FUNDAMENTALS

UGANDA MPC UPDATE: THE FIRST CUT IS THE DEEPEST

14 AUGUST 2023

Economist
Churchill Ogutu
+254 711 796 739
churchill.ogutu@ic.africa

IN BRIEF

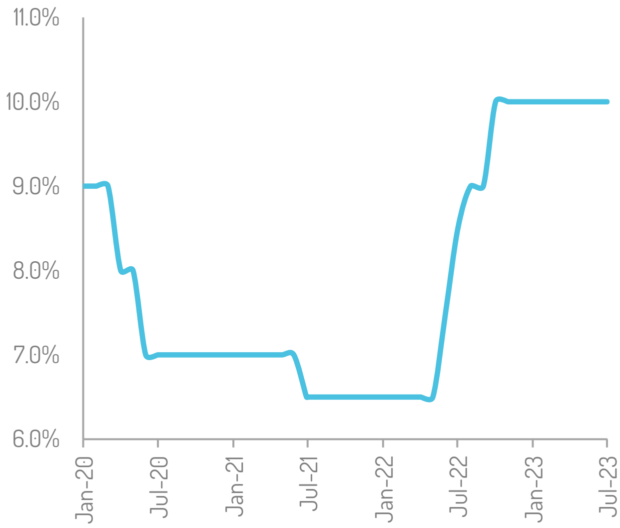
- We foresee the Bank of Uganda delivering the biggest rate cut (200bps) since October 2012, in its upcoming MPC meeting that is scheduled to be held tomorrow 15th August 2023. This rate cut should lower the Central Bank Rate to 8.0% from the current 10.0%. Furthermore, we expect an equal 200bps reduction on the Cash Reserve Requirement (CRR) to 8.0%, to support credit mediation.
- The policymakers have maintained a neutral stance in the previous three meetings this year, on the back of the cumulative 350bps rate hike delivered in 2022. Inflation outturn (July 2023: 3.9%) has surprised the monetary policymakers' expectation, falling below the end-3Q2023 forecast of 5.0% as per the June 2023 MPC meeting, strengthening our "cut" view.
- Notwithstanding the restrictive monetary and fiscal policy stance since FY23, both headline and core inflation outturn has surprised the policymakers' expectation (end 3Q2023: 5.0%). Against the IMF's estimated average neutral rate of 4.25%, we deem the current ex-post real policy rate of 6.1% as 'tight'. As such, a 200bps cut will be appropriate to bring monetary policy back to neutral levels with our expectation of lower inflation in the near term.
- With BoU broadly staying from USD sales, FX reserves jumped USD 504.94mn m/m to USD 4.1bn in June 2023, supporting the Uganda Shilling (UGX) to +1.3% YTD against the USD as of 9 August 2023. On the back of the World Bank statement halting new public financing following the enactment of the Anti-Homosexuality law, the UGX shed 1.9% on Thursday 10 August 2023, erasing the hitherto modest YTD gains but steadied in Friday's session.
- On a YTD basis, Ugandan rates have adjusted downwards by an average of 130bps across the curve. That gives some wiggle room for a further 70bps average decline to fully bake in the upcoming 200bps rate cut in our baseline. At these levels, we foresee limited upside in Ugandan rates in the near-term, but we will be assessing attractive entry points.

The first cut is the deepest

~ Cat Stevens, Songwriter (1965)

This report in no way intends to reignite the inconclusive debate of which artiste performed the best rendition of this song. (Though we rank Marcia Griffiths' rendition highly). We foresee the Bank of Uganda delivering the biggest rate cut (200bps) since October 2012, in its upcoming MPC meeting that is scheduled to be held tomorrow 15th August 2023. This rate cut should lower the Central Bank Rate to 8.0% from the current 10.0%. Furthermore, we expect an equal 200bps reduction on the Cash Reserve Requirement (CRR) to 8.0%, to support credit mediation. The policymakers have maintained a neutral stance in the previous three meetings this year, on the back of the cumulative 350bps rate hike delivered in 2022. Inflation outturn (July 2023: 3.9%) has surprised the monetary policymakers' expectation, falling below the end-3Q2023 forecast of 5.0% as per the June MPC meeting, strengthening our "cut" view. In our assessment, the recent World Bank statement halting public financing to Uganda will drag, not dent, FX reserves in the near-term.

POLICY RATE



SOURCE: BANK OF UGANDA

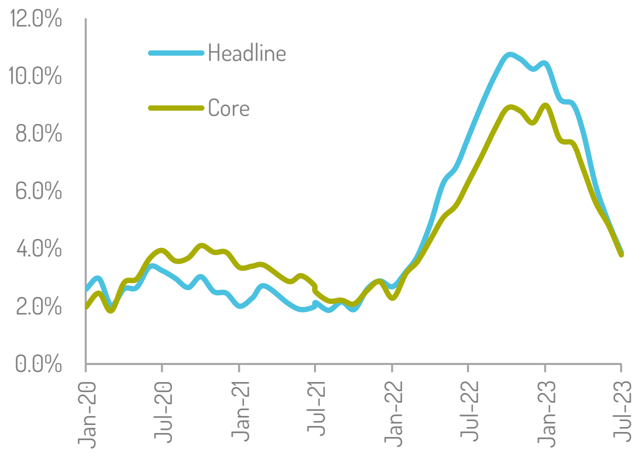
Positive inflation surprise anchors policy cut

And I'm sure gonna give you a try
And if you want, I'll try to love again

The moderation of core inflation (3.8% y/y) in July 2023 dragged the headline print to a 16-month low of 3.9% y/y. Deceleration in select processed food commodities dialed other goods inflation lower to 4.8% y/y (June 2023: 6.0%) whereas moderation in passenger transport dragged services inflation to 2.5% y/y from 3.3% y/y in June 2023. Combined, these two sub-indices led to the slowdown in core inflation to a 16-month low. An improved harvest stretched the monthly disinflation trend for food crops and related items to a third consecutive month. On a year-on-year basis, food crops inflation has been on a backpedal (July 2023: 9.3%) from a peak of 29.4% at the end of 2022.

We applaud the monetary authorities for their proactiveness at the start of the tightening cycle, delivering a cumulative 350bps hike last year. In addition, the fiscal authorities also mirrored monetary tightening measures by finetuning government spending over the previous FY23 budget to anchor the hawkish bias. These measures notwithstanding, both headline and core inflation outturn has surprised the policymakers' expectation (end 3Q2023: 5.0%). Against the IMF's estimated average neutral rate of 4.25%, we deem the current ex-post real policy rate of 6.1% as 'tight'. As such, a 200bps cut will be appropriate to bring monetary policy back to neutral levels with our expectation of lower inflation in the near term.

INFLATION OUTTURN



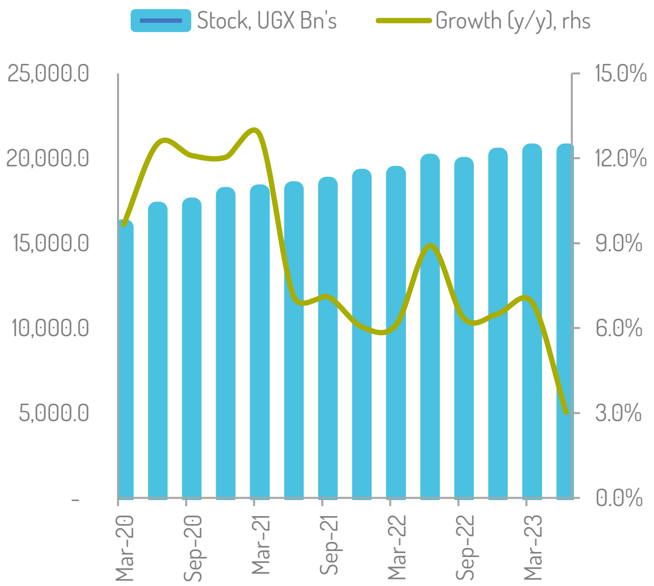
SOURCE: UGANDA BUREAU OF STATISTICS

Slash in CRR will boost credit mediation

I would have given you all of my heart
But there's someone who's torn it apart

A rate cut will rejig credit mediation to the private sector. Growth in private sector credit slowed to 3.0% in June 2023 from 9.7% in May 2022 ahead of the current tightening-and-pause cycle. With the average interbank rate steady at 10.26%, the tighter policy stance has disincentivized credit mediation. Contraction in the credit to agriculture, manufacturing and real estate sector scaled down the stock of private sector credit by UGX 123.2bn m/m to UGX 20.4tn, exposing the real sector fragility. Nevertheless, private sector sentiment as gauged by the Purchasing Managers Index remains in expansion territory, driven by robust output. We believe a rate cut will offer some tailwinds to the real sector. Furthermore, the reduction of CRR from 10.0% to 8.0% will also be supportive of private sector credit mediation.

PRIVATE SECTOR CREDIT



SOURCE: BANK OF UGANDA

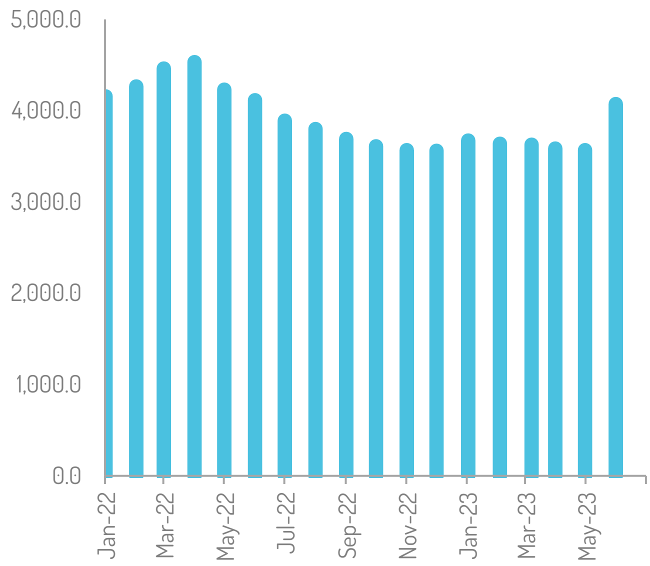
FX to remain stable despite headwind from the World Bank's funding cut

I still want you by my side
Just to help me dry the tears that I've cried

With BoU broadly staying from USD sales, FX reserves jumped USD 504.94mn m/m to USD 4.1bn in June 2023, supporting the Uganda Shilling (UGX) to +1.3% YTD against the USD as of 9 August 2023. On the back of the World Bank statement halting new public financing following the enactment of the Anti-Homosexuality law, the UGX shed 1.9% on Thursday 10 August 2023, erasing the hitherto modest YTD gains but steadied in Friday's session. With current FX reserves levels and equally healthy net foreign asset position for the banking system, we believe Uganda can smooth out volatile UGX swings, should the situation be warranted.

Although the stock of World Bank financing accounts for 55.1% of the multilateral external debt, we believe its decision to halt new financing to Uganda to be unilateral as at this juncture and it is still vague whether other multilateral institutions, such as the IMF, will follow suit. Cumulative World Bank loan pipeline to Uganda over FY24 and FY25 stands at USD 1.7bn, and we opine this will lead to a rebalancing of the financing mix towards commercial external financing and/or domestic borrowing, If the latter is in consideration, potentially this should fast track Uganda's plan of project-based infrastructure bonds issuance. Nevertheless, the Ministry of Finance has telegraphed a potential reduction in FY24 financing to absorb the loss of World Bank financing.

FX RESERVES, USD MN'S



SOURCE: BANK OF UGANDA

Our assessment of the June 2023 indicative targets signal that the primary budget deficit (UGX 3.0tn -vs- UGX 3.4tn target) and tax revenue (UGX 23.7tn -vs- UGX 23.5bn target) were met. Furthermore, Uganda exceeded its targeted repayment of outstanding domestic arrears by UGX 128.9bn. We believe this authorities' credibility towards implementing necessary reforms will see continuation of the IMF programme until maturity on 1 June 2024.

As of end of last week, the S&P Uganda Sovereign Bond Index had minted a YTD gain of 14.1% and 13.9% in UGX and USD terms, respectively. On a YTD basis, Ugandan rates have adjusted downwards by an average of 130bps across the curve. That gives some wiggle room for a further 70bps average decline to fully bake in the upcoming 200bps rate cut in our baseline. At these levels, we foresee limited upside in Ugandan rates in the near-term, but we will be assessing attractive entry points.

For more information contact your IC representative

Business development & client relations

Derrick Mensah
Head, Business Development
+233 24 415 5765
derrick.mensah@ic.africa

Dora Youri
Head, Wealth Management
+233 23 355 5366
dora.youri@ic.africa

Kelvin Quartey
Analyst, Business Development
+233 57 604 2802
kelvin.quartey@ic.africa

Corporate Access

Joanita Hotor
Corporate access
+233 50 137 6100
Joanita.hotor@ic.africa

Insights

Courage Kingsley Martey
Head, Insights
+233 240 970 832
courage.martey@ic.africa

Lydia Adzobu
Senior Analyst, Financial sector
+233 24 656 8669
Lydia.adzobu@ic.africa

Churchill Ogutu
Economist
+254 711 796 739
churchill.ogutu@ic.africa

Investing

Isaac Adomako Boamah
Chief Investment Officer
030 225 2623
isaac.boamah@ic.africa

Obed Odenteh
Portfolio Manager, Fixed Income
+233 54 707 3464
obed.odenteh@ic.africa

Timothy Schandorf
Portfolio Manager, Risk Assets
+233 24 292 2154
Timothy.schandorf@ic.africa

Herbert Dankyi
Analyst, Rates
+233 55 710 6971
herbert.dankyi@ic.africa

Clevert Boateng
Analyst, Consumer, Technology,
Media & Telecommunication
+233 24 789 0452
clevert.boateng@ic.africa

Operations

Nana Amoa Ofori
Chief Operating Officer
+233 24 220 6265
nanaamoa.ofori@ic.africa

Emmanuel Amoah
Fund Administrator
+233 20 847 2245
emmanuel.amoah@ic.africa

Kelly Addai
Fund Accountant
+233 20 812 0994
kelly.addai@ic.africa

Trading

Randy Ackah-Mensah
Head, Global Markets
+233 24 332 6661
randy.amensah@ic.africa

Allen Anang
Equities,Trader
+233 54 084 8441
allen.anang@ic.africa

Isaac Avedzidah
Trader, Fixed Income
+233 24 507 7382
isaac.avedzidah@ic.africa