Bank of Uganda

Remarks by

Prof. Emmanuel Tumusiime-Mutebile
Governor, Bank of Uganda

Uganda Banker's Association

Informal Dinner

Piato Restaurant

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Good evening Ladies and Gentlemen,

Thank you all for coming here this evening for our informal UBA dinner.

I spoke last week at the Institute of Banking and Financial Services annual banking dinner about the current challenges facing the banking industry. Tonight I would like to make a few brief remarks about the current macroeconomic situation and prospects, notably as regards economic growth, the exchange rate and inflation.

Real economic growth, over the last five years, has averaged about five percent per annum. This is very likely close to the economy’s sustainable potential growth rate, given growth of the labour force, capital stock and productivity. In the last fiscal year, which ended in June 2016, real GDP growth was 4.8 percent, which is slightly below potential, but is far from being a recession as some people have claimed, although I appreciate that trading conditions have been difficult for many businesses.

There were factors which probably depressed economic growth in FY 2015/16, such as the increase in market interest rates, the exchange rate volatility in the first half of the fiscal year and the election in the third quarter. Without an election, and with probably lower interest rates and hopefully less volatile exchange rates (although that is hard to predict) I would expect that conditions in the current fiscal year will be more conducive to growth and so I would expect that we will experience a small rise in the real GDP growth, to five percent or even slightly higher.

Let me now turn to the exchange rate, which has depreciated in recent weeks, after a long period – nearly 11 months – of stability. Against the US dollar, the Shilling has depreciated by 4.7 percent since the end of October. However, more than half of that depreciation is attributable to the strengthening of the US dollar against major currencies since the Presidential election in the US, which has led to expectations of higher interest rates in that country.

My staff calculates an index of the Uganda Shilling against a weighted basket of Uganda's trading partners. This index – called the nominal effective exchange rate index – has depreciated by only 2.3 percent since the end of October. Furthermore, a nominal depreciation of the exchange rate has been necessary to ensure that Uganda remains competitive against its trading partners. Our exchange rate policy, which entails a flexible, market determined exchange rate, is motivated by the need to ensure that our balance of payments is sustainable. Our interventions in the foreign exchange market, such as that which we carried out last week, are intended only to dampen volatility in the exchange rate, and not to impede adjustments in the exchange rate which are necessary to maintain external balance.

Finally, I want to address the issue of inflation. The outturn for inflation in 2016 has been better than we had feared it would be at this time last year, when inflationary pressures were building up. Annual core inflation declined during the first half of 2016 and for the last four months it has settled down at an average of approximately 5 percent, which is in line with our policy target for inflation.

The better than expected inflation outturn in 2016 is attributable to a combination of the tightening of monetary policy by the BOU in mid 2015, when we raised interest rates, and the relatively stable exchange rate since October of last year. When we look at core inflation outturns over a longer horizon, we can see that they have been very close to our policy target. Over the last four years, annual inflation has sometimes been above 5 percent and sometimes been below, but it has averaged 4.9 percent. I hope that you will agree that this demonstrates the effectiveness of our inflation targeting monetary policy framework.

To conclude, ladies and gentlemen, I believe that the prospects for macroeconomic stability in the near to medium term are currently very good. In 2017 we can look forward to real GDP growth which is close to the economy's medium term potential growth of around 5 percent per annum. With inflationary pressures firmly under control we can also be confident that annual core inflation will continue to trend around our medium term target of 5 percent.

Thank you for listening.