WEDNESDAY, DECEMBER 28, 2016
Daily Monitor
WWW.MONITOR.CO.UG

2016: A year of declining CBR, uncertain oil prices

Aim. Bank of Uganda has been easing the monetary policy since April 2016 to lift aggregate demand.

BY MARTIN LUTHER OKETCH
moketch@ug.nationmedia.com

Mr Emmanuel Tumusiime-Mutebile, the Governor Bank of Uganda. FILE PHOTO

KAMPALA. The sustained easing of monetary policy by the Central Bank over the past five months has seen lending rates coming down by 2.4 percentage points in Uganda's credit market.

With the interest of revamping economic growth as well as lift the aggregate demand in the economy; Bank of Uganda (BoU) has been easing monetary policy since April 2016 by one percentage point.

From April to December 2016, the Central Bank Rate (CBR) has been reduced by 5 percentage point, starting from a peak of 17 per cent in March 2016 to 12 per cent in December 2016.

The declining interest rate trends signify that the cost of loans in the country is stably coming down thus saving the private sector from high credit costs, and reduce the levels of non-performing loans.

The executive director research at BoU, Mr Adam Mugume said on December 14 that lending rates declined from a weighted average peak of 25.2 per cent in February 2016 to 22.8 per cent in October 2016.

"Time deposit rates declined from 17.3 per cent in January 2016 to 11.5 per cent in October 2016," he said.

Due to tight monetary policy that was instituted by BoU at the beginning this financial year 2016/17 to guard against the expected run-away inflation due to general elections that took place in February 2016, and to stabilise foreign exchange market that had seen sharp depreciation of the Shilling against the US dollar.

As a result of tight monetary policy; private sector credit growth in Uganda has been generally below the policy target. Mr Mugume said growth in private sector credit remains subdued largely reflecting heightened risk aversion by commercial banks.

Mr Mugume explains that: "The ratio of lending to total assets of commercial banks has declined during this period."

General stability

The economy remains generally stable despite depreciation of the Shilling, and the BoU monetary policy report for December 2016 shows that proxies for demand and supply of credit indicate that demand is relatively robust, while supply is largely muted, in part explaining risk aversion by commercial banks.

"Number and value of loan applications (proxy for demand for credit) has been relatively robust. Number of applications approved (proxy for supply of credit) has been paltry," the report reveals.

The new development in Uganda's monetary and financial sector development also reveals that the NPLs, however, declined to 7.7 per cent in September 2016 from 8.3 per cent in June 2016.

In an interview with *Daily Monitor* on December 19, the executive director Private Sector Foundation Uganda, Mr Gideon Badagawa, said the private sector is hopeful that the easing of monetary policy over the last five months will lead to peak in private sector credit growth.

"We are happy with what the governor Bank of Uganda has been doing in the recent months because we have had a snag in private sector growth due to tight monetary policy," he said.

Inflation developments

BoU says headline inflation averaged 4.3 per cent in the quarter to November 2016 compared to 5.3 per cent in the quarter to August 2016, while core inflation averaged 4.8 per cent down from 5.9 per cent in the same period.

"Excess capacity in the global economy and low commodity prices have suppressed inflation globally and led to declines in the prices of the goods Uganda imports," BoU says.

In addition, the Uganda Shilling overvaluation in the first 10 months of 2016, contributed to dampening of inflation. Development in Uganda's inflation trend indicates that Energy Fuel Utility (EFU) inflation averaged minus 4.1 per cent in the quarter to November 2016 compared to minus 1.9 per cent in quarter to August 2016.

The monetary policy outlook by the BoU reveals that whereas the risks to the inflation forecast were previously assessed to be more or less balanced, the risks are more on the high side.

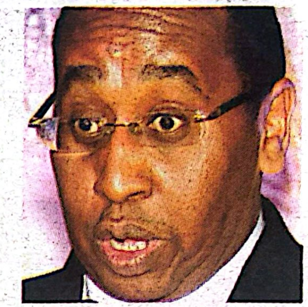
BoU explains that increased uncertainty followed the US presidential election; the Brexit; and the uncertainty surrounding the economic policies of the new US administration.

The Bank adds that oil prices have slightly edged up following agreement to limit production, with the World Bank raising its 2017 forecast for crude oil prices to $55 per barrel from $53 per barrel.

BoU further predicted: "The exchange rate is projected to weaken on account of domestic forex demand pressures and volatility in global financial markets leading to higher domestic oil pump prices."

In his monetary policy statement for December 2016, the Governor BoU, Mr Emmanuel Tumusiime-Mutebile, said: "In the short term, we forecast inflation to be slightly higher, mainly as a result of price shock and the increase in fuel prices. However, we expect that inflation will be around the target of 5 per cent in 12 months."

The IMF resident representative in Uganda, Ms Clara Mira, recently told *Daily Monitor*: "Exchange rate should adjust to absorb external pressures where feasible, coupled with tighter monetary policy stance, to contain inflation."



Mr Adam Mugume, the executive director research at Bank of Uganda.