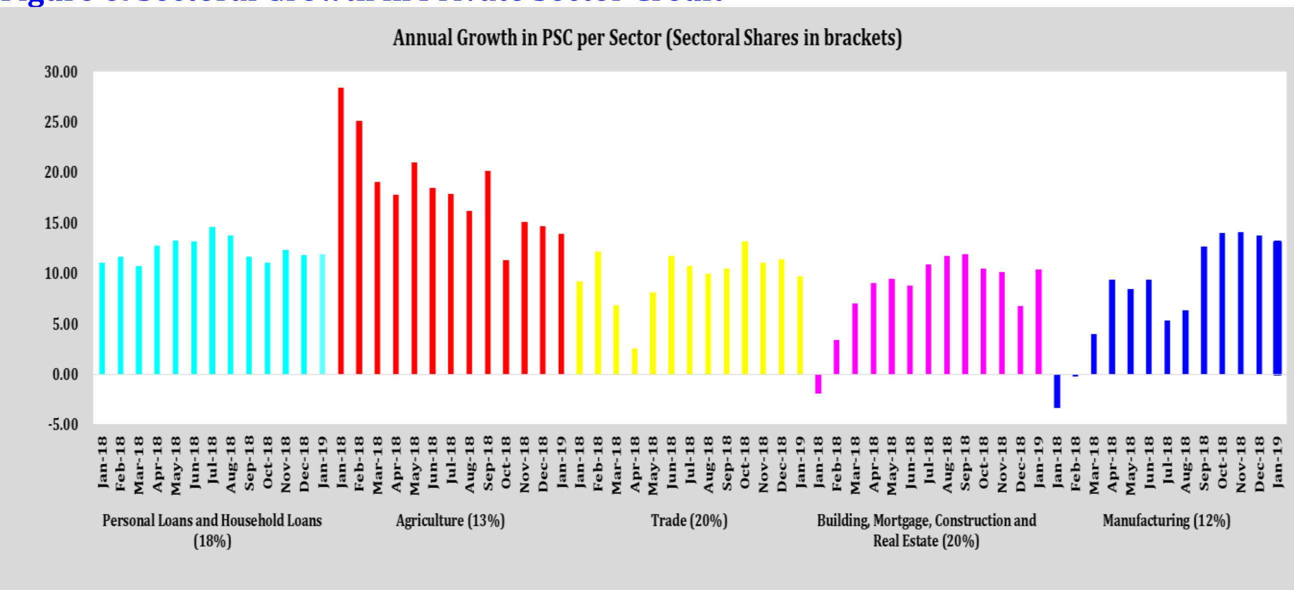


Source: Bank of Uganda

A sectoral decomposition (**Figure 6**) shows that credit growth remains positive across all sectors. However, compared to the quarter ended October 2018, year-on-year average growth was slower for the agriculture, trade and building, mortgage, construction and real estate sectors in the quarter to January 2019.

In the medium-term, PSC growth is likely to improve further on account of a projected improvement in economic activity. This increase in credit growth if sustained is likely to boost private investment & consumption, which in turn should support growth.

Figure 6: Sectoral Growth in Private Sector Credit



Source: Bank of Uganda

In terms of assets quality, non-performing loans (NPLs) as a percentage of total loans fell to 3.4 percent in the quarter to December 2018 compared to 4.7 percent recorded in the quarter to September 2018, and 5.6 percent in the quarter ended December 2017. The agriculture sector remained the most risky sector, registering a sectoral NPL ratio of 6.4 percent during the quarter, accounting for a 26 percent share of total NPLs. Going forward, the NPLs are expected to remain relatively low on account of improved economic activity. The lower NPLs could facilitate further easing of credit standards by commercial banks and in turn boost private sector credit. PSC growth is likely to remain relatively robust in line with projected growth in economic activity and waning supply side constraints. The increase in credit growth, if sustained, will boost private investment and consumption, which in turn should support further economic growth.

3.4 Fiscal Policy and Operations

Fiscal operations in the first seven months of FY 2018/19 were less expansionary than the budget. Total government revenue (including grants) over the period July 2018 to January 2019 amounted to Shs. 10,049.3 billion, which was Shs. 265.0 billion lower than the amount programmed in the approved budget due to underperformance in project grants (**Table 3**). Grant receipts during the period amounted to Shs. 425.8 billion compared to the budget projection of Shs 1120.1 billion while domestic revenue amounted to Shs. 9,623.5 billion, which was Shs. 429.3 billion higher than the programmed amount in the approved budget.

Notably, all the tax heads registered surpluses, with direct and international trade tax collections posting the largest surpluses amounting to Shs. 160.2 billion and Shs. 103.4 billion, mainly due to higher than programmed collections from Pay As You Earn (PAYE) and corporate tax and to VAT on imports, respectively. This was followed by a surplus of Shs. 54.1 billion in indirect domestic tax collections mainly due to Value Added Tax (VAT) collections on manufactured items. The surplus in fees and licenses amounted to Shs. 22.0 billion, mainly from stamp duty and embossing fees. The above target performance may be attributed to a pick-up in economic activity over the period.

Total government expenditure and net lending over the same period under review amounted to Shs. 13,446.4 billion. This outturn was Shs.3,321.3 billion lower than the programmed expenditure, mainly due to an under performance of Shs.2,752.9 billion in development expenditure. The shortfall in development expenditure was largely on account of lower than programmed external financing for government projects which could be attributed to the slow absorption of fiscal spending by government projects.

Table 3: Fiscal Operations (Shs. Billion)

	July'17-Jan'18	Prel. July'18-Jan'19	Approved Budget July'18-Jan'19	Variation
Revenue & Grants	**8,593.1**	**10,049.3**	**10,314.3**	**-265.0**
Revenue	8,088.9	9,623.5	9,194.2	429.3
Grants	504.2	425.8	1,120.1	-694.3
Expenditure & Lending	**11,660.4**	**13,446.4**	**16,767.7**	**-3,321.3**
Current Expenditure	6,354.6	7,280.9	7,418.6	-137.7
Development	3,980.1	5,613.1	8,366.0	-2,752.9
Net lending/repayments[1]	1,095.1	248.6	722.6	-473.9
Domestic arrears	230.6	303.8	260.6	43.3
Deficit (including grants)	**-3,067.3**	**-3,397.1**	**-6,453.4**	**3,056.3**
Financing (net)	**3,067.3**	**3,397.1**	**6,453.4**	**-3,056.3**
External Financing (net)	2,243.6	1,918.5	4,439.0	-2,520.5
Domestic Financing	243.9	1,200.2	2,014.4	-814.2
Errors & Omissions	579.9	278.3	0.0	

The developments in government revenue and expenditure resulted in a fiscal deficit of Shs. 3,397.1 billion, which was lower than the programmed deficit by Shs. 3,056.3 billion. This performance may be attributed to the lower than programmed government development expenditure over the seven months. The deficit was majorly financed by external sources which amounted to Shs. 1,918.5 billion of the total financing.

3.4.1 Public Debt Stock

The provisional stock of public debt as at end January 2019 stood at Shs. 44,349.2 billion, representing growth of 4.5 percent relative to June 2018, compared to the increase of 11.1 percent in the same period a year ago. The growth in the stock of total public debt between June 2018 and January 2019 was mainly due to a 12.3 percent increase in the public domestic debt. However, the public external debt maintained a dominant share of 64.8 percent of the total public debt.

All the public domestic debt risk indicators were within the Public Debt Management Framework (PDMF 2013) medium term benchmarks as at end January 2019, with the exception of the ratio of the stock of government securities to the stock of private sector credit which stood at 106.0 percent, above the benchmark of 75 percent, (**Table 4**). In addition, the risk indicators improved relative to June 2018, with the exception of the percent maturing in one year and the ratio of the stock of government securities to the stock of private sector credit.

Table 4: Public Debt Developments

	PDMF	Jan'18	Jun-18	Jan'19
Percent maturing in 1 year	<40%	32.4	36.8	38.8
Percent maturing in any year after year 1	< 20%	15.5%; 10.5%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years	14.1%; 10.0%, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years	14.2%; 6.9 %, for maturities in 2 and 3 years respectively, and remainder for maturities beyond 3-years
Tbonds/Tbills (at face value)	70/30	74/26	72/28	73/27
Average Time to Maturity (ATM) (years)	>3Yrs	3.9	3.8	3.9
Total Stock/PSC	<75%	98.0	99.5	106.0

Source: Bank of Uganda

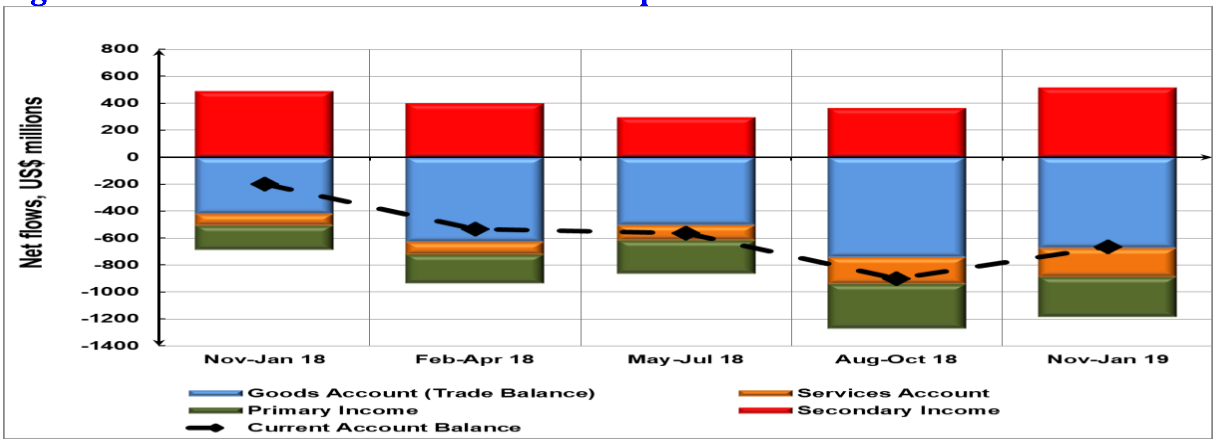
Going forward, there are inherent risks which may have implications for debt sustainability. These risks include the slow growth of exports, the increased rate of debt accumulation, particularly on non-concessional terms and significant risks related to non-debt variables, particularly interest rates and the exchange rate. Interventions to support growth in exports and borrowing on concessional terms could help mitigate these risks.

3.5 Balance of Payments and Exchange rates

The overall balance of payments (BOP) position deteriorated in the twelve months to January 2019. The weakness in the BOP position during this period could largely be attributed to a significant deterioration in the current account that in turn reflects a widened trade balance. However, this picture greatly improves when one looks at the more recent period. For instance, the BOP position strengthened in the quarter ended January 2019, recording a surplus of US$ 143.7 million, relative to a surplus of US$ 40.25 million and a deficit of US$ 46.3 million in the quarter ended December 2018 and quarter ended October 2018, respectively. The improvement in the BOP position, during the recent period could largely be attributed to a strong rebound in the current account that is mainly reflected in the narrowing trade balance.

Similarly, the current account deficit widened, increasing by US$ 1,440.5 million to US$2,667.5 million in the twelve months to January 2019. However, on quarterly basis, the current account deficit (**Figure 7**) improved in the quarter ended January 2019 to US$ 666.2 million, compared to US$ 733.6 million and US$ 901.7 million in the quarter ended December 2018 and quarter ended October 2018, respectively. The improvement in the current account in this quarter, largely reflect narrowing deficit in the services and secondary income. The current account deficit continues to be driven in part by the trade deficit. However, the trade deficit has recently improved due to a faster decline in imports relative to the deceleration in exports. Indeed, during the quarter ended January 2019, the trade deficit declined by 9.2 percent to US$ 669.6 million, compared to US$ 749.8 million and US$ 737.2 million in the quarter ended December 2018 and October 2018, respectively. The decline in export receipts during this period was largely attributed to a decline in export receipts of tobacco, sugar and base metals and maize. While the decline in the import bill was on account of a reduction in government and private sector imports, perhaps reflecting a subdued activity in this period.

Figure 7: Current Account Balance and Components



Source: Bank of Uganda

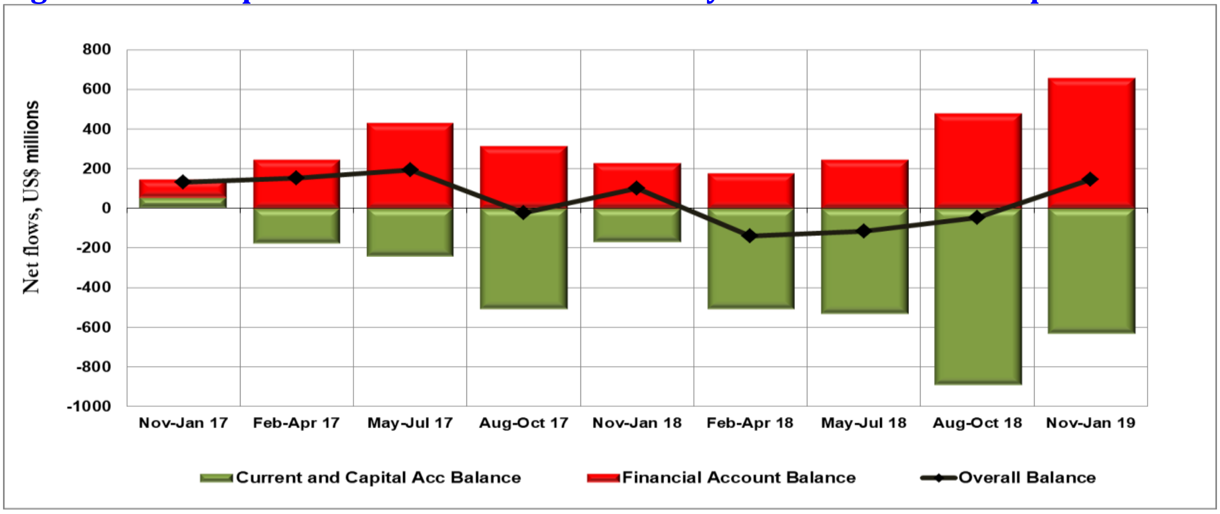
The capital account balance increased by US$21.4 million in the quarter ended January 2019 to US$31.1 million. The developments in the current and capital account yielded a net borrowing balance of US$635.1 million, a decrease of US$256.8 million relative to the quarter ended October 2018. On an annual basis however, the capital and current accounts significantly widened, increasing by US$1,470.8 million to US$2573.5 million on an account of deterioration in all sub accounts with the exception of the secondary income account.

During the twelve months to January 2019, the surplus in the financial account increased by US$339.3 million to US$ 1,564.5 million on account of decreased outflows through the portfolio investment and increased direct investment flows. Similarly, on quarterly basis, the net capital inflows through the financial account increased by US$179.6 million in the quarter ended January 2019 and as a result caused capital inflows of US$660.3 million. These developments were largely supported by a rise in other investment and direct investment that increased by US$118.8 and US$103 million respectively over this period. In contrast, portfolio investment transactions contributed to an outflow of US$31 million, compared to a net inflow of US$12.6 million recorded in the quarter to October 2018. This was largely attributed to marked increase inholdings of debt securities assets abroad by Ugandan residents and the exit of offshore investors from the government debt securities market. Perhaps an indication of relatively unfavourable investment returns in the country.

On a quarterly basis, the financial account surplus was sufficient to finance the deficit on the current and capital accounts leading to a build-up in reserve assets by US$ 143.7 million during the quarter ended January 2019 as depicted in **Figure 8**. However, while considering the longer period, the financial account surplus was insufficient enough to finance the high current and capital account deficit recorded in the year and as a result there was a drawdown in reserve assets to a tune of US$158.4 million in the twelve months to January 2019. The stock of reserves as at the end January 2019 increased by 2.6 percent to US$3,407.7 million, equivalent to 4.7 months of future imports of goods and services, compared to reserves of US$3,322.3 million, equivalent of 4.4 months of import cover as at end October 2018.

Going forward, the current account is expected to remain weak over the medium term supported by an increase in the import bill on account of infrastructure development spending due to the growth in the in the oil sector.

Figure 8: Developments in Overall Balance of Payments and Main Components



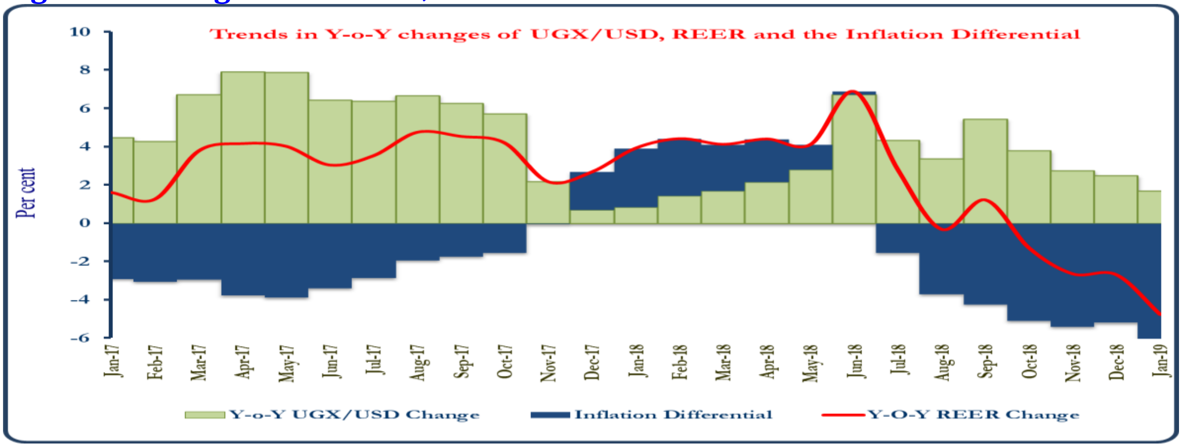
Source: Bank of Uganda

3.5.1 Exchange Rate Developments

In the three months to February 2019, the shilling was relatively strong, appreciating by about 2 percent in the quarter to Shs.3,696.48/US$. The appreciation pressure during this period is largely attributed to increased dollar inflows reflecting seasonal factors coupled with a low demand for foreign currency for imports on account of low activity.

In line with the developments in the nominal exchange rate, the trade weighted nominal effective exchange rate (NEER) appreciated by 2 percent in the quarter to January 2019. A similar trend observed in the real effective exchange Rate (REER) which appreciated by 3 percent in the quarter and 4.8 percent in the year to January 2019. These developments in the exchange rate are depicted in **Figure 9**.

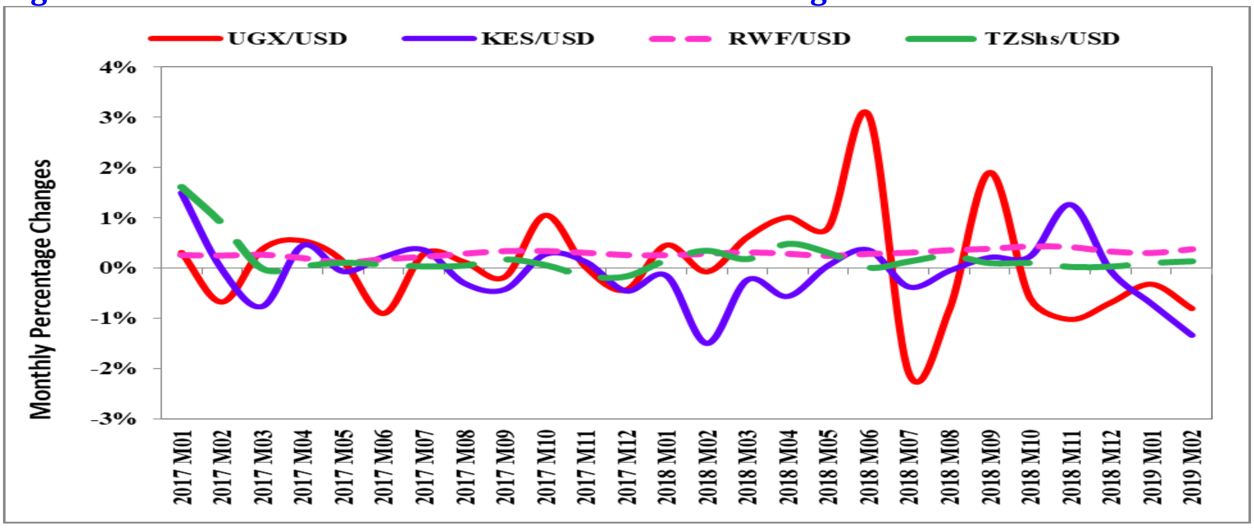
Figure 9: Changes in the NER, Inflation Differential and REER



Source: Bank of Uganda

The developments in the exchange rate during the last three months were not restricted to only the Uganda Shilling, as the Kenya Shilling appreciated against the US dollar during this period albeit at a slower pace (**Figure 10).** Notably, the Kenya Shilling appreciated by 0.05 percent in the quarter ended February 2019 from the previous quarter ended November 2018. However, both the Rwanda Franc and the Tanzanian Shilling depreciated against the US dollar by 1.1 percent and 0.2 percent, respectively during this period.

Figure 10: Trends of Selected EAC Partner State Exchange Rates



Source: Bank of Uganda

The favourable conditions in the interbank foreign exchange market (IFEM) enabled the BoU to build foreign exchange reserves. Indeed, in the three months to February 2019, the BoU purchased US$319.1 million for reserve build-up and sold US$34.2 million to UETCL in targeted sales, as a result the net foreign currency purchased in the IFEM for reserve build-up was US$285 million. To date, the BoU has purchased US$ 605 million on a net basis for the 2018/19 financial year, compared to the target of US$ 716 million, representing about 84 percent of the target.

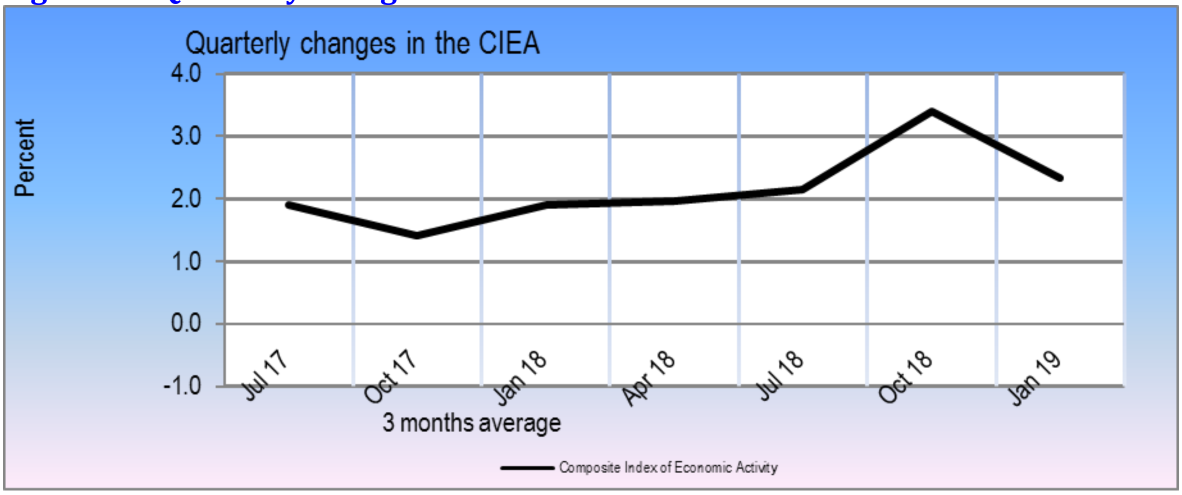
Going forward, in the near term, the exchange rate could come under heightened depreciation pressures on account of increased economic activity coupled with anticipated dividend payments by multinational corporations. Similarly, over the medium term, the exchange rate could depreciate on account of a high import bill due to anticipated developments in the oil sector.

3.6 Domestic Economic Activity

Economic growth is expected to pick up to about 6.3 percent in 2018/19 financial year, and to 6.5-7 percent in the medium term mostly supported by accommodative monetary policy stance, multiplier effects of public infrastructure development, improved agriculture performance and the pickup in private sector credit. The Bank of Uganda's Composite Index of Economic Activity (CIEA) continues to point to stronger performance in the economy, albeit at a reduced rate. Indeed, CIEA grew at around 2.3 percent in the three months to January 2019 compared to 3.4 percent in three months to October 2018 as depicted in **Figure 11**.

Growth was generated from all sectors albeit at a reduced rate. Agricultural production is estimated to have grown at a rate of 0.5 percent in the quarter to January 2019, having remained stable in the quarter to October 2018. This was largely on account of an increase in the production of maize, matooke, sweet and Irish potatoes. Over the same period, industrial activity grew at a slightly lower rate of 1.5 percent compared to 1.6 percent growth in the quarter to October 2018. The growth in the sector was supported by the growth in the manufacturing sub-sector. During the same period, the activities in the services sector increased at a lower rate of 1.3 percent compared to 2.6 percent in the quarter to October 2018. This was mainly attributed to the growth in the transport and communication and wholesale and retail trade sub-sectors.

Figure 11: Quarterly changes in CIEA



Source: Bank of Uganda

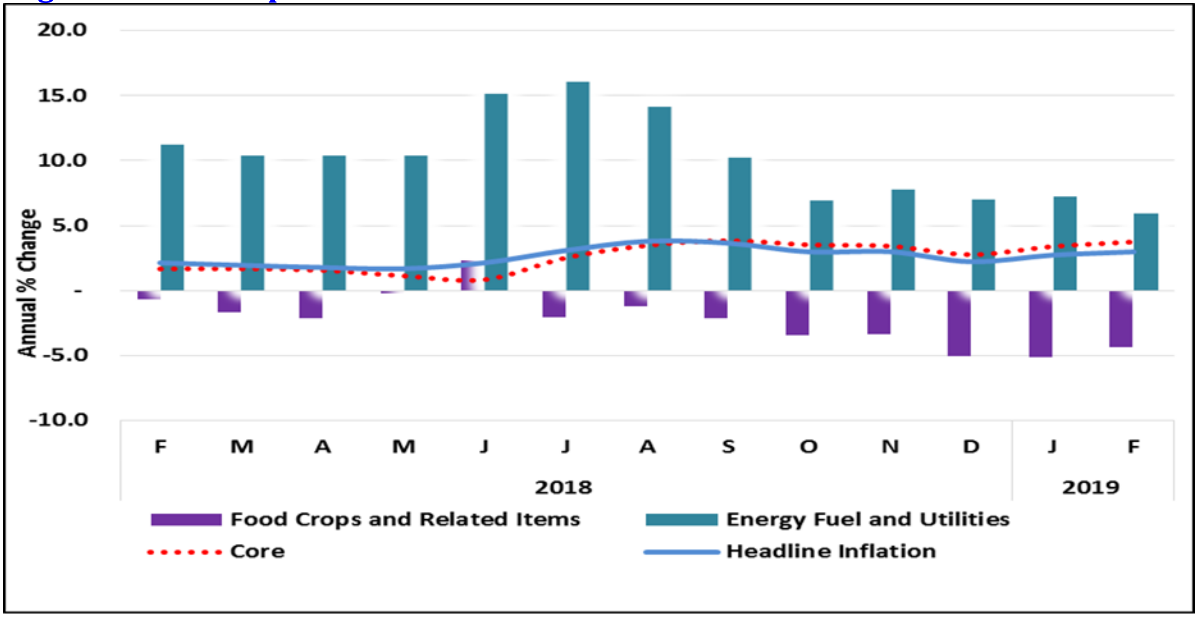
Although the economy is expected to continue strengthening in this financial year and in the medium-term, there are downward risks to these growth prospects. These include the weaker global growth prospects arising from escalating trade tensions, the slow execution of the public infrastructural projects, and the closure of the Rwanda-Uganda border which could have adverse effects on the exports and lead to a decline in growth.

3.7 Consumer Price Inflation

3.7.1 Recent Inflation Developments

Inflation continued rising in February 2019 with annual core inflation increasing to 3.7 percent from 3.4 percent in January 2019 while headline inflation rose to 3.0 percent from 2.7 percent over the same period. Headline inflation was mainly driven by a rise in communication prices which rose to 21.4 percent for the year to February 2019, up from 5.5 percent for the period to January 2019. Notably, food crops and related items inflation eased slightly to *minus* 4.4 percent from *minus* 5.2 percent on account of an increase in prices of fruits over the period. However, energy Fuel and Utilities inflation declined to 5.9 percent in February 2019 from 7.2 percent in the previous month on account of a fall in prices for liquid fuels which more than offset the increase in prices of solid fuels. Developments in domestic inflation are shown in **Figure 12**.

Figure 12: Developments in Domestic Inflation

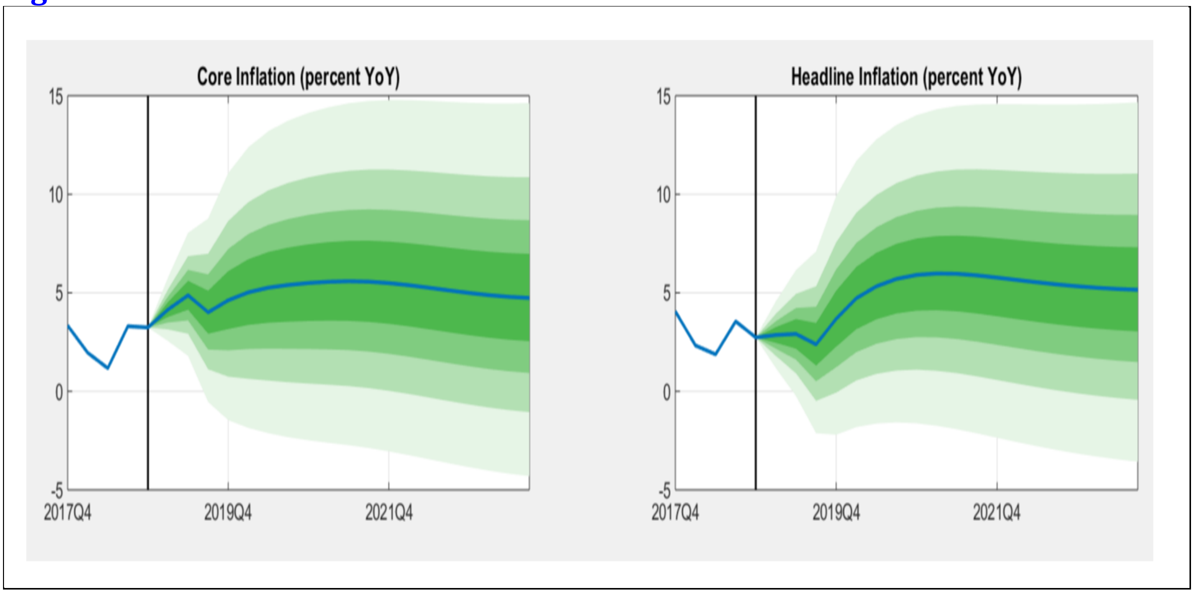


Source: Uganda Bureau of Statistics (UBOS)

3.7.2 Inflation Outlook

The inflation outlook remained relatively unchanged from the February 2019 forecast round. Headline and Core inflation are expected to gradually rise and converge to 5 percent in the medium term. The inflation outlook is depicted in **Figure 13**.

Figure 13: Inflation Outlook



Source: Bank of Uganda

The risks to the inflation forecast are relatively balanced. On the upside, there is a possibility of a more depreciated exchange rate given the volatile global market conditions resulting from heightened risk sentiment mainly arising from uncertainty surrounding trade policies and the Brexit negotiations. In addition, a higher fiscal deficit and domestic demand pressures as a result of a positive output gap could also put upward pressure on inflation. On the down side, the softening momentum in global growth may weaken oil demand further resulting in lower than anticipated increases in crude oil prices. In addition, if the tensions between Rwanda and Uganda escalate, it could lead to a decline in exports resulting in lower growth. Finally, lower global commodity prices could lead to lower domestic inflation.

In line with the objective of keeping inflation close to the target and the need to contribute to attaining sustainable economic growth, a neutral monetary policy stance was warranted. Therefore, during the April 2019 MPC meeting, the CBR was maintained at 10 percent.

4 Conclusion

Economic growth is expected to pick up to about 6.3 percent in 2018/19 financial year and to, 6.5-7 percent in the medium term. This is mainly supported by the accommodative monetary policy stance, multiplier effects of public infrastructure development, improved agriculture performance and the pickup in private sector credit. While, the Bank of Uganda's composite index of economic activity (CIEA) continues to point to stronger performance in the economy, it is at a reduced rate. The CIEA grew at around 2.3 percent in the three months to January 2019 compared to 3.4 percent in three months to October 2018. However, annually, the CIEA trend suggests annualised growth rate of 7-8 percent in 2018 implying that that growth in FY2018/19 could be higher than the projected of 6.3 percent. Although the economy is expected to continue strengthening in this financial year and in the medium-term, there are downward risks to these growth prospects. These include the weaker global growth prospects arising from escalating trade tensions, the slow execution of the public infrastructural projects, and the closure of the Rwanda-Uganda border which could have adverse effects on the exports and lead to a decline in growth.

Inflation continued rising in February 2019 with annual core inflation increasing to 3.7 percent from 3.4 percent in January 2019 while headline inflation rose to 3.0 percent from 2.7 percent respectively. The inflation outlook remained relatively unchanged from the February 2019 forecast round. Core inflation is projected to converge to the 5 percent target in the medium term. There are however risks to the inflation forecasts that are relatively well balanced. On the upside, there is a possibility of a more depreciated exchange rate given the volatile global market conditions resulting from heightened risk sentiment mainly arising from uncertainty surrounding trade policies and the Brexit negotiations. In addition, a higher fiscal deficit and domestic demand pressures as a result of a positive output gap could also put upward pressure on inflation. On the down side, the softening momentum in global growth may weaken oil demand further resulting in lower than anticipated increases in crude oil prices. In addition, if the tensions between Rwanda and Uganda escalate, it could lead to a decline in exports resulting in lower growth. Finally, lower global commodity prices could lead to lower domestic inflation.

The evolution of the BOU's monetary policy over the medium term will continue to be determined by the forecasts for inflation. Indeed, the BoU has upheld a neutral monetary policy stance since October 2018, supported by the forecasts that have consistently determined inflation to remain within the 5 percent target in the medium term. However, if inflationary pressures emerge which threaten the target for core inflation; the BoU will tighten monetary policy.