HALF YEAR MACROECONOMIC & FISCAL PERFORMANCE OF THE ECONOMY, 2021/22

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OUTLINE

1. Macroeconomics;

Real Sector [Growth and Inflation]
Financial Sector [Lending Rates, Government Securities, Private Sector Credit and Exchange Rate]
External Sector [Exports, Imports and Trade Balance]

2. Fiscal Performance;

Revenue
Expenditure
Deficit

3. EAC Performance

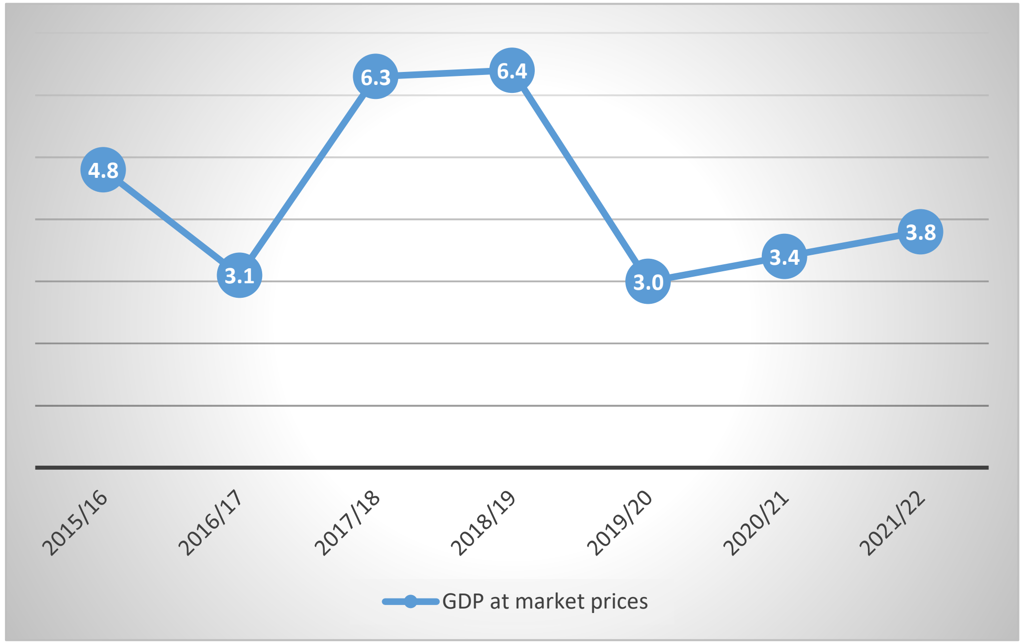
4. Outlook

Economy is projected to grow at 3.8% in 2021/22

- The first quarter of Financial Year 2021/22 registered economic growth of 3.8 percent reflecting an improvement in GDP from the same quarter of the previous Financial Year. This was mainly due to an **increased growth momentum in both the industry and services** sectors.

- Going forward, the **economy is projected to grow at 3.8 percent** this Financial Year from 3.4 percent registered in the Financial Year 2020/21. This is on account of expected **recovery in production, aggregate demand and trade** following the full reopening of the economy in January 2022.

Real GDP Growth Rates of Uganda (%)



Source: Uganda Bureau of Statistics

- Growth will also be driven by Government policy interventions such as the **support to small businesses through the SBRF** as well as an **accommodative monetary policy**. In addition, the anticipated global recovery is expected to boost Uganda's international trade further supporting economic growth.

Reasons for the growth

Uganda’s economic growth is affected by both global and domestic factors;

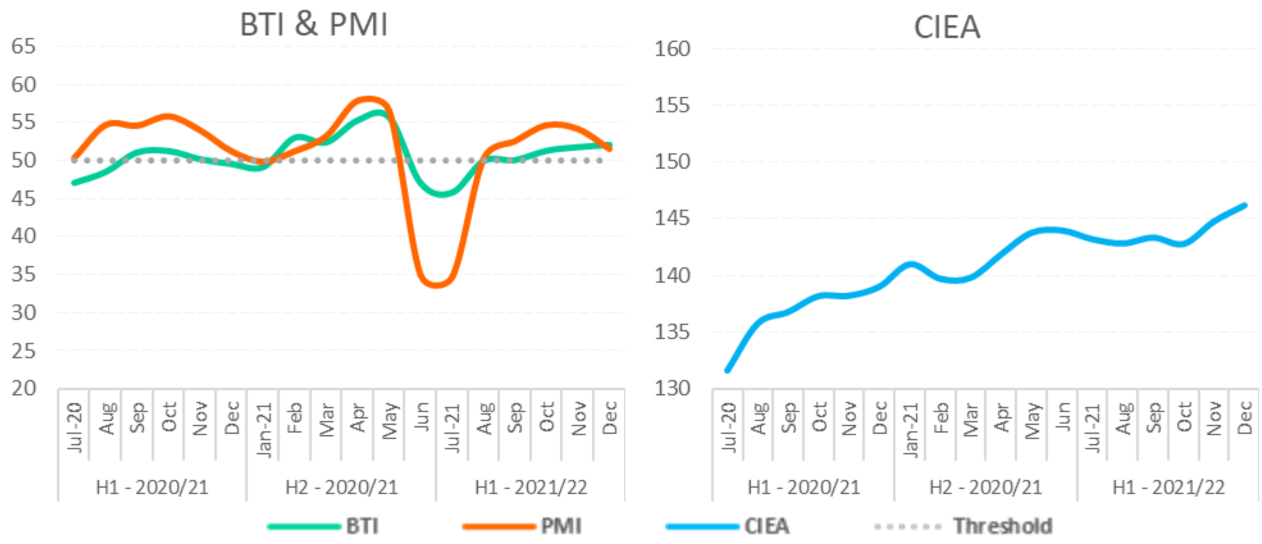
- The global economy is projected to grow at **5.9** percent in 2021 and **4.4** percent in 2022, from **-3.1** percent in 2020.

- Economic growth in Sub-Saharan Africa is projected to increase to **4.0** percent in 2021 and **3.7** percent in 2022, from **-1.7** percent in 2020.

- As vaccination and policy support continue, it will further support recovery in Uganda’s economic growth.
- New variants of the virus, associated lockdown measures and supply chain disruptions however pose concerns to economic growth.

Indicators of Economic Activity show recovery

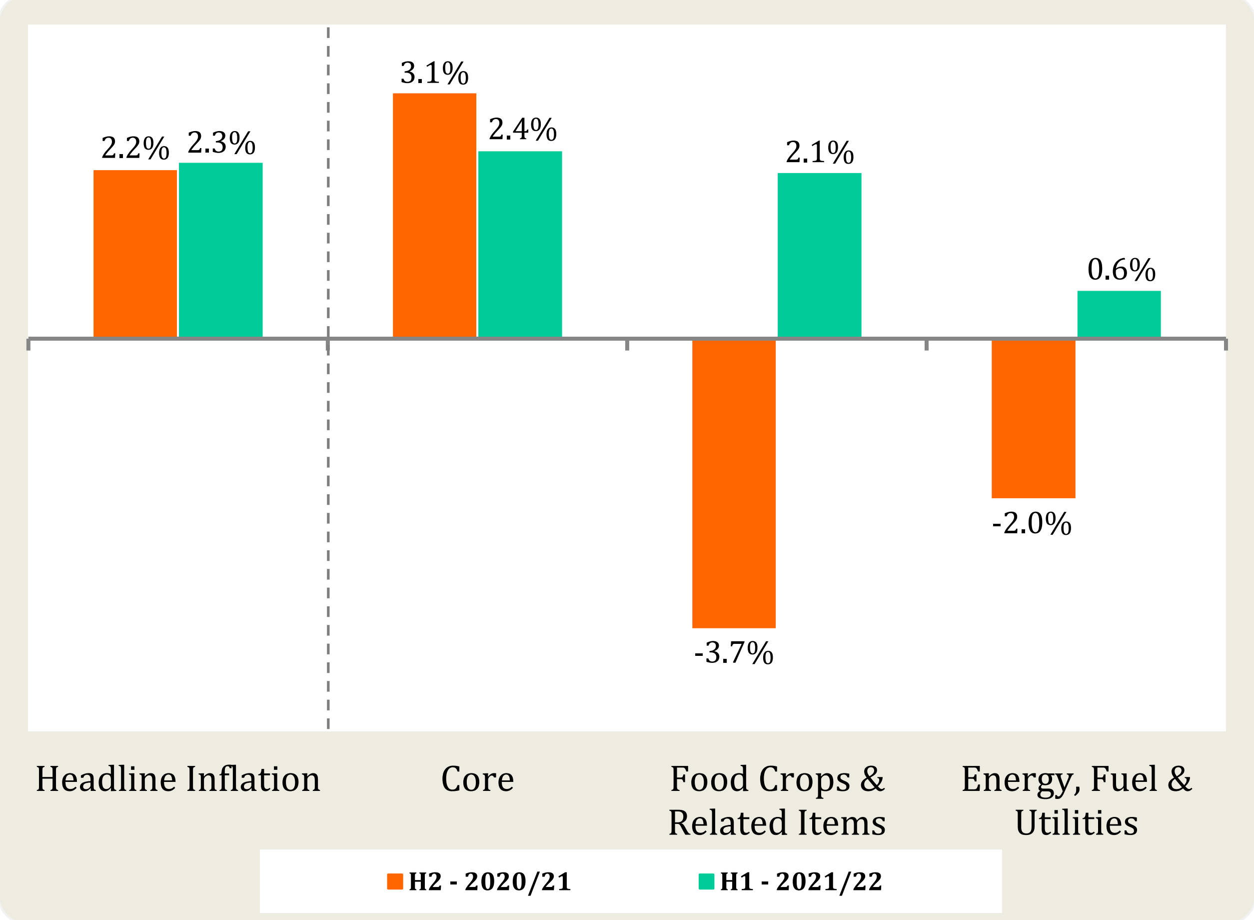
- **High frequency indicators** of **economic activity** particularly the Composite Index of Economic Activity (CIEA), the Purchasing Manager's Index (PMI) and the Business Tendency Index (BTI) all reflected continued recovery in business activity for the first half of FY2021/22.



Source: Bank of Uganda; Stanbic Bank Uganda

- While these indicators reflected a bit of economic struggle during the month of July as the economy had just emerged from the 2nd lockdown, they bounced back in the months that followed.
- The CIEA on average grew at **5 percent** compared to the same period last year while the PMI and the BTI both recorded indices above the **50-mark threshold** from August to December 2021 as the gradual easing of the June-July lockdown measures led to growth in output and new orders.

Annual Inflation remained low



Source: Uganda Bureau of Statistics

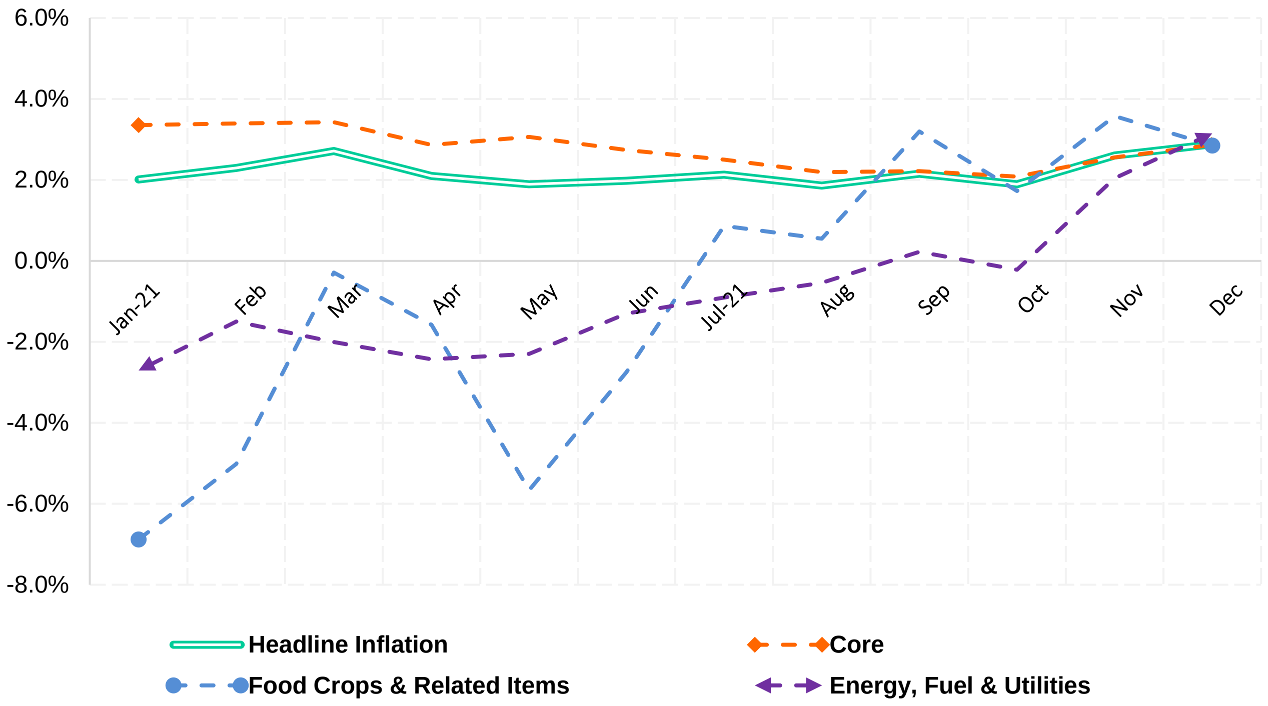
- ❑ Annual headline inflation recorded a six-month average of **2.3 percent** in the first half of FY2021/22, up from a **2.2 percent** average in the previous half.
  - The increase in annual headline inflation was attributed to a rise in both food crops and EFU inflation rates.

- ❑ Food crop prices increased due to a rise in demand alongside reduced supply following less than average rainfall that translated into lower crop harvests.

- ❑ EFU inflation rose as domestic fuel prices increased in tandem with the rise in international oil prices. The rise in domestic fuel prices was also partly attributed to the increase in the tax levy on each litre of fuel by 100 Uganda Shillings.
  - However, a decline in core inflation, dampened the effect of the rise in both food crop and EFU inflation leading to the minimal increase in headline inflation.

Food & EFU inflation increased while Core inflation declined, in H1 2021/22

- **Core inflation** declined to a six-month average of **2.4 percent** in first half of the financial year from **3.1 percent** in the previous half. The decline in core inflation was largely on account of a slower pace at which costs of transportation services increased.
- Transport costs have been high since 2020 when transport operators hiked transport charges following restrictions in vehicle capacity that were set in line with the SOPs to curb the spread of the COVID-19 pandemic.
- Besides the above developments in transport costs, **fees charged on internet data** declined significantly by **28 percent** compared to the same period of the previous financial year, further contributing to the decline in core inflation.



Source: Uganda Bureau of Statistics

- **Food crop inflation** increased to a **2.1 percent** average during the first half of the financial year from a **-3.7 percent** average in the previous half. Throughout the previous half, food crop prices were on a downward trend. The start of H1 FY2021/22 however saw a reversal in this trend with food crop inflation turning positive and increasing, reflecting a gradual increase in prices of food crops.
- The rise in food crop prices was largely attributed to a **pickup in demand** amidst **reduced supply** following less than average rainfall that translated into lower crop harvests. Some of the food crops whose prices increased significantly include; Pawpaw, passion fruits, cabbage, tomatoes, green pepper, onions, garlic, yams, matooke and sweet potatoes.

- **Energy Fuel and Utilities (EFU) inflation** also increased to a six months average of **0.6 percent** during the first half of the FY2021/22 from a **-2 percent** average during the previous half.
- The increase in EFU inflation was largely attributed to **a rise in domestic fuel prices** particularly petrol, diesel, paraffin and liquefied gas prices, whose increase was a feedthrough effect of the soaring international oil prices witnessed in the same period.

Global Commodity Prices

- During the first half of FY2021/22, the international price of Brent crude oil increased to an average of **US$ 76.5/barrel** from **US$ 65.3/barrel** that was recorded for the second half FY2020/21. The hike in international oil prices was on account of rising global demand for oil that outmatched supply.

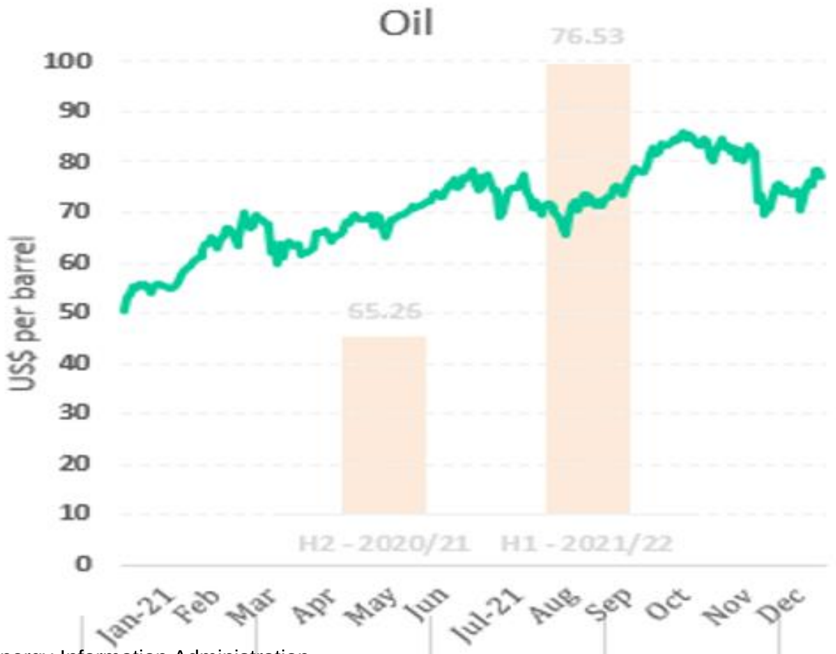
  - On the demand side, the global loosening of COVID-19 related restrictions combined with a pickup in global economic activity resulted into a rise in global demand for oil. On the supply side however, there was a slower increase in global oil production which followed a deliberate decision by Oil Producing and Exporting Countries (OPEC) to limit oil production increases throughout 2021.

    This was in a bid to support higher crude oil prices following the oil price slump that was experienced in 2020. As such, global oil production increased more slowly than demand, altogether driving up the international oil price.

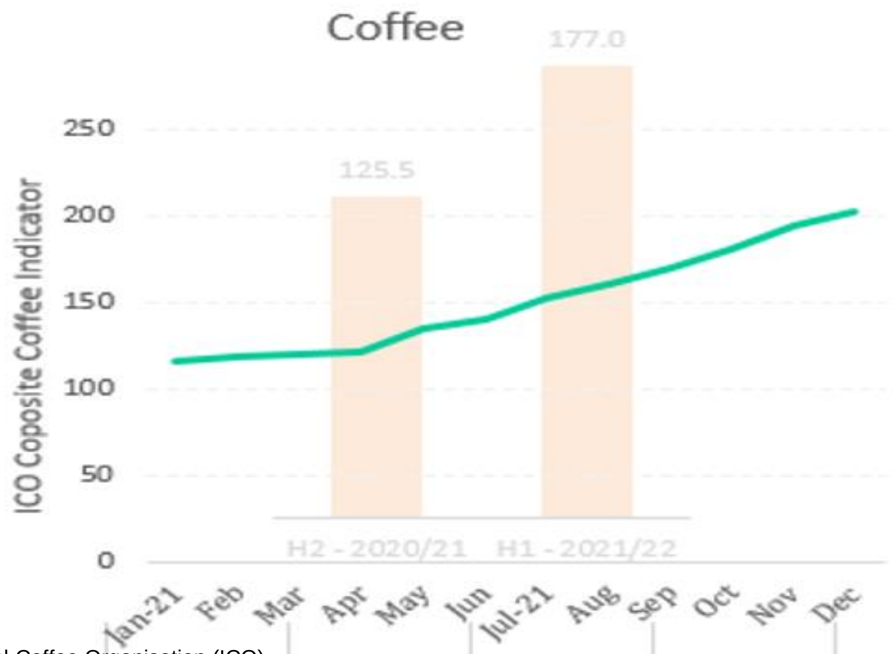
- The coffee composite price indicator published by the International Coffee Organization (ICO) trended upwards to an average of **177.03** in the first half of FY 2021/22 from a **125.55** average in the second half of FY 2020/21, reflecting a general rise in the international coffee price.

  - The rise in international coffee prices was attributed to a global shortfall in coffee supply that resulted from extremely unfavourable weather conditions in Brazil that destroyed coffee produce.

    The drop in coffee supply was further exacerbated by congestion in global shipping services and scarcity of container availability which made it more difficult to get coffee to its markets.



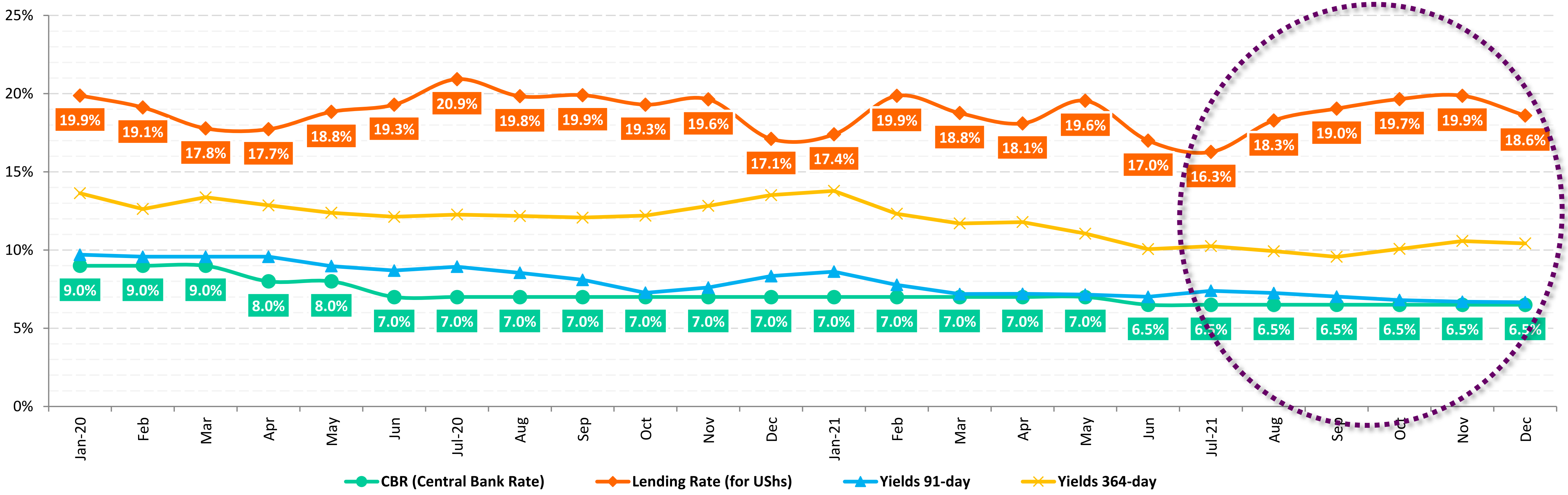
Source: US Energy Information Administration



Source: International Coffee Organisation (ICO)

Yields on T-bills declined in H1 2021/22 compared to H1 2020/21

- The **average annualised yields** for the 91-day and 364-day T-bills declined to **6.97 percent** and **10.14 percent** during the first half of FY2021/22, from **7.49 percent** and **11.79 percent** in the second half of FY 2020/21, respectively.
  - This was attributed to low inflation and increased demand for government securities particularly from both domestic and off-shore players on account of relatively favourable interest rates. In addition, the yields reduced due to a decrease in Government domestic borrowing levels.

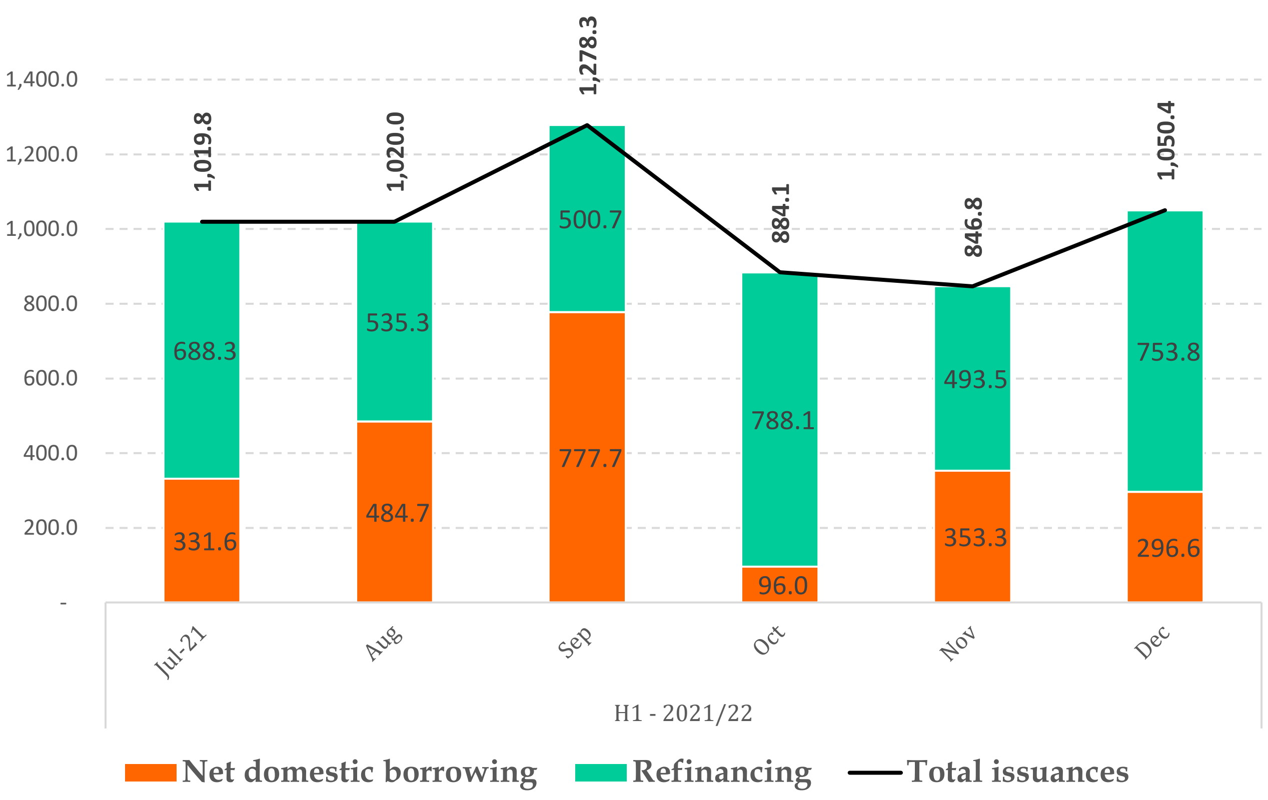


Source: Bank of Uganda

- Commercial bank lending rates increased to an average of **18.62 percent** in H1 2021/22, from **18.44 percent** in the previous 6-month period.
- This increase was partly explained by increased risk aversion as Non-Performing Loans (NPLs) went up from **4.8 percent** in **June 2021** to **5.4 percent** in **September 2021**. Borrowers were affected by the slowdown in economic activity during the second lockdown (June-July 2021) and thus unable to service their loans which resulted into the increase in NPLs

Government Securities

Breakdown of Government Securities Issued in UShs Billion



Source: Ministry of Finance, Planning and Economic Development

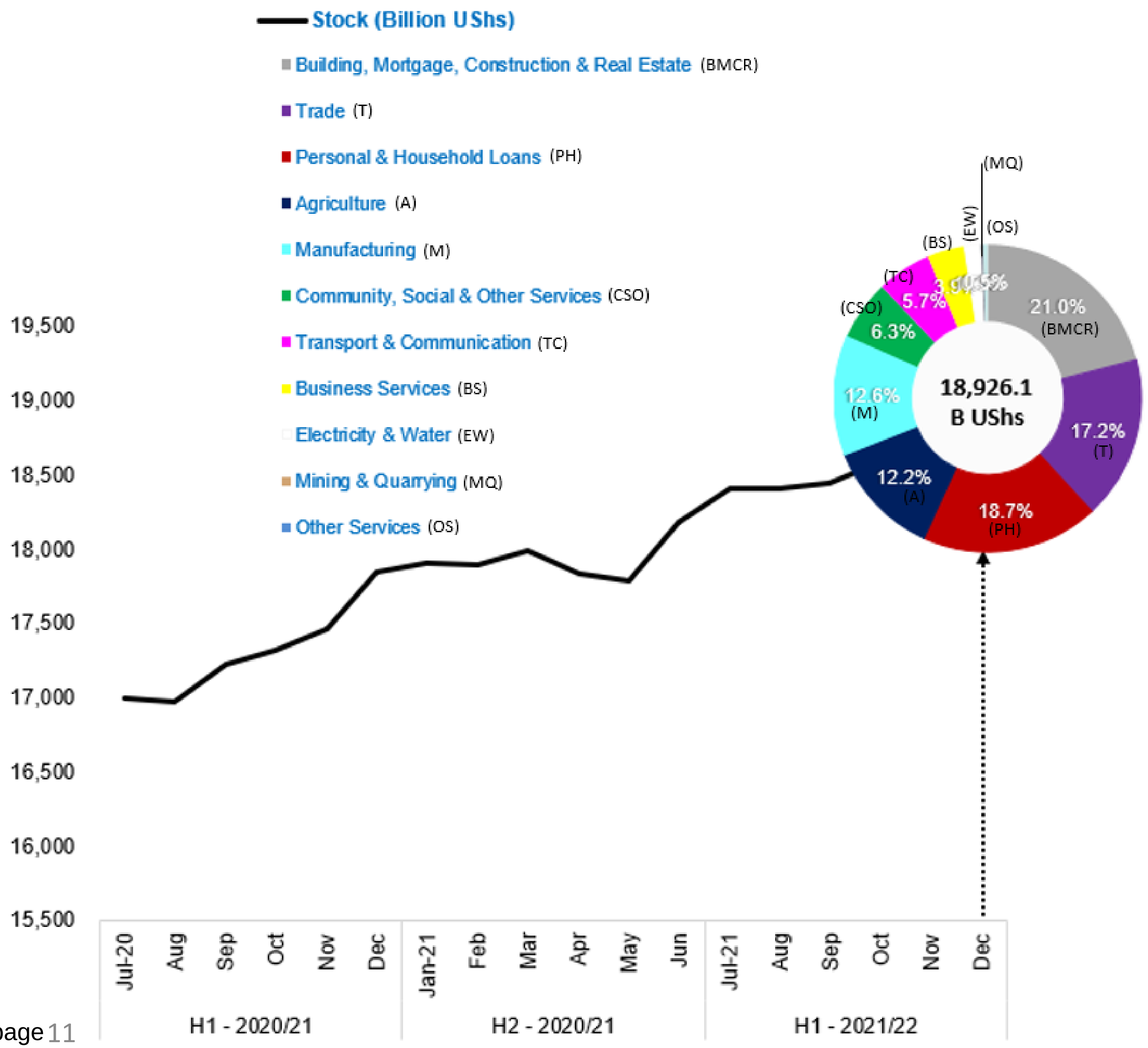
- During the first half of FY 2021/22, Government held auctions for both Treasury Bills and Treasury Bonds. These auctions resulted in a total issuance of **UShs 6,099.4 billion** (at cost).

  Of the amount raised;

  - UShs 3,759.58 billion was used for the refinancing of maturing debt, whilst
  - UShs 2,339.86 billion went towards financing other activities in the Government budget.

- So far, Government has borrowed **79.5 percent** of the total domestic borrowing requirement approved in the budget as there was need to frontload borrowing so as to deal with the covid-19 interventions in the first half of FY2021/22.

There was growth in Private Sector Credit



Source: Bank of Uganda

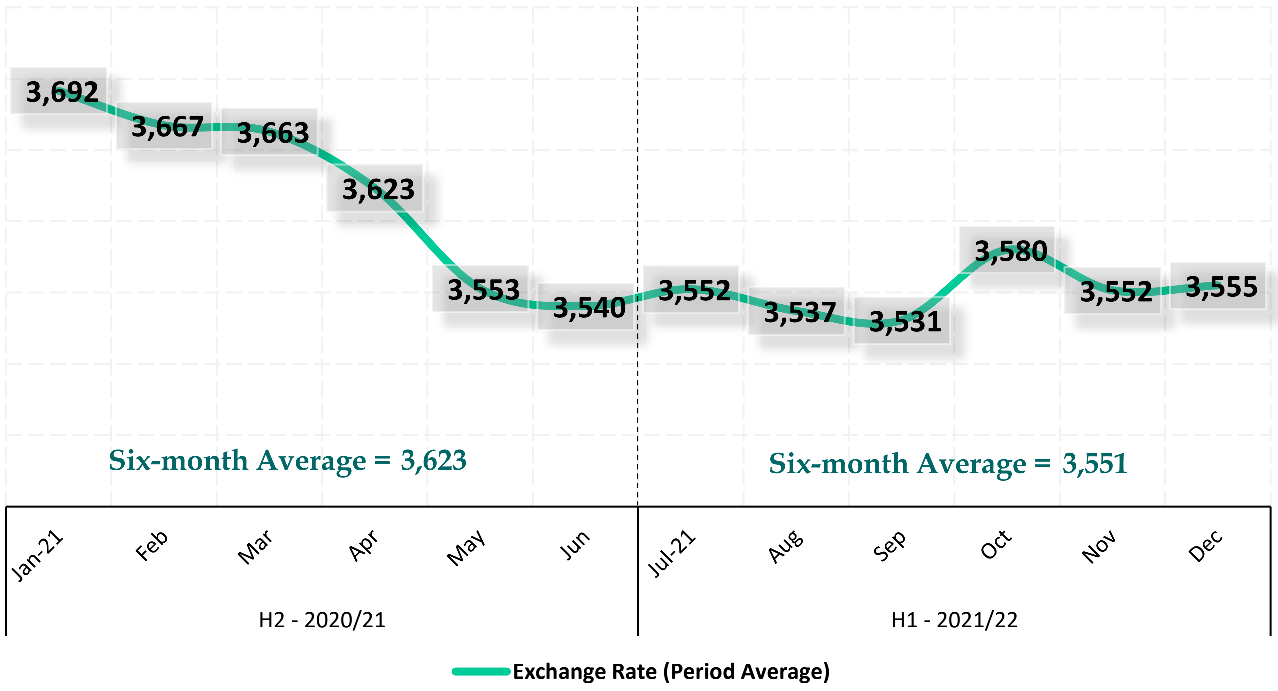
- The stock of outstanding private sector credit amounted to **UShs 18.93 trillion** as at end December 2021 recording a growth of **4.1 percent** from the **UShs 18.19 trillion** outstanding as at end June 2021. This compares favourably against a growth rate of **1.9 percent** recorded between end December 2020 and end June 2021.

  - The value of credit approved in the six months to December 2021 amounted to UShs 5,485.1 billion, slightly up from UShs 4,417 billion approved in the preceding six-month period. The recovery in private sector lending is partly driven by the improvement in economic activity following the continued easing of lockdown measures during the period under review.

The Shilling appreciated against the US Dollar

- The Ugandan Shilling appreciated against the US$ by **1.98 percent** to a period average of **UShs 3,551 per US$** in the first half of FY2021/22 from **UShs 3,623 per US$** in H2 2020/21.

The strengthening of the shilling during this period was supported by steady dollar inflows from offshore investors in government securities coupled with increased coffee receipts and foreign direct investments (FDI).



Source: Bank of Uganda

- ❑ Compared to H2 2020/21, the Ugandan shilling appreciated against the US$ by 1.98 percent to a period average exchange rate of UShs 3,551 per US$ in H1 2021/22 from UShs 3,623 per US$.

Exports declined by 29.4%

- Export receipts during the first half of FY2021/22 declined, largely **due to no exportation of gold**. At the start of FY2021/22, Government imposed a levy of 5 percent on every kilogram of refined gold and 10 percent on unprocessed gold exports. Due to this levy, no gold was exported during the first half of FY2021/22 as Government and players in the gold industry were having negotiations to review this tax measure.
  - Subsequently, total merchandise export receipts declined by 29.4 percent (US$ 759.47 million) to **US$ 1,823.6 million** during the first half of FY2021/22, from **US$ 2,583.1 million** in the corresponding period of FY2020/21. Other export items that recorded major declines include maize and cotton. Maize exports were affected by poor standards and Non-tariff barriers which were imposed by Kenya and Rwanda during the period.

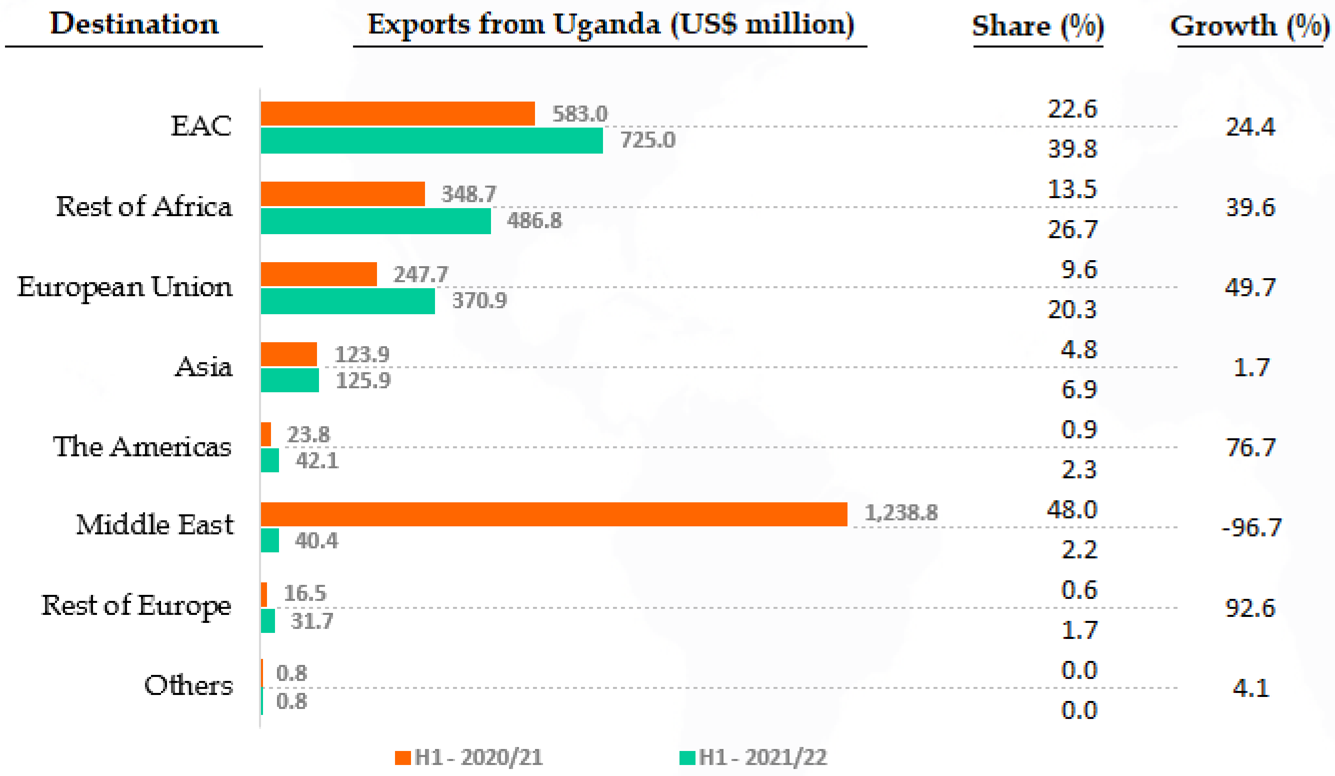
- Earnings from coffee increased to **US$ 419.4 million** during the first half of FY2021/22, from **US$ 255.4 million** in the corresponding period of FY2020/21. This increase was attributed to a rise in the global coffee prices and higher export volumes.
  - The rise in global coffee prices was attributed to severe frost and drought conditions in Brazil which destroyed coffee fields.
  - Government interventions in the coffee sub sector which resulted in planting of new coffee trees that have started to yield results. These interventions include provision of quality seedlings, and extension services among others.

Top Commodity Exports of Uganda in H1 2021/22 (US$ Million)

Source: MOFPED calculations based on data from BOU

EAC was the main destination of Uganda's exports

Destination of Uganda's Exports to different Regional Blocs



Source: MOFPED calculations based on data from BOU

- Uganda's merchandise exports to the **East African Community accounted for 39.8 percent** of the total exports during the first half of the financial year. This was followed by the Rest of Africa accounting for 26.7 percent, and the European Union 20.3 percent of total exports.

  - The East African Community surpassed the Middle East which was the main export destination in H1 FY2020/21, on account of non-exportation of mineral products during the period.

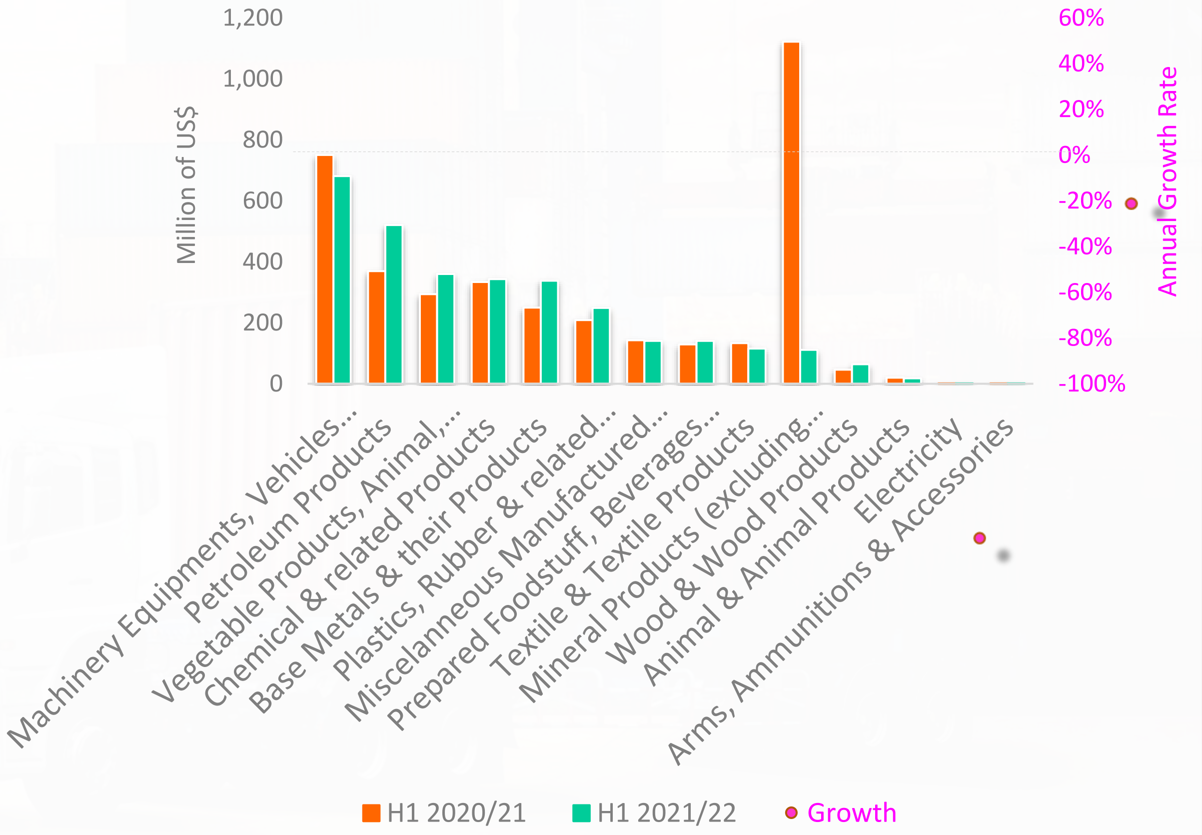
Imports decreased by 20.4%

- Merchandise worth **US$ 3,271.4 million** was imported during the first half of FY2021/22. The value of imports declined by 20.4 percent compared to the same period last year, largely due to lower imports of mineral products that dropped to **US$ 110.8 million** in H1 FY2021/22 from **US$ 1,122.2 million** recorded in the same period last year. The decline in imports of mineral products was on account of the imposition of a new tax.

  - **Formal private sector imports** constituted **94.3 percent** of the total merchandise imports in the first half of FY2021/22. The major formal private sector imports were: Machinery equipment(); Vehicles & Accessories (US$ 681.8 million); and Petroleum Products (US$ 520.6 million).

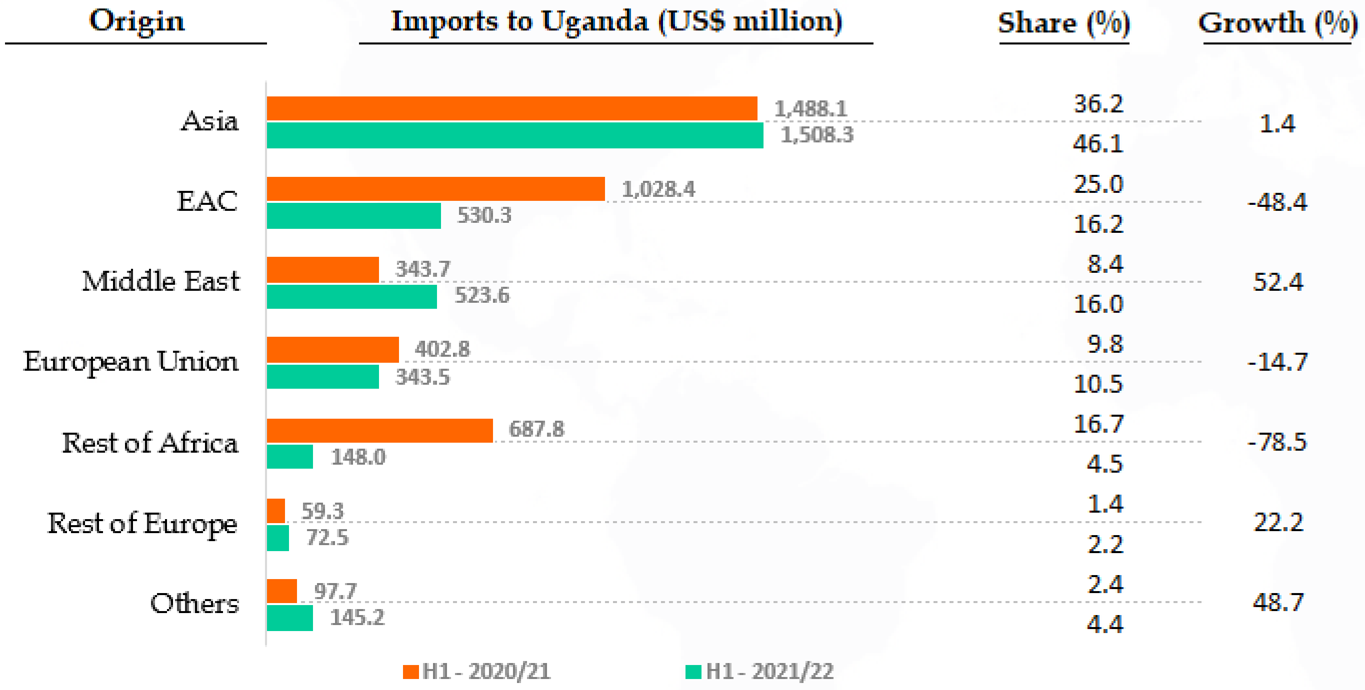
(US$ million)	H1 2020/21	H1 2021/22	Difference (value)	Growth Rate
Total Imports (f.o.b)	4,107.7	3,271.4	-836.3	-20.4%
Government Imports	287.2	156.4	-130.8	-45.5%
Project	287.2	139.6	-147.6	-51.4%
Non-Project	0.0	16.8	16.8	
Formal Private Sector Imports	3,801.3	3,084.4	-716.9	-18.9%
Oil imports	369.6	520.6	151.0	40.9%
Non-oil imports	3,431.8	2,563.8	-868.0	-25.3%
Estimated Private Sector Imports	19.1	30.5	11.4	59.6%
Total Private Sector Imports	3,820.5	3,114.9	-705.5	-18.5%

Source: Bank of Uganda



Asia remained Uganda's main source of imports

Origin of Uganda's Imports from different Regional Blocs



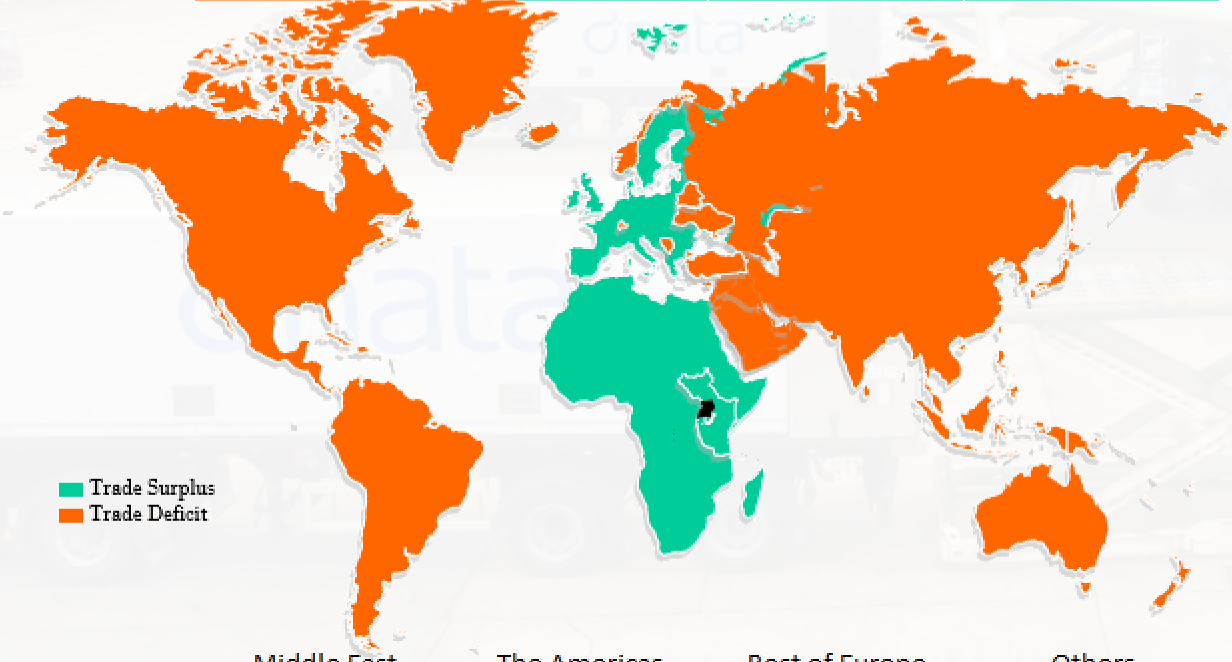
Source: MOFPED calculations based on data from BOU

- Asia remained the leading source of merchandise imports accounting for 46.1 percent followed by the EAC (16.2 percent) and Middle East (16.0 percent).
  - China, India and Japan accounted for 79.9 percent of the imports from Asia.

Uganda's trade with the Rest of the World resulted in a merchandise trade deficit

Uganda's Trade Balance across Regional Blocs in H1 2021/22 (US$ Million)

	Asia		EAC		European Union		Rest of Africa	
	H1-20/21	H1-21/22	H1-20/21	H1-21/22	H1-20/21	H1-21/22	H1-20/21	H1-21/22
Total Trade	1,611.9	1,634.2	1,611.4	1,255.3	650.5	714.4	1,036.5	634.9
Trade Balance	-1,364.2	-1,382.4	-445.4	194.7	-155.1	27.5	-339.1	338.8



	Middle East		The Americas		Rest of Europe		Others	
	H1-20/21	H1-21/22	H1-20/21	H1-21/22	H1-20/21	H1-21/22	H1-20/21	H1-21/22
Total Trade	1,582.5	564.0	111.6	169.6	75.8	104.2	10.6	18.5
Trade Balance	895.1	-483.2	-64.0	-85.5	-42.8	-40.8	-9.1	-16.8

Source: MOFPED calculations based on data from BOU

Note: Total Trade is equal to merchandise exports plus merchandise imports, and Trade Balance is equal to merchandise exports minus merchandise imports

- A merchandise trade deficit of **US$ 1,447.7 million** was recorded during H1 FY2021/22 compared to a deficit of **US$ 1,524.6 million** registered for the same period a year earlier. The narrowing of the merchandise trade deficit was attributed to a higher reduction in the import payments (down by US$ 836.4 million) that more than offset the fall in export receipts (down by US$ 759.5 million).

- During the first half of FY 2021/22, **Asia remained the major trading partner of Uganda** with total trade of US$ 1,634.2 million from US$ 1,611.9 million registered in H1 FY 2020/21. This was followed by the East African Community, Middle East, the Rest of Africa and the European Union. Uganda had a trade surplus with the EAC, the rest of Africa and the European Union while trade deficits were registered with the other regional blocs.

Overview

- The budget for the financial year 2021/22 is premised on the theme "Industrialisation for Inclusive Growth, Employment and Wealth Creation" as the Government continues to safeguard livelihood, jobs, businesses and industrial recovery amid the COVID-19 pandemic (which has had adverse effects on both the economy and the population's wellbeing).

  - As such, Government planned expenditure for the first half of FY2021/22 was **UShs 17,201.9 billion**. However, due to slow execution of public investment projects, overall expenditure was lower than planned by **15.5 percent** or **UShs 2,662.6 billion**.

  - Similarly, revenues and grants received were short of the planned target of UShs 11,984.9 billion by **UShs 1,401.8 billion**.

  - This resulted into a deficit of **UShs 3,956.2 billion** against the programmed target of UShs 5,216.9 billion.

Billion Shs	Program	H1 FY2021/22 Outturn	H1 FY2021/22 Performance	Deviation
Revenues and Grants	**11,984.93**	**10,583.10**	**88.3%**	**(1,401.82)**
Revenues	**11,093.19**	**10,213.03**	**92.1%**	**(880.17)**
Tax Revenue	10,356.18	9,660.74	93.3%	(695.45)
Non-Tax Revenue	737.01	552.29	74.9%	(184.72)
Grants	**891.73**	**370.08**	**41.5%**	**(521.66)**
Budget Support	-	90.92	-	90.92
Project Support	891.73	279.16	31.3%	(612.57)
Expenditure and Lending	**17,201.87**	**14,539.31**	**84.5%**	**(2,662.56)**
Current Expenditures	**8,594.97**	**9,272.81**	**107.9%**	**677.84**
Wages and Salaries	2,764.28	2,862.54	103.6%	98.26
Interest Payments	2,118.98	2,118.98	100.0%	-
Domestic	1,677.53	1,677.53	100.0%	-
External	441.46	441.46	100.0%	-
Other Recurr. Expenditures	3,711.71	4,291.29	115.6%	579.58
Development Expenditures	**8,277.26**	**4,747.91**	**57.4%**	**(3,529.34)**
Domestic Development	4,423.91	3,399.24	76.8%	(1,024.67)
External Development	3,853.34	1,348.67	35.0%	(2,504.68)
Net Lending/Repayments	60.63	85.68	141.3%	25.06
Domestic Arrears Repaym.	269.01	432.90	160.9%	163.89
Overall Fiscal Bal. (incl. Grants)	**(5,216.94)**	**(3,956.21)**		

Source: Ministry of Finance, Planning and Economic Development

Fiscal Operations … (1/3)

Category	Key highlights
Revenues	❑ Revenue collections for the first half of the FY 2021/22 amounted to **UShs 10,213 billion**. This was against a planned target of **UShs 11,093.2 billion**, resulting into a shortfall of UShs 880.2 billion (92.1 percent performance against the target). ▪ Direct domestic tax collections in H1 2021/22 amounted to UShs 3,376.7 billion, thus registering a shortfall of UShs 273.6 billion against a planned target of UShs 3,650.35 billion. This was on account of shortfalls registered for corporate tax; presumptive; withholding; and rental income tax categories, majorly due to covid-19 restrictions that led to supply chain disruptions. ▪ Indirect taxes were projected at UShs 2,783.6 billion during the first half of FY2021/22. However, only UShs 2,296.4 billion was collected, resulting into a shortfall of UShs 487.2 billion. This was on account of lower than planned collections for both excise duty and VAT during this period. ▪ Taxes on international trade and transactions resulted into a shortfall of UShs 26.3 billion. This performance was mainly on account of shortfalls registered under import duty as taxes charged on dutiable goods such as motor vehicles and insulated wires were lower than projected. This offset the surpluses registered under petroleum duty and VAT on imports over the same period. ❑ Non-tax revenue collections in H1 2021/22 amounted to UShs 552.3 billion against a target of UShs 737 billion, thus registering a shortfall worth UShs 184.7 billion or a **performance of 74.9 percent**. This shortfall was due to the fact that most MDAs that collect this revenue were not fully operational following the covid-19 related restrictions in the country. ❑ Government received grants totaling to UShs 370.1 billion from the development partners in H1 2021/22. This was a **41.5 percent performance** against the planned target of UShs 891.7 billion. Of this amount, UShs 90.9 billion went towards supporting general budgetary activities (budget support) while UShs 279.2 billion went towards specific development projects (project support).
Expenditure	❑ Total Government spending **performed at 84.5 percent** for the period, on account of lower than planned spending on externally financed development projects which performed at 35.0 percent. ❑ Government's recurrent expenditure in H1 2021/22 amounted to UShs 9,272.8 billion over and above the planned amount for the period on account of issuance of supplementary expenditures towards the health sector, law enforcement, and the agricultural sector. ❑ Government planned to spend UShs 269 billion towards clearance of arrears. However, by the end of December 2021, UShs 432.90 billion had been spent. This was in line with Government's decision to increase arrears payments in a bid to support the private sector's recovery from the negative effects of the COVID-19 pandemic. ❑ On the other hand, development expenditure in H1 2021/22 amounted to UShs 4,747.9 billion against the program of UShs 8,277.3 billion, translating into a performance of 57.4 percent. This was mainly on account of underperformance of externally financed development spending, owing to execution challenges among MDA's that affected disbursements from the development partners.

Fiscal Operations … (2/3)

Category	Key highlights
Financing	❑ The resultant fiscal deficit in the first half of FY 2021/22 (i.e., UShs 3,956.2 billion) was financed from both **domestic and external sources**. ❑ Net external financing amounted to UShs 2,408.37 billion during the period (which is equivalent to 60.9 percent of the overall fiscal deficit). ▪ All principal debt repayments (amortisation) planned during the period were paid and amounted to UShs 785.58 billion. ▪ A total of UShs 1,659.49 billion was received as project support loans which translated into a performance of 54.9 percent of the planned amount for the period. This low performance was on account of slow project execution during the period under review.
Debt Sustainability Analysis	❑ The stock of total public debt grew from **US$ 15.34 billion** at end June 2020 to **US$ 19.54 billion (UGX 69,512 billion)** by end June 2021. Of this, external debt was US$ 12.39 Billion (UGX 44,061 billion), while domestic debt was US$ 7.2 Billion (UGX 25,451 billion). This represents an increase in nominal debt to GDP from **41.0 percent** in June 2020 to **47.0 percent** in June 2021. The increase in debt was largely on account of increased expenditure in response to the health and economic crises arising from the pandemic. ❑ Debt is **assessed** as being **sustainable**, despite a projected increase in the deb-to-GDP ratio to 51.6 percent at the end of FY2021/22 and to 52.9 percent in FY2022/23. Thereafter, debt is projected to decline over the medium to long-term. To reduce debt vulnerabilities, Government will put in place a number of measures including reducing reliance on debt by increasing revenue collection through full operationalization of the reforms under the Domestic Revenue Mobilisation Strategy (DRMS), continue to prioritize concessional financing over domestic and commercial external debt.

Fiscal Operations … (3/3)

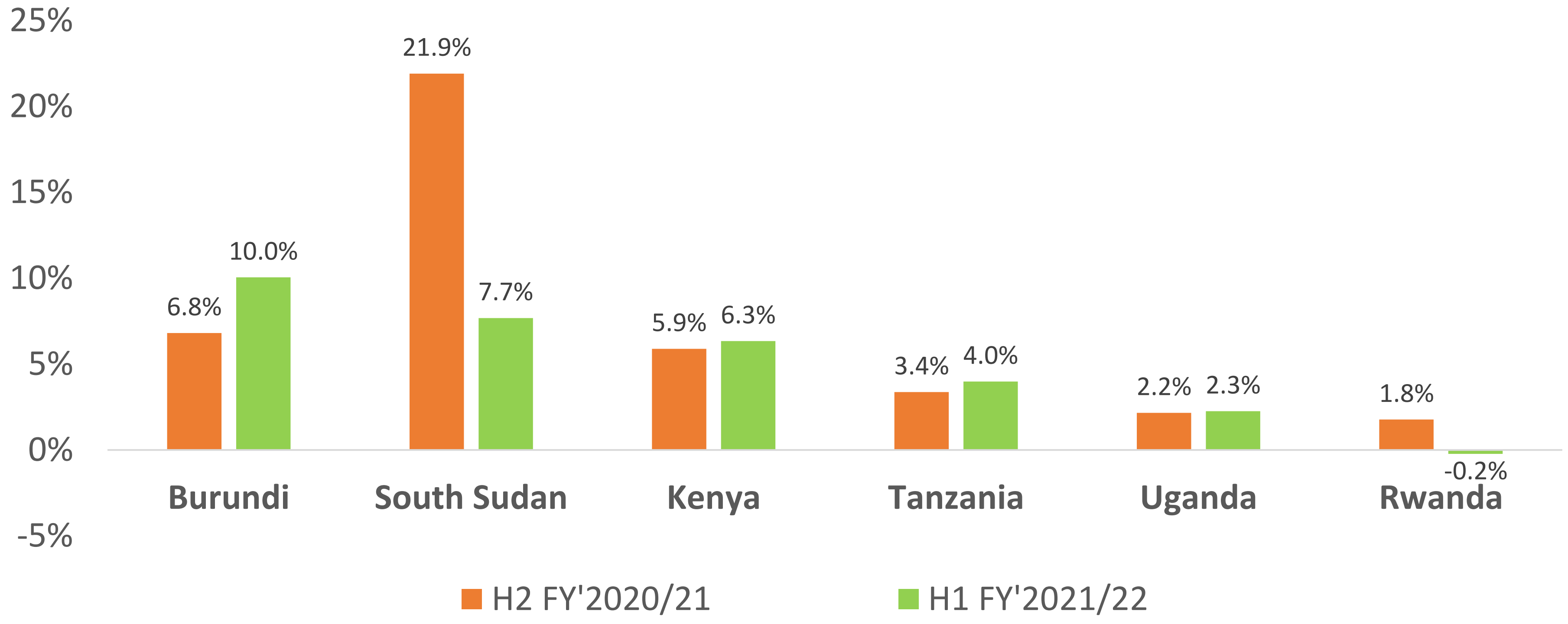
Category	Key highlights
Charter for Fiscal Responsibility	❑ The **new charter** was **considered and approved by Parliament** on 27th January 2022, with some proposed amendments. It provides Government's fiscal policy objectives over the five years that will ensure sustainable delivery of the country's goal of socioeconomic transformation resulting in increased household incomes and improved quality of life of Ugandans. ❑ Like the previous one, this charter remains mindful of the fact that public debt and the overall fiscal balance must **remain at sustainable levels**. In addition, a new unique feature that takes into consideration the start of commercial oil production in FY2024/25, with a measurable target on the management of oil revenues which states that; ▪ A maximum of Oil revenue worth 0.8 percent of the preceding year's estimated non-oil GDP outturn shall be transferred to the Consolidated Fund for budget operations. The balance shall be transferred to the Petroleum Revenue Investment Reserve (PRIR) for investment in accordance with the Public Finance Management Act (2015) as amended.
Petroleum Fund	❑ The opening balance of the petroleum fund as at 1st July 2021 was UShs 228.70 billion. However, of this amount, UShs 200 billion was appropriated in the budget for the FY2021/22. In the first quarter, this amount was drawn down to finance development expenditures. ❑ During the first half of the financial, deposits were made on the fund and as at 31st December 2021, the petroleum fund account stood as UShs 81 billion.

EAST AFRICAN COMMUNITY

PERFORMANCE

Except for Burundi, all other EAC Partner States inflation was below target

- With the exception of Burundi, all other EAC partner states registered an **average annual headline inflation rate** that was **below the EAC convergence target of 8 percent** for H2 2021/22.
- Nonetheless, Uganda, Kenya, Tanzania, and Burundi all reported increases in their respective average headline inflation rates when compared to the previous half of the year (H2 FY2020/21).

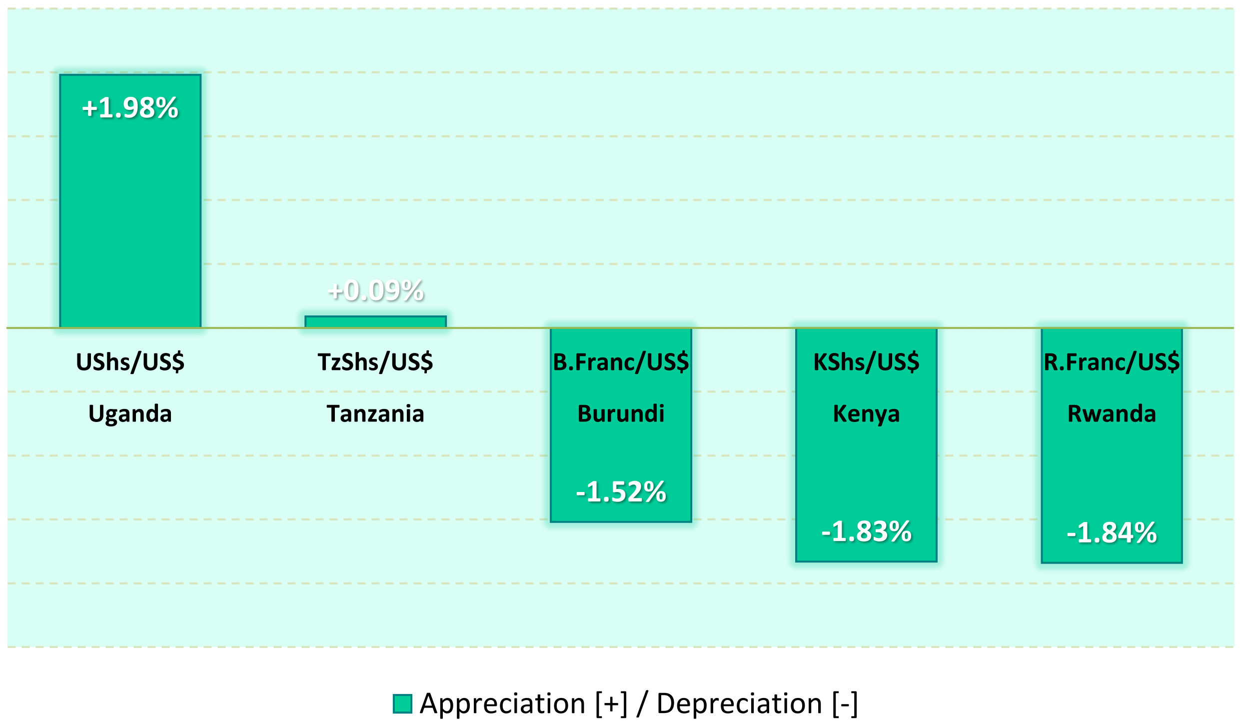


Source: Respective National Bureaux of Statistics

- The common drivers of the increases in inflation were a rise in food prices and an increase in domestic fuel prices associated with the upsurge in international oil prices.

Exchange Rates within the EAC

Change in Exchange Rates (Period Average) in EAC for H2 2020/21 Vs H1 2021/22



Source: Respective Central Banks

Note: Exchange Rate data for South Sudan was not available

- Within the EAC, both the Ugandan and Tanzanian Shillings appreciated against the US dollar in the first half of FY2021/22 when compared to the second half of FY2020/21.
    - The Tanzanian Shilling remained relatively stable against the US dollar, appreciating slightly by 0.09 percent between the second half of FY2020/21 and the first half of FY 2021/22.
- All other currencies of the EAC Partner States registered a depreciation against the US dollar in the period under review. The Kenyan Shilling, Rwandan and Burundian Francs, weakened against the US dollar by 1.83%, 1.84% and 1.52% respectively.
    - The weakening of these currencies against the dollar is partly explained by the global strengthening of the dollar.

OUTLOOK ON THE ECONOMY

Looking ahead >>>

Economic Growth

- Following the **full reopening of the economy**, economic growth is expected to **rebound** during the second half of the Financial Year with the manufacturing, construction, education, and arts & entertainment sectors expected to pick up.
- The economy is expected to grow at **3.8 percent** in **this Financial Year**, and rebound to **6 percent** in **FY2022/23** and to **at least 7 percent** in the **medium term**.

Inflation

- Headline inflation is likely to **increase** slightly in the rest of FY2021/22 largely driven by a pickup in demand after the full re-opening of the economy. **Energy** and **food prices** are specifically likely to increase further as schools re-open and international oil prices remain high.
- Over the medium term, inflation is forecast to **rise** and **stabilise** around the **5 percent** target as demand fully recovers.

Financial Sector

- The outlook points to a **continued pickup** in **private sector credit growth** and a **reduction** in **commercial bank lending rates** in the medium term as economic activity continues to recover.
- However, there are downside risks to the short-term outlook stemming largely from a decline in commercial banks' asset quality with the share of Non-Performing Loans (NPLs) to total gross loans rising to 5.4 percent in September 2021 from 4.8 percent in June 2021.

External Sector

- By the end of the Financial Year 2021/22, the **merchandise trade deficit** is **expected** to have **widened** compared to the previous Financial Year as growth in merchandise imports outpaces merchandise exports due to a pick-up in domestic demand.

- FDI inflows are expected to recover as activity in the oil and gas sector picks up following the signing of the Final Investment Decisions. Additionally, secondary income account is expected to increase in line with a strengthening of worker's remittances as well as higher inflows of project aid in support of post pandemic economic recovery.

Fiscal Operations

- The **pandemic** has led to **revenue shortfalls** and **necessitated additional expenditure** in health; security; support to vulnerable groups of people; payment of domestic arrears; among other, initiatives to support the private sector.

- As a result, the fiscal deficit is expected to stand at 7.5 percent of GDP by the end of FY2021/22 before gradually declining to 5.2 percent of GDP in FY2022/23 and to below 3.0 percent of GDP over the medium term.

Fiscal Risks

- **Changes** in **macroeconomic assumptions** create risks to both revenue and expenditure projections as they play a key role in the formulation of the budget. A comprehensive analysis of fiscal risks is key for prudent fiscal management.

- Volatility and optimism bias in growth projections can have negative effects on tax revenues and public debt. This has been exacerbated by the uncertainty arising from the resurgence of the COVID-19 pandemic and its consequences.