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Monetary Policy Statement for February 2012

After peaking in October 2011, inflationary pressures have continued to abate, for the third successive month. Annual headline and core inflation declined to 25.7 percent and 28.1 percent respectively in January 2012, from 27.0 percent and 29.2 percent in December 2011. Annual food inflation also fell to 27.3 percent in January from 34.7 percent in December 2011.

Monthly core inflation declined to 0 percent in January 2012 from 0.7 percent in December 2011, hence there was no increase in the average prices of the goods and services in the core inflation basket during January. Monthly food and food crops inflation have been negative in each of the last 3 months, an indication that the impact of supply-side shocks to food prices are now abating. Annual non-food inflation, however, increased to 24.2 percent in January 2012 from 22.9 percent in December 2011, in part because of the increase in power tariffs.

The rise in interest rates which took place during the second half of 2011 has brought about a marked deceleration in the growth of bank lending, which had been growing at a very fast rate earlier in the year. This is helping to dampen demand side pressures, especially on non food inflation. Furthermore, the strengthening of the Shilling against the U.S. Dollar since November 2011 will also help to ease pressures on non-food inflation in the near-term. Nonetheless, major upside risks to inflation remain, not least from Uganda's weak current account position and the consequences that this may have for the exchange rate.

The Bank of Uganda is determined to bring down inflation sharply and to stabilise it around the policy target of 5 percent in the medium-term. The increase in interest rates implemented by the BOU since the middle of last year has already yielded positive results, as reflected in the strengthening of the exchange rate and the sharp decline in the growth of commercial bank credit, which has dampened inflationary pressures. The softening of domestic demand and the projected decline in global commodity prices, especially oil prices are both likely to contribute to lower inflation in the period ahead.

Compared to the previous month, the BOU now believes that the prospects for a fall in inflation during the course of 2012 have strengthened. The BOU is now confident that inflation will be reduced to single digit levels by the end of 2012. This is because of the sharp fall in credit and monetary growth, the strengthening of the exchange rate and the fall in global commodity prices that have occurred over the last few months. Because of this, a very cautious easing of the monetary policy stance is now warranted. Accordingly, the BOU will reduce the Central Bank Rate (CBR) to 22 percent in February 2012, from 23 percent. The band on the CBR will remain at plus/minus 3 percentage points and the margin on the rediscount rate will remain at 4 percentage points on the CBR. The rediscount rate and the Bank rate will therefore fall by one percentage point to 26 percent and 27 percent, respectively.

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GOVERNOR
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