

Bank of Uganda



Monetary Policy Report

April 2020

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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
US\$	United States Dollar
WAI	Weighted Average Interest rate
WALR	Weighted Average Lending Rate
WEO	World Economic Outlook
Y-o-Y	Year-on-Year

Executive Summary

Bank of Uganda (BoU) reduced the Central Bank Rate (CBR) by 1 percentage point to 8 percent in April 2020. The band on the CBR was also maintained at +/-3 percentage points and the margin on the rediscount rate at 4 percentage points on the CBR, and therefore, the rediscount rate and the bank rate were 12 percent and 13 percent, respectively.

BoU also directed Supervised Financial Institutions (SFIs) to defer the payments of all discretionary distributions such as dividends and bonus payments for at least 90 days effective March 2020, depending on the evolution of the COVID-19 pandemic. This would ensure that SFIs have adequate capital buffers, while supporting the real economy.

BoU will also undertake the following: Provide exceptional liquidity assistance to commercial banks that are in liquidity distress for a period of up to one year; Provide liquidity to commercial banks for a longer period through issuance of reverse REPOs of up to 60 days at the CBR, with opportunity to roll over; Purchase Treasury Bonds held by Microfinance Deposit taking Institutions (MDIs) and Credit Institutions (CIs) in order to ease their liquidity distress whenever it arises. MDIs and CIs that do not hold Treasury bills or bonds in their asset holdings will be provided with liquidity secured by their holdings of unencumbered Fixed Deposits or Placements with other SFIs; Grant exceptional permission to SFIs to restructure loans of corporate and individual customers including extending the moratorium on loan repayment for borrowers that have been affected by the pandemic, on a case by case basis at the discretion of the SFIs for up to 12 months, effective April 1st, 2020.

After an environment of relatively eased liquidity conditions in line with the accommodative monetary policy stance, money market conditions tightened in March 2020. This was largely on account of the intervention sales in the Interbank Foreign Exchange Market (IFEM) aimed at stemming exchange rate volatility caused by turbulent global financial markets as a result of the COVID-19 pandemic and the mid-month tax remittances. The weighted average 7-day interbank money market rate averaged 9.6 percent in the quarter ended March 2020, compared to 9.2 percent recorded in the quarter ended December 2019.

Commercial bank lending interest rates remained relatively stable in the quarter ending February 2020, reflecting the eased monetary policy stance. The average commercial bank shilling lending interest rate declined to 19.28 percent in the quarter to February 2020, from 19.32 percent in the previous quarter.

Private sector credit (PSC) remained robust, slightly improving in the quarter to February 2020. The year-on-year growth in PSC averaged 12.2 percent in the three months to February 2020, up from 11.8 percent in the quarter to November 2019. The growth in PSC was mainly supported by shilling denominated loans which grew by 16.6 percent year-on-year, while foreign currency denominated loans grew by 3.8 percent over the same period.

The COVID-19 pandemic is however likely to reduce the demand for credit on account of slackening economic activity, at least in the short-term. The sectors that are likely to be most affected include trade, tourism, transportation and construction. PSC extensions to these sectors constitute 45 percent of the total PSC. Assuming that NPLs in these sectors increase by 50 percent due to fallout from the COVID-19 pandemic, the ratio of NPLs would worsen from 4.7 percent in December 2019 to 5.9 percent in the first quarter of 2020.

The COVID-19 pandemic is also likely to worsen Uganda's external position, through its adverse effects on the flow of international trade, tourism, workers' remittances, foreign direct investment (FDI) and loan disbursements. The Uganda external position remains weak, characterised by, a relatively large current account deficit. In the 12 months to February 2020, the current account deficit stood at US\$ 2,384.5 million, albeit it slightly improved by US\$90.7 million, relative to the year to February 2019. The stock of reserves as at the end of February 2020, was estimated at US\$3,305.4 million (including valuation changes), equivalent to 4.3 months of future imports of goods and services. The Foreign exchange reserves are however projected to decline to about 3.5 months of import cover by end of FY 2019/20 mainly on account of the coronavirus.

Fiscal operations in the eight months of FY 2019/20 were constrained by lower than programmed government revenue and underperformance in development expenditure. Government revenue (including grants) amounted to Shs. 12,675.6 billion, which was lower than programmed levels by Shs. 1,976.5 billion. The lower than target revenue was underpinned by the underperformance of both domestic revenue and grants.

Economic activity slackened in 2019. Indeed, the Uganda Bureau of Statistics (UBOS) estimates economic growth at 3.6 percent in Q4 2019 from 7.5 percent in Q4 2018 and a total growth rate of 3.3 percent in the first half of 2019. In the near term, activity in the Ugandan economy is likely to decline considerably. Indeed, the BoU has revised its growth rate projection for FY2019/20 to 3-4 percent. Manufacturing, construction and the services sectors are the most affected. The services sector is projected to slow down significantly, with considerable effects on trade, hotels and accommodation, repairs, transportation, storage, financial and insurance activities mainly caused by a decline in tourism, travel restrictions and supply chain disruptions.

Inflation remained relatively subdued in March 2020. Annual headline inflation declined to 3.0 percent in March 2020 from 3.4 percent in February 2020. Similarly, annual core inflation averaged at 2.5 percent from 3.1 percent over the same period. Inflation is projected in the range of 2-4 percent in 2020 and is expected to converge to the target of 5 percent in the medium-term.

1. Global Economic Environment

1.1 Global Economic Activity

Global economic growth has slackened in 2020. Indeed, the Economist Intelligent Unit (EIU) projects global growth at 1 percent this year, with global growth for 2021 projected to recover moderately to 2.7 percent (**Table 1**). Similarly, the Purchasing Managers' Indices (PMI) for many countries in Asia, Europe and North America also points to a big fall in manufacturing and services activity. An exception to this has been China where three of the four measures moved above the 50-mark benchmark suggesting the economy has started to grow after the lockdown on COVID-19 was lifted. The COVID-19 pandemic has not only clouded the near-term outlook but has also brought extraordinary and intense uncertainty into the global economy.

The COVID-19 pandemic has already caused several deaths and has had adverse effects on the global economy. In China and the rest of the World, containment efforts have involved quarantines and widespread restrictions on labour mobility and travel, resulting in cut back in consumption, sharp cutbacks in many service sector activities increased risk aversion and elevated capital outflows especially from Emerging Markets and Developing Economies (EMDEs). These measures imply a sizeable output contraction whilst the effects of the outbreak persist. Subsequent outbreaks in other countries, including Korea and Italy, have also prompted containment measures such as quarantines and border closures. It is too early to tell how persistent the effects of the coronavirus will be and at what point the global economy will return to an improving path.

Table 1: Global Economic growth forecasts in selected Countries

	Jan-2020 Forecasts			Mar-2020 Forecasts		Difference	
	2019	2020	2021	2020	2021	2020	2021
World Output	2.8	3.1	3.4	1.0	2.7	(2.1)	(0.7)
OECD Economies	1.7			0.5	1.8	0.5	1.8
United States	2.3	1.7	1.8	1.0	1.9	(0.7)	0.1
Euro Area	1.2	1.3	1.6	-0.1	1.5	(1.4)	(0.1)
Japan	0.8			-0.2	0.8		
Non-OECD	3.8			2.4	4.5		
China	6.1	5.9	5.7	2.1	5.8	(3.8)	0.1
SSA	2.1	2.4	3.3	1.6	3.1	(0.8)	(0.2)

Source: Economist Intelligent Unit (EIU)

The adverse consequences of the COVID-19 pandemic on global economic activity are significant, including the direct disruption to global supply chains, weaker final demand for imported goods and services, and the wider regional declines in international tourism and business travel. The projections are based on the assumption that the pandemic peaks in the first half of 2020, with a gradual recovery through the second half of the year aided by significant governments' policy interventions. However, downside risks to the baseline scenario still exist with an emergency of second or third waves of infection which would further dent growth.

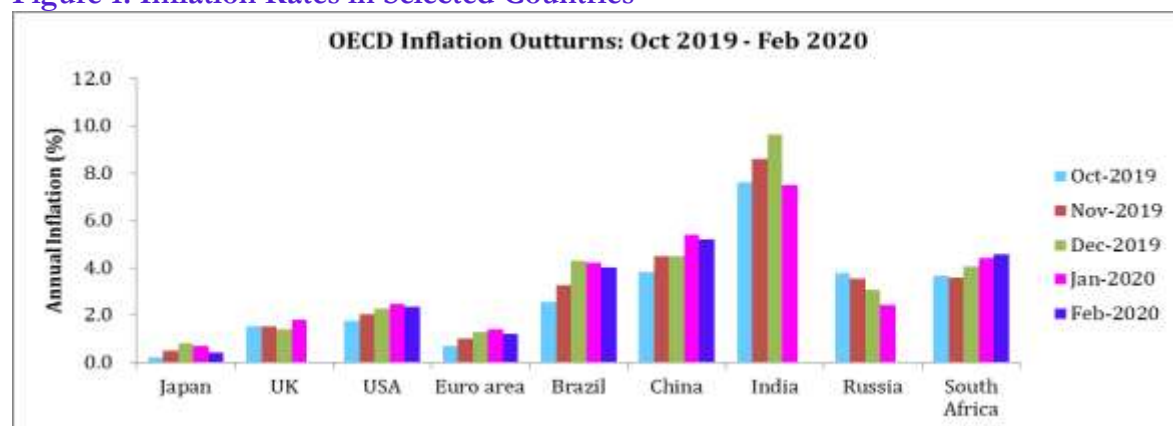
Together with the recent marked deterioration in global financial conditions and heightened uncertainty, this will depress global GDP growth in the early part of the year, possibly even pushing it below zero in the first quarter of 2020. In addition, job growth is likely to decline globally and workers who are required to self-quarantine may lose earnings in the near term. Tourism abroad has also dropped with the airline industry most affected.

1.2 Global Inflation and International Commodity Prices

1.2.1 Global Inflation

Global inflation remained relatively subdued in February 2020. Inflation declined to 2.3 percent, 1.7 percent, 0.4 percent and 1.2 percent in the US, UK, Japan and the Euro Area, respectively from 2.5 percent, 1.8 percent, 0.7 percent and 1.4 percent in January 2020. In the Emerging Economies, inflation declined to 6.8 percent, 2.3 percent, 4.0 percent and 5.2 percent in India, Russia, Brazil and China respectively from 7.5 percent, 2.4 percent, 4.2 percent and 5.4 percent in the same period. However, SA recorded an increase in inflation. Going forward, the current shutdown and restricted travel in some countries around the world on account of COVID-19 may cause supply shortages. Furthermore, there is evidence that consumers are currently stocking supplies, as shelves in major shopping chains remain empty. These shortages may lead to price hikes. The impact of these supply shortages on global inflation will depend on the extent of persistence of the pandemic. Inflation developments in selected countries are shown in **Figure 1**.

Figure 1: Inflation Rates in Selected Countries



Source: OECD Statistics

1.2.2 International Commodity Prices

Global crude oil prices which have been declining since the beginning of 2020 plummeted in March 2020 with the Brent crude oil prices declining to as low as US\$ 33 per barrel from about US\$56 per barrel in February 2020. While the fall in crude oil prices could in part be attributed to the disagreement between Russia and Saudi Arabia, demand side constraints on account of COVID-19 could have exacerbated the downward spiral. With China at a virtual standstill, the demand for oil was severely diminished yet Organization for Petroleum Exporting Countries (OPEC) stood pat. It wasn't until the first week of March that OPEC announced a cut in

production of 600,000 barrels per day. This nonetheless fell short of market expectations in both timing and volume. Expectation was for OPEC to be pre-emptive and announce one million barrels per day cut in production. Oil markets have since been in decline and it's likely that we will continue to see this move lower until further actions are executed. Furthermore, COVID-19 has also affected the demand for travel and car manufacturing resulting in lower demand for oil as economic activity in most affected countries slackens. Developments in crude oil prices are presented in **Figure 2**.

Figure 2: Crude Oil Price Developments



Source: Reuters

Global food prices on the other hand remained relatively stable. After remaining relatively stable in January, the FAO food price index declined by 4.3 percent month-on-month in February 2020 mainly on account of the COVID-19 demand contractions that have led to a decline in export prices of vegetable oils, meat and grains. On the other hand, the current shutdown on account of COVID-19 has affected the supply of some food items. The impact of these supply shortages on global food prices will depend on the extent of persistence of the pandemic.

1.3 Global Financial Markets

In March 2020, financial market sentiments declined sharply driven by concerns about the economic impact of the ensuing pandemic as the disease spread to the rest of the world and dented investor confidence, shaking financial markets. Risk aversion increased in financial markets, with the US 10-year interest rate falling to a record low and equity prices declining sharply, diminishing business and consumer confidence. Major stock market indexes fell, registering the largest declines since the 2008 global financial crisis; credit spreads widened and longer time yields in declined drastically in all major economies, raising fears of a possible global recession.

In response to the uncertainty and volatility created by the COVID-19 pandemic and in order to resuscitate the global economy, most Central Banks and governments such as the USA, UK, Japan, China and European Union (EU) announced a number of stimulus packages and credit extension packages. Specifically, the US Fed cut its policy rate by 50 basis points to a range of 1 - 1.25 percent in an unscheduled meeting on March 03, 2020. Furthermore, in just two weeks, the

Federal Reserve Board FOMC lowered the target range for the federal funds rate by 100 basis points to 0 - 0.25 percent on March 15, 2020. In addition, it would buy at least US\$700 billion in government and mortgage-related bonds as part of a wide-ranging emergency action to protect the economy from the impact of the COVID-19 outbreak.

These measures set by the Advanced Economies were aimed at stabilizing their domestic financial market with ripple effects in the global market in the short term. However, in the long term, intermittent episodes of financial market volatility remain likely due to the risk factors facing global growth. The global financial market volatility is likely to pass through to domestic foreign exchange markets through continued portfolio investment outflows, thereby elevating exchange rate depreciations which are expected to increase Uganda's debt burden. The business and labour disruptions in foreign countries and in particular, donor countries will likely reduce foreign direct investment inflows adding to the exchange rate depreciation pressures.

2. Domestic Economic Developments

2.1 Interest rates, private sector credit and asset quality

After an environment of relatively eased liquidity conditions in line with the accommodative monetary policy stance, money market conditions tightened in March 2020. This was largely on account of the intervention sales in the Interbank Foreign Exchange Market (IFEM) aimed at stemming exchange rate volatility caused by turbulent global financial markets as a result of the COVID-19 pandemic and the mid-month tax remittances. The weighted average 7-day interbank money market rate averaged 9.6 percent in the quarter ended March 2020, compared to 9.2 percent recorded in the quarter ended December 2019. There was excess volatility in the interbank money market in the month of March 2020, with the 7-day and overnight rates trending outside the CBR band as depicted below in **Figure 3**.

Figure 3: 7-day Interbank Rate and the Central Bank Rate (CBR)



Source: Bank of Uganda

Treasury bill yields in the primary market edged up slightly, in the quarter to March 2020. The 91-day, 182-day and 364-day Treasury bill rates rose to 9.6 percent, 11.1 percent and 13.2 percent, respectively in the three months to March 2020 from 8.8 percent, 10.8 percent and 11.7

percent in the quarter to December 2019. Similarly, yields on Treasury bonds also increased with the 2-year, 3-year, 5-year and 10-year papers rising to 14.0 percent, 15.6 percent, 16.5 percent and 15.7 percent, respectively in the quarter to March 2020 from respective rates of 13.4 percent, 14.9 percent, 15.6 percent, and 14.9 percent in the quarter to December 2019. However, the 15-year Treasury bond declined in the quarter to March 2020 averaging 15.3 percent compared to 15.5 percent recorded in the quarter ending December 2019.

Yields in the secondary market also edged up in line with developments in the primary market. **Figure 4** shows the trend in the secondary market yields on government securities.

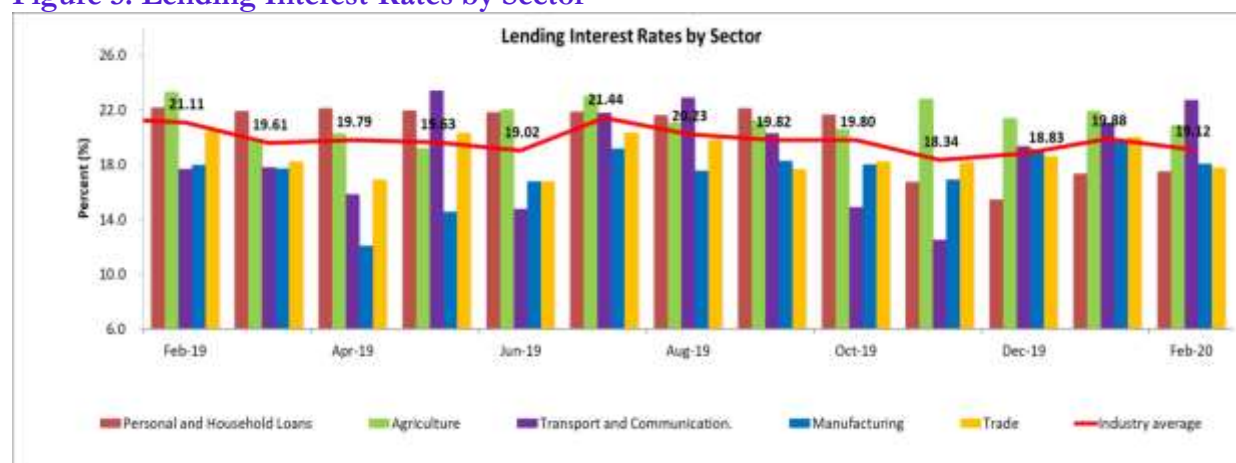
Figure 4: Secondary Market Yields on T-bills and T-bonds



Source: Bank of Uganda

Commercial bank lending interest rates remained relatively stable in the quarter ending February 2020, reflecting the eased monetary policy stance. The average commercial bank shilling lending interest rate declined to 19.28 percent in the quarter to February 2020, from 19.32 percent in the previous quarter. This decline was mainly on account of lower rates to the manufacturing, trade, mortgage, personal and household loans and agricultural sectors to average rates of 19.0 percent, 18.8 percent, 22.0 percent, 16.8 percent and 21.4 percent, respectively. Lending interest rates by sector are shown in **Figure 5**.

Figure 5: Lending Interest Rates by Sector

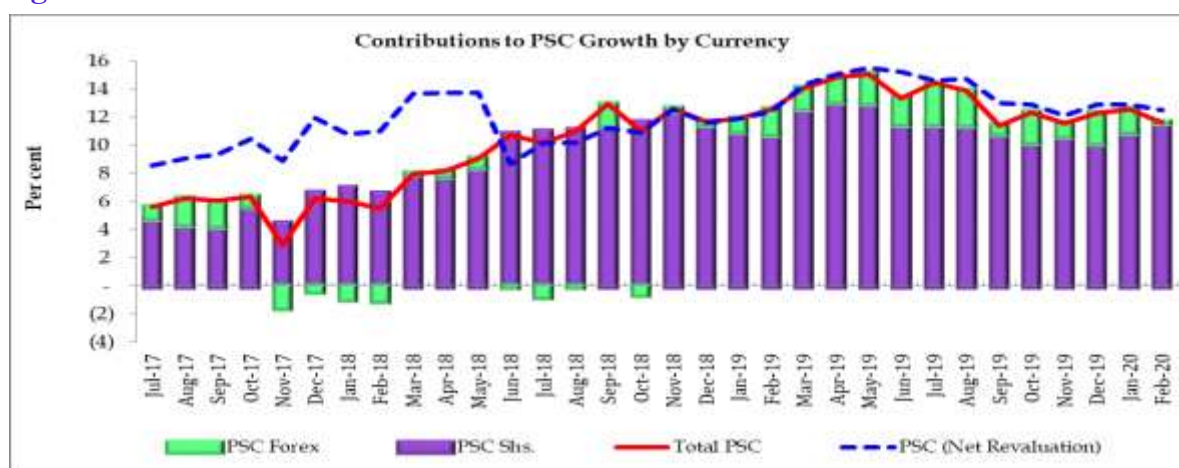


Source: Bank of Uganda

The average lending rates of US dollar denominated loans declined to 6.6 percent from 6.8 percent in the previous quarter. Rates on local currency time deposits remained stable at about 10 percent in the quarter to February 2020, relative to the previous quarter, while foreign currency denominated time deposits dropped to 2.5 percent from 2.97 percent over the same period.

Private sector credit (PSC) remained robust, slightly improving in the quarter to February 2020. The year-on-year growth in PSC averaged 12.2 percent in the three months to February 2020, up from 11.8 percent in the quarter to November 2019. The growth in PSC was mainly supported by shilling denominated loans which grew by 16.6 percent year-on-year, while foreign currency denominated loans grew by 3.8 percent over the same period. Net of exchange rate valuation changes, PSC grew by 12.8 percent year-on-year in the quarter to February 2020, relative to 12.7 percent growth recorded in the quarter to November 2019. **Figure 6** depicts the annual private sector credit growth.

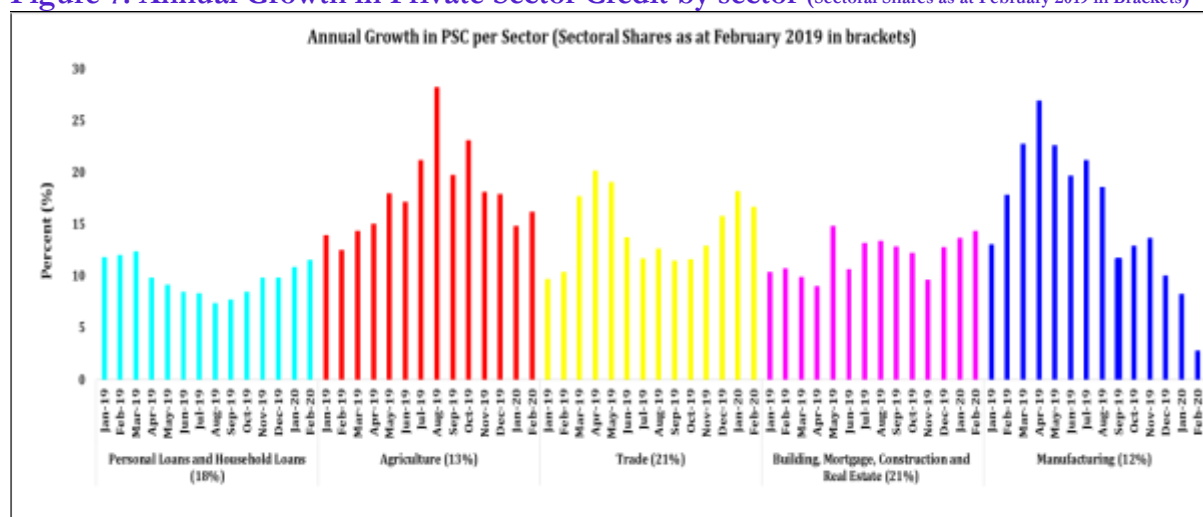
Figure 6: Annual Private Sector Credit Growth



Source: Bank of Uganda

A sectoral decomposition of credit as shown in **Figure 7** reveals faster growth in lending to trade, building, mortgage, construction and real estate and personal & household sectors during the quarter to February 2020 supported by higher household spending during the festive season. Average annual credit growth to the trade; building, mortgage, construction, real estate and personal & household loans rose from 12.0, 11.6 and 8.7 percent to 16.9 percent, 13.6 percent and 10.8 percent, respectively in the quarter to February 2020. Credit to the agricultural and manufacturing sectors also grew but at a declining rate in the three months to February 2020. The average annual credit growth to the manufacturing sector was 7.0 percent lower than 12.7 percent in the previous quarter while growth in the agriculture sector was 16.3 percent relative to 20.3 percent.

Figure 7: Annual Growth in Private Sector Credit by sector (Sectoral Shares as at February 2019 in Brackets)



Source: Bank of Uganda

The COVID-19 pandemic is however likely to reduce the demand for credit on account of slackening economic activity, at least in the short-term. Furthermore, given the exposure of Ugandan businesses to the banking system, slackening economic activity will have a toll on Non-performing loans (NPLs) as these businesses may be unable to service their debt obligations. The sectors that are likely to be most affected include trade, tourism, transportation and construction. Private sector credit extensions to these sectors constitute 45 percent of the total private sector credit. Assuming that NPLs in these sectors increase by 50 percent due to fallout from the COVID-19 pandemic, the ratio of NPLs would worsen from 4.7 percent in December 2019 to 5.9 percent in the first quarter of 2020 as shown in **Table 2**.

Table 2: Impact of coronavirus on non-performing loans

NPL RATIO (percent)	Sep 18	Dec 18	Mar 19	Jun 19	Sep 19	Dec 19	Mar- 2020 Proj.
Agriculture	9.83	7.89	9.69	9.14	8.36	7.78	7.78
Mining & Quarrying	4.73	0.41	0.32	0.77	0.34	0.28	0.28
Manufacturing	1.92	2.31	2.90	2.68	1.99	2.41	2.41
Trade & Commerce	6.26	4.03	3.61	3.19	4.96	7.48	11.23
Transport & Communication	4.33	2.63	1.51	3.39	3.77	2.90	4.35
Building, Construction & Real Estate	3.91	2.25	2.49	2.97	4.42	4.51	6.77
Electricity & Water	0.13	0.03	0.14	0.32	0.07	0.09	0.09
Business Services	3.68	2.70	3.05	2.82	2.69	2.70	2.70
Community, Social and Other Services	3.81	2.97	8.04	7.56	5.73	5.36	5.36
Personal and Household Loans	3.26	2.60	2.76	2.64	2.75	2.80	2.80
Other Activities	21.84	8.64	6.66	4.01	17.01	4.99	4.99
Overall NPL Ratio	4.71	3.41	3.82	3.79	4.35	4.71	5.94

Source: Bank of Uganda

2.2 Balance of Payments

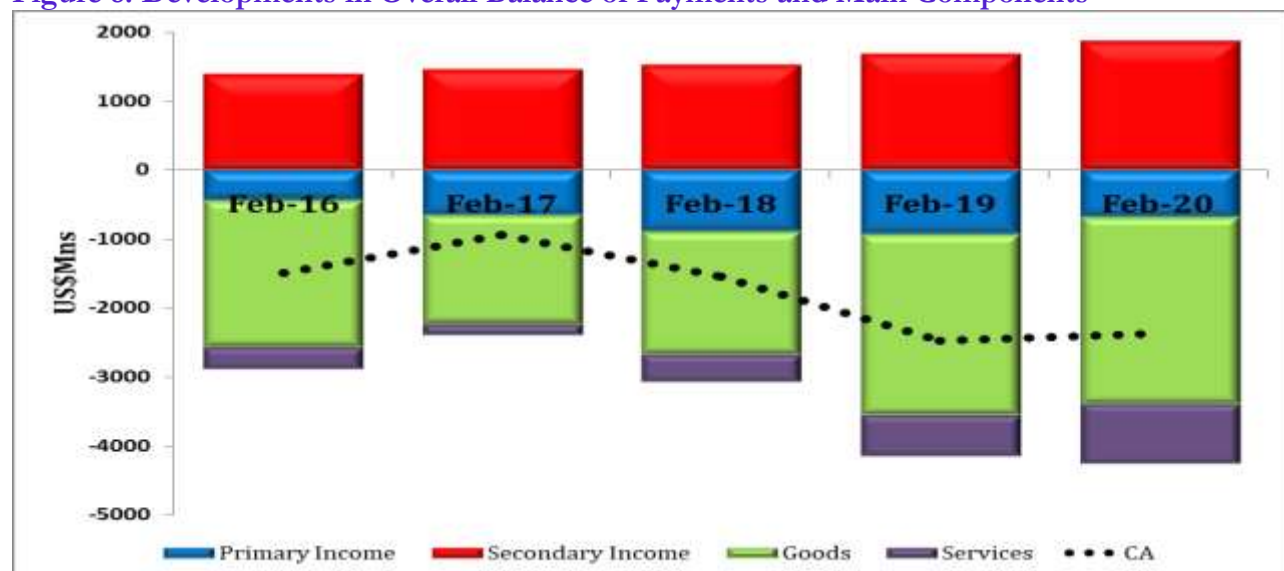
2.2.1 Balance of Payments Developments

The Uganda external position remains weak, characterised by, a relatively large current account deficit. In the 12 months to February 2020, the current account deficit stood at US\$ 2,384.5 million, albeit it slightly improved by US\$90.7 million, relative to the year to February 2019. This was largely driven by higher deficits in both the goods and services accounts. The trade deficit worsened mainly on account of a higher import bill than export receipts. Compared to a year ago, the import bill grew by 11.9 percent (or US\$739.4 million) to US\$ 6,944 million in the twelve months to February 2020, mainly driven by increased imports of general merchandise and non-monetary gold.

On the other hand, exports excluding gold slowed down during the same period, to US\$2,908.2 million from US\$2,998.8 million due to low international commodity prices and decline in exports to the regional markets. Notably, gold exports and imports grew to US\$1,324 million and US\$1,378.3 million, from US\$585.7 million and US\$551.9 million, respectively on account of expansion in gold trade supported by operation of an additional gold refinery and trading enterprises in the sector. The services account deficit worsened during the same period. In the 12 months to February 2020, the services account deficit declined to US\$ 863.4 million from US\$ 595.4 million in the year to February 2019. This was attributed to lower transport service inflows.

The primary and secondary income accounts improved during the same period. The primary income deficit decreased to US\$ 677.5 million from US\$ 937.2million. The secondary income surplus widened to US\$ 1,870 million from US\$ 1,677.6 million due to increased personal transfer inflows. **Figure 8** shows the developments in the balance of payments.

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



Source: Bank of Uganda

The financial account surplus decreased by 12 percent (US\$225.9 million) to US\$ 1,719.1 million in the twelve months to February 2020 compared to US\$1,945 million during the previous period. This was mainly on account of resident entities acquiring financial assets from abroad and a build-up in currencies and deposits assets abroad by commercial banks. The capital inflows were insufficient to cover the current account deficit resulting in a drawdown of US\$72.8 million in reserve assets. The stock of reserves as at the end of February 2020, was estimated at US\$3,305.4 million (including valuation changes), equivalent to 4.3 months of future imports of goods and services.

2.2.2 Balance of Payments Outlook

The COVID-19 pandemic is likely to worsen Uganda's external position, through its adverse effects on the flow of international trade, tourism, workers' remittances, foreign direct investment (FDI) and loan disbursements. Uganda currently sources about 40 percent of its import requirements from Asia, with China supplying about 15 percent of Uganda's total imports. A decline in imports could imply a shortage of supply of consumer goods and inputs, which could lead to an increase in prices; closure of small businesses that largely depend on Chinese imports; a decline in government revenue, which could hurt the already low government revenue; and an increase in the financing gap given that several public projects are funded by the Chinese government. In the remaining part of FY 2019/20, imports could decline by about 45 percent, although there are now indications that China is now slowing starting to reopen. This will have profound implications, not only for domestic consumers and government, but also for the manufacturing sector that heavily relies on imported inputs from China.

Exports are also likely to be affected as global economic growth slackens. Uganda's main export destinations are COMESA, with about 42 percent; Middle East, with about 31 percent; and the European Union (EU), with about 12 percent. Ugandan exports could decline drastically since the virus is spreading rapidly in Europe and the Middle East, and with most countries in Europe now instituting virtual lockdowns. In the COMESA, trade has also been restricted with the introduction of strict movement controls in most of our trading partners. Given these developments, exports could decline by about 65 percent in the remaining part of FY 2019/20. However, although the trade deficit may not be significantly affected since Uganda is a net-importer; the short-term impact of the supply chain disruption on the respective sectors may be profound.

The COVID pandemic on the travel and hotel industry, and consequently the tourism industry has been momentous. In line with what is happening elsewhere on the globe, several airlines have already cancelled flights to Entebbe. The lower demand for travel, coupled with government travel restrictions has virtually crippled the tourism sector. An example is the recently cancelled G77 conference, which Uganda was due to host. Given the restrictions in place in most countries, a 90 - 100 percent decline in tourism receipts in the remaining part of this financial year is not an overstatement. The decline in travel and tourism inflows will have adverse implications for the domestic tourism sector, resulting in lower inflows and a worsening current account balance.

Foreign direct investment (FDI) and workers remittances will also likely decline drastically, as the global economy continues to slowdown. BoU projects that given the current developments, FDI and workers' remittances may decline by as much as 80 percent in the remaining part of this financial year. Loan disbursements may also decline by as much as 50 percent in the remaining part of the year for several reasons. First, the shutdowns in development partners and the associated disruption in the supply of project inputs are likely to delay projects execution and the associated loan disbursement. Second, some of the Chinese nationals managing some of the projects had gone back to China for the new Luna year celebrations, and have been caught up by the travel restrictions.

The COVID-19 pandemic has also caused a lot of panic and uncertainty in global financial markets, with some markets experiencing unprecedented dramatic declines, resulting in a significant loss of wealth. In times of such turbulence and uncertainty, flight for safe havens may be unavoidable. Indeed, there are indications that offshore institutional investors have already started exiting the domestic securities market. For instance offshore holdings of Government securities declined by Shs 59 billion between February 2020 and 6th March 2020, while their holding of total deposits in domestic banking system declined by Shs 105.7 billion during the same period.

The overall external position will therefore likely to deteriorate, putting upward pressures on the exchange rate and economic activity. The precise degree to which the external position will worsen will depend on the persistence and severity of the pandemic. However, the assumption here is that the pandemic will be temporary and will fade out by the close of FY 2020/21. Its effects will nonetheless persist, at least in the short-term. **Table 3** summarises the impact of coronavirus pandemic on the Balance of Payments.

In FY 2020/21, we assume that activity will gradually recover in H2, but remain muted in H1. As shown in **Table 3**, all foreign exchange earnings are expected to remain drastically muted in FY 2020/21 relative to both the earlier projection for FY 2020/21 and the revised projection for FY 2019/20 after incorporating the effects of the COVID-19 pandemic. The current account may deteriorate further, leading to a weaker shilling given the restraint financial account inflows. Foreign exchange reserves are projected to decline from 4.2 future months of imports to about 3.5 months of import cover by end of FY 2019/20. To support stability of the exchange rate and to ensure that international reserve buffers remain strong, the Government of Uganda may require BoP support amounting to about US\$500 million. In the same vein, the current account balance in FY 2020/21 could worsen by about US\$ 1.6 billion to US\$4.1 billion. International reserves on the other hand would decline to 3.6 months of future imports of goods and services in FY2020/21 from the 4.6 projection that did not consider the COVID-19 pandemic. Consequently, the BoP support needed to support stability of the exchange rate and to ensure that international reserve buffers remain strong would amount to US\$800 million.

Table 3: Impact of Coronavirus on the External Position

US Dollars (millions) unless otherwise stated	FY 2017/18	FY 2018/19	Projection before the COVID-19 Pandemic			Projection after incorporating effects of the COVID-19 Pandemic				
			FY 2019/20 (a)	FY 2020/21 (b)	Percentage change [b from a]	FY 2019/20 (c)	FY 2020/21 (d)	Percentage change		
								[d from c]	[c from a]	[d from b]
Current Account	-1,771.59	-2,965.52	-2,850.8	-2,558.4	10	-3,213.9	-4,110.3	-28	12	-60
Exports	3,536.6	3,960.8	3,696.5	3,912.6	6	2,928.2	1,424.4	-51	-21	-64
Imports	5,619.2	6,827.9	6,396.3	6,425.2	0	5,332.9	3,609.2	-32	-17	-44
Tourism	1,006.3	1,114.3	1,208.9	1,294.4	7	748.7	369.8	-51	-38	-71
Remittances	1,252.4	1,369.0	1,153.5	1,193.9	4	955.6	238.8	-75	-17	-80
FDI	971.5	1,447.4	1,184.0	1,514.1	28	766.5	302.5	-61	-35	-80
Loan Disbursements	1,280.5	1,398.8	2,159.7	2,027.0	-6	1,288.8	1,013.5	-21.	-40	-50
Reserves (months of Imports)			4.2	4.6		3.5	3.6			

Source: Bank of Uganda

2.3 Exchange Rate Developments

The shilling remained relatively stable in January 2020; however depreciation pressures emerged in February and March 2020. The shilling depreciated by 1.8 percent year-on-year and 2.6 percent month-on-month to a mid-rate of Shs. 3,772.91/USD in March 2020. This depreciation was largely driven by the panic on account of the COVID-19 pandemic which led to exit of offshore investors, speculative tendencies and the usual demand for dividend payments from manufacturing and telecom sectors, which increased demand pressures in the domestic foreign exchange market.

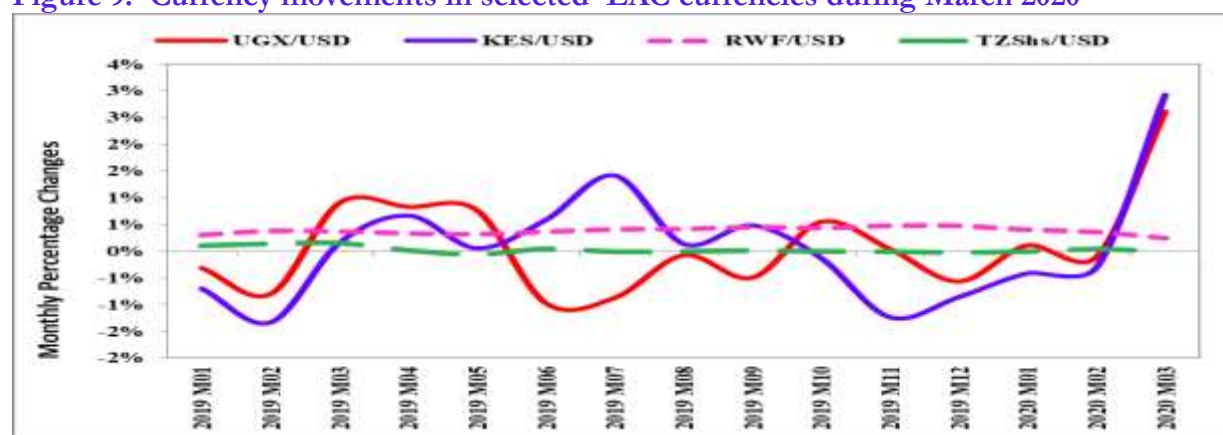
Indeed, to counter the sharp exchange rate depreciation resulting from volatility in the global financial markets and the rush to hold safe havens assets, BoU sold US\$ 198.9 million during this period. This intervention managed to calm down the markets however; reduced inflows largely caused by the COVID-19 pandemic may further aggravate depreciation pressures in the domestic foreign exchange market. The resultant negative sentiments from investors may translate into a continued preference for safe haven markets. Overall, BoU will intervene in the foreign exchange market to smoothen volatility while letting the shilling adjust to external pressures.

Conditions in the interbank foreign exchange market (IFEM) enabled the BoU purchase US\$ 2 million on a gross basis for reserve build-up in March 2020. This amounted to a net sale of US\$ 204.86 million taking into account the intervention Sales amounting to US\$ 198.9 million and targeted Sales to Uganda Electricity Transmission Company Limited (UETCL) of US\$ 7.96 million.

The regional currencies faced depreciation pressures in March 2020 with the exception of the Tanzanian Shilling. The Kenya Shilling and the Rwandan Franc depreciated month-on-month by

2.93 percent and 0.25 percent respectively. However, the Tanzanian Shilling remained relatively stable over the same period as depicted in **Figure 9**.

Figure 9: Currency movements in selected EAC currencies during March 2020



Source: Bank of Uganda and Partner Central Banks

2.4 Fiscal Policy and Developments

2.4.1 Government Expenditure and Revenue

Fiscal operations in the eight months of FY 2019/20 were constrained by lower than programmed government revenue and underperformance in development expenditure. Government revenue (including grants) amounted to Shs. 12,675.6 billion, which was lower than programmed levels by Shs. 1,976.5 billion. The lower than target revenue was underpinned by the underperformance of both domestic revenue and grants. Grant receipts amounted to Shs. 635.1 billion, which was Shs. 644.3 billion, lower than programmed, while domestic revenue amounted to Shs. 12,040.5 billion, which was Shs. 1,332.1 billion lower than programmed (**Table 4**). The shortfalls in domestic revenue were largely observed in indirect domestic taxes and tax on international trade by Shs. 543.5 billion and Shs.300.2 billion, respectively. The shortfalls in indirect domestic taxes could in part be a reflection of the lower than projected growth, while the shortfalls in international trade taxes were largely driven by lower than programmed imports and a relatively appreciated exchange rate.

With the dawn of the COVID-pandemic, there is no doubt that government revenues will underperform further in the remaining part of the financial year. The taxes which will mainly be affected are international trade taxes due to the fall in the value of imports, as well as consumption taxes, such as VAT and Excise duty due to the slowdown in projected growth of the industry and services sectors. At the aggregate level, Ministry of Finance Planning and Economic Development (MoFPED) projects an additional domestic revenue shortfall of about Shs.288 billion on account of the COVID-19 pandemic alone during the remaining part of FY 2019/20 and a shortfall of about Shs.200 billion in FY 2020/21.

Table 4: Fiscal Operations (Shs. Billion)

	July'18 - Feb'19	Prel. July'19- Feb'20	Prog. Jul'19 - Feb'20	Variati on
Revenue & Grants	11,627.9	12,675.6	14,652.1	-1,976.5
Revenue	10,854.7	12,040.5	13,372.7	-1,332.1
Grants	773.2	635.1	1,279.4	-644.3
Expenditure & Lending	15,714.3	18,756.8	23,063.8	-4,307.0
Current Expenditure	8,303.0	9,884.9	10,262.7	-377.8
Development Expenditure	6,195.7	8,509.6	11,649.8	-3,140.3
Net lending/repayments ¹	860.0	53.5	701.8	-648.4
Domestic arrears repayment	355.6	308.9	449.5	-140.6
Deficit (excluding grants)	-4,859.6	-6,716.3	-9,691.2	2,974.9
Deficit (including grants)	-4,086.4	-6,081.2	-8,411.7	2,330.5
Financing (net)	4,086.4	6,081.2	8,411.7	-2,330.5
External Financing (net)	2,071.6	1,607.7	4,636.0	-3,028.3
Domestic Financing (net)	1,349.5	3,520.1	3,775.7	-255.7
Errors & Omissions	665.3	953.5		

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

Government expenditure also underperformed during the first 8 months of FY 2019/20 mainly on account of a shortfall in development expenditure due to slow absorption by some government projects. Government expenditure amounting to Shs. 18,756.8 billion, which was Shs. 4,307.0 billion lower than the programmed levels. The developments in government revenue and expenditure resulted in a fiscal deficit of Shs.6,081.2 billion, which is lower than the programmed deficit by Shs.2,330.5 billion.

The COVID-19 pandemic is also likely to slow down the rate of execution of Government's development projects, especially in the transport and the energy sectors due to the impact on project financing as well as the likely impact of the travel restrictions and supply chain disruptions on required inputs that are largely imported. In addition, there is a risk to private sector financing for Public-Private Partnership (PPP) projects, which could delay completion of planned projects.

2.4.2 Public Debt

The provisional total public debt stock as at end February 2020 stood at Shs. 51,032.6 billion, corresponding to an increase of 8.0 percent compared to 5.4 percent in the previous year. This increment is attributed to 12.6 percent increase in the public domestic debt. While the rate of increase in public debt has of recent largely been driven by the increase in domestic public debt, public external debt still constitutes a dominant share, accounting for about 65 percent of the total public debt. Although most of the external debt is from multilateral creditors, there has been a significant increase semi-and non-concessional borrowing, in part reflecting increased borrowing from bilateral lenders, particularly China. Indeed, the share of multilateral debt declined from 90 percent of total external debt in FY 2010/11 to 56 percent in December 2019, while the share of non-concessional borrowing from China rose from 3.3 percent to 24.2 percent over the same period. This non-concessional borrowing, however, is more costly and carries more risks.

While Uganda remains at low risk of debt distress, significant vulnerabilities are evident. The rise in debt levels has been accompanied by a shift in the cost of the debt, which has become much more expensive. More expensive debt means that government has to spend more of its revenues repaying it. Estimates indicate that the amount the government is paying to service debts has almost doubled in recent years, taking up more than 20 percent of government revenue in 2019/20, compared to under 10 percent in 2013. This means less for other priorities like health, education, or infrastructure. It also leads to an increased probability that debt will increase, as borrowing may be needed to plug holes in expenditure caused by the diversion of revenues to repay debt.

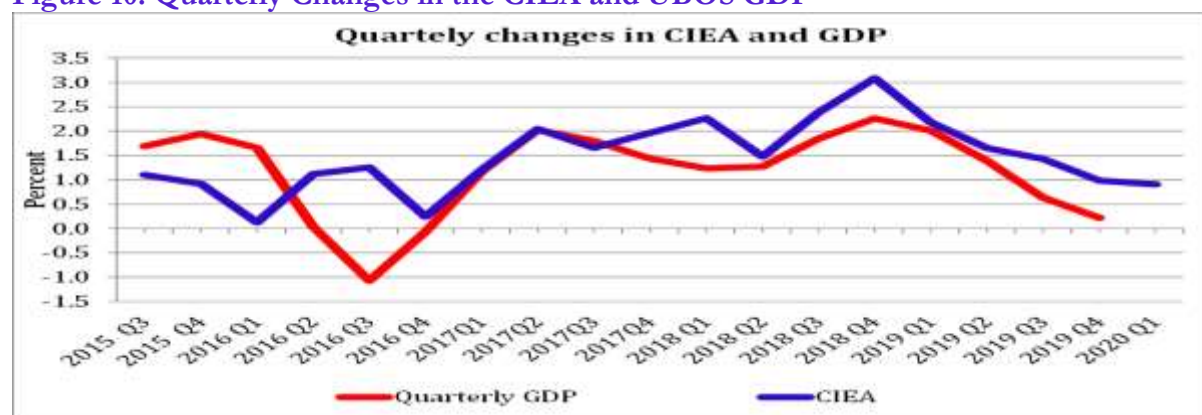
Moreover, although the multilateral creditors have put in place facilities to dampen the adverse effects of the COVID-19 pandemic, uncertainties relating to the ensuing expenditure pressures, subdued economic activity and declining tax revenues, and a possible further decline in grants could lead to further borrowing on non-concessional terms.

2.5 Domestic Economic Activity

2.5.1 Domestic Economic Developments

Economic activity slackened in 2019. Indeed, the Uganda Bureau of Statistics (UBOS) estimates economic growth at 3.6 percent in Q4 2019 from 7.5 percent in Q4 2018 and a total growth rate of 3.3 percent in the first half of 2019. Similarly, economic activity measured by Bank of Uganda's Composite Index of Economic Activity (CIEA) and the Purchaser Manager's Index (PMI) also estimates a slowdown in economic activity. The BoU's CIEA index estimates growth at 1.0 percent in the quarter to February 2020 compared to the 1.1 percent growth in the quarter to November 2019 (**Figure 10**). On an annual basis, the CIEA grew at 4.7 percent between July 2019 and February 2020. The PMI was reported at 45.3 a number below the 50.0 no-change mark and lower than the 56.2 posted in February 2020. This is the first decline in private sector business conditions since January 2017. Underlining this drop was a reduction in both output and new orders as the survey respondents report new orders suffered due to COVID-19 pandemic and a lack of customers all leading to a reduction in output.

Figure 10: Quarterly Changes in the CIEA and UBOS GDP



Source: Bank of Uganda and Uganda Bureau of Statistics

The COVID-19 pandemic has led to a severe contraction in economic activity due to a combination of global supply chain disruptions, travel restrictions, measures to limit contact between persons, and the sudden decline in demand. Consumer-facing sectors have been severely affected by social distancing measures and heightened uncertainty, while the manufacturing sector has declined on account of disruptions to the inflow of raw materials. Economic activity in the trade sector has also been weighed down by the decline in external demand and supply chain disruptions, while service sectors such as finance, insurance, and information and communications are affected by the general stall in business activity and investment.

2.5.2 Domestic Economic Outlook

In February 2020, BoU projected that GDP growth for FY 2019/20 would remain in the range of 5.5 – 6.0 percent, supported by the accommodative monetary policy stance, robust growth in private sector credit, fiscal stimulus and multiplier effects of public infrastructure investments and improved performance in all the sectors. However, given the social and economic integration of the Ugandan economy to the global economy, the brunt of the global recession on account of the COVID-19 pandemic will not spare the Ugandan economy.

In the near term, activity in the Ugandan economy is likely to decline considerably. Indeed, the BoU has revised its growth rate projection for FY2019/20 to 3-4 percent. Manufacturing, construction and the services sectors are the most affected due to the fact that a significant proportion of their inputs are imported. Indeed, many firms are already feeling the negative effects. The services sector is projected to slow down significantly, with considerable effects on trade, hotels and accommodation, repairs, transportation, storage, financial and insurance activities mainly caused by a decline in tourism, travel restrictions and supply chain disruptions.

The weakness in the agriculture sector is also likely to persist in the first quarter, especially in light of the locust invasion. Household spending is expected to grow at a slower pace amid moderate income growth. Private sector investment activity is projected to grow moderately but public infrastructure investment is to remain solid underpinned by on-going projects. Although GDP growth is projected to gradually recover in the second half of FY2020/21, the output gap is projected to persist until 2022. However, there is significant uncertainty over the depth and duration of the current slowdown. There are key downside risks, mainly stemming from the evolving nature and prolonged impact of the COVID-19 outbreak, and continued weakness in commodity-related sectors.

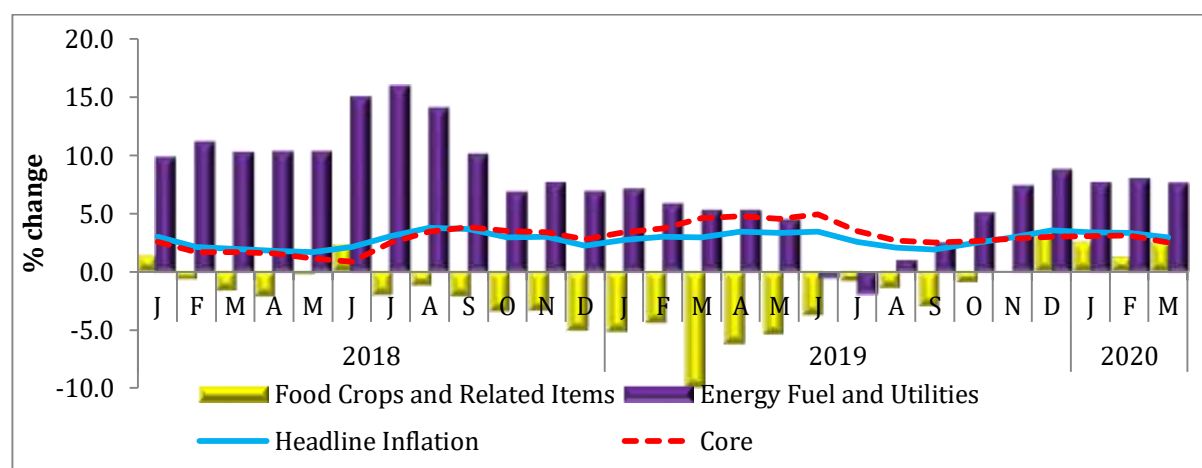
Given the evolving situation, it is difficult to predict how large and long-lasting the effect will be. Once the coronavirus is contained, the Ugandan economy is expected to return to an improving trend. This outlook is supported by high levels of spending on infrastructure and expected recoveries in construction and household consumption.

2.6 Domestic Consumer Price Inflation

2.6.1 Domestic Inflation Developments

Inflation remained relatively subdued in March 2020. Annual headline inflation declined to 3.0 percent in March 2020 from 3.4 percent in February 2020. Similarly, annual core inflation averaged at 2.5 percent from 3.1 percent over the same period on account of lower clothing and footwear as well as transport inflation. Annual energy, fuel and utilities (EFU) inflation declined to 7.7 percent in March 2020 from 8.0 in the February mainly due to a decline of charcoal and firewood prices. Food crops and related items inflation however increased slightly to 2.5 percent from 1.3 percent over the same period. This increase was largely driven by annual fruits inflation that increased to *minus* 3.7 from *minus* 12.4 in February 2020. As depicted in **Figure 11**, annual headline, core, as well as food crops and related items inflation has remained below 5 percent for longer than two years.

Figure 11: Domestic Inflation Developments

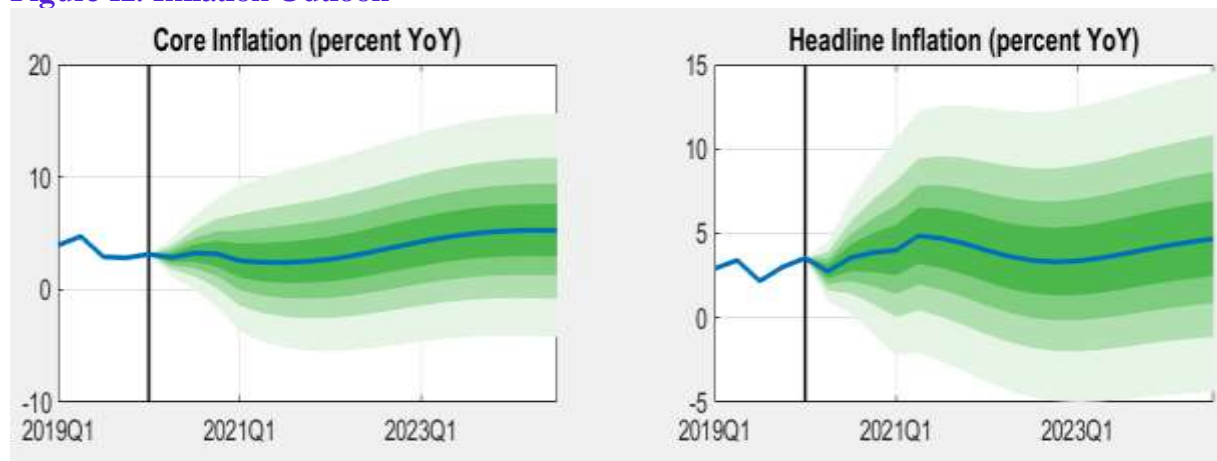


Source: Uganda Bureau of Statistics (UBOS)

2.6.2 Inflation Risks and Outlook

The inflation forecasts are relatively subdued compared to the February 2020 forecast round (**Figure 12**). Inflation is projected in the range of 2-4 percent in 2020 and is expected to converge to the target of 5 percent in the medium-term. Nonetheless, the forecasts are susceptible to a number of risks. On the downside, low world oil prices coupled with slower global demand would deflate domestic inflationary pressures. Demand constraints related to Covid-19 could overwhelm effects of supply disruptions on inflation in the near term. Additional tighter prolonged lock-down measures related to the Covid-19 pandemic could constrain demand further. However, on the upside, if the COVID-19 pandemic persists, inflation could increase higher than predicted. In addition, a worsening current account balance on account of the pandemic could put pressures on the exchange rate, thereby fuelling inflationary pressures. The rising fiscal deficit due to large spending pressures against domestic revenue shortfalls could also exert pressure on domestic inflation. Furthermore, unpredictable and adverse weather conditions coupled with the threat from the impact of the locust invasion on agricultural output could stoke food crop inflation.

Figure 12: Inflation Outlook



Source: Bank of Uganda

3. Conclusion and Policy decisions

In February 2020, BoU projected that GDP growth for FY 2019/20 would remain in the range of 5.5 – 6.0 percent supported by the accommodative monetary policy stance, robust growth in private sector credit, fiscal stimulus and multiplier effects of public infrastructure investments and improved performance in all the sectors. However, given the social and economic integration of the Ugandan economy to the global economy, the brunt of the global recession on account of the COVID-19 pandemic will not spare the Ugandan economy.

In the near term, activity in the Ugandan economy is likely to decline considerably. Indeed, the BoU has revised its growth rate projection for FY2019/20 to 3-4 percent. Manufacturing, construction and the services sectors are the most affected due to the fact that a significant proportion of their inputs are imported. Indeed, many firms are already feeling the negative effects. The services sector is projected to slow down significantly, with considerable effects on trade, hotels and accommodation, repairs, transportation, storage, financial and insurance activities mainly caused by a decline in tourism, travel restrictions and supply chain disruptions.

The Bank of Uganda has also revised its inflation forecasts downward in the near term. Inflation is projected in the range of 2-4 percent in 2020 and is expected to converge to the target of 5 percent in the medium-term. Nonetheless, the forecasts are susceptible to a number of risks including; low world oil prices, demand constraints related to Covid-19 , prolonged lock-down measures related to the Covid-19 pandemic that could constrain demand further, a worsening current account balance on account of the pandemic could put pressures on the exchange rate, the rising fiscal deficit and adverse weather conditions coupled with the threat from the impact of the locust invasion on agricultural output could stoke food crop inflation.

Given the deterioration in macroeconomic conditions and in order to ensure adequate access to credit and the normal functioning of financial markets, Bank of Uganda eased monetary policy. The BoU reduced the Central Bank Rate (CBR) by 1 percentage point to 8 percent. 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, and therefore, the rediscount rate and the bank rate were 12 percent and 13 percent, respectively.

BoU also directed Supervised Financial Institutions (SFIs) to defer the payments of all discretionary distributions such as dividends and bonus payments for at least 90 days effective March 2020, depending on the evolution of the pandemic. This would ensure that SFIs have adequate capital buffers, while supporting the real economy. In addition, BoU will undertake the following:

- i) Provide exceptional liquidity assistance to commercial banks that are in liquidity distress for a period of up to one year.
- ii) Provide liquidity to commercial banks for a longer period through issuance of reverse REPOs of up to 60 days at the CBR, with opportunity to roll over.
- iii) Purchase Treasury Bonds held by Microfinance Deposit taking Institutions (MDIs) and Credit Institutions (CIs) in order to ease their liquidity distress whenever it arises. MDIs and CIs that do not hold Treasury bills or bonds in their asset holdings will be provided with liquidity secured by their holdings of unencumbered Fixed Deposits or Placements with other SFIs
- iv) Grant exceptional permission to SFIs to restructure loans of corporate and individual customers including extending the moratorium on loan repayment for borrowers that have been affected by the pandemic, on a case by case basis at the discretion of the SFIs for up to 12 months, effective April 1st, 2020.

BoU will continue to monitor the evolving financial market and macroeconomic conditions and calibrate its operations to meet the need for any additional liquidity support, as may be warranted.