BANK OF UGANDA

37/45 KAMPALA ROAD, P.O. BOX 7120, KAMPALA;
Telephone: 256-414-258441/6, 258061, 0312-392000, 0417-302000. Telex: 61069/61344; Fax: 256-414-233818
Web site: www.bou.or.ug E-mail address: info@bou.or.ug

MONETARY POLICY STATEMENT FOR JUNE 2012

Inflation declined in May 2012 for the seventh successive month. Annual headline inflation fell to 18.6 percent from 20 percent in April while core inflation fell to 21.2 percent from 22.8 percent in April.

Since the start of the year, the monthly inflation rates indicate that inflationary pressures in the economy have subsided markedly compared to the last half of 2011. Monthly headline inflation averaged only 0.8 percent during January-May 2012, compared to an average of 2.2 percent in final five months of 2011. The decline in monthly core inflation has been even more notable. Monthly core inflation averaged only 0.3 percent during January-May 2012 compared to 2.6 percent in the final five months of 2011. Monthly non-food inflation has also been subdued since the start of 2012, averaging only 0.6 percent, compared to 2.6 percent in the previous five months. It is now clear that disinflationary momentum in the economy has solidified, providing further evidence of the effectiveness of the tight monetary policy stance implemented by the BOU.

However, on the downside, real economic activity has stagnated in 2011/12, mainly because of subdued domestic and external demand. This month the Uganda Bureau of Statistics has forecast that real GDP growth for 2011/12 is now 3.2 percent, which is below the economy's potential sustainable growth rate of 6-7 percent.

The global economy remains a significant source of risk for the Ugandan economy. In particular, there is a possibility that the problems in the Euro area could trigger renewed turbulence in global financial markets. This in turn could have adverse effects on the exchange rate in Uganda, as well as in other frontier markets. Although the BOU does not target a specific exchange rate, it will act decisively to avoid disruptive shocks to the exchange rate emanating from volatile short term capital flows.

The short to medium term prospects for inflation have improved significantly since the last Monetary Policy statement, especially because the May data confirm that disinflationary trends are taking root. This has strengthened the BOU's confidence that core inflation will be reduced to single digits by the end of 2012 and that it will fall further in 2013. The policy priorities of the BOU are to maintain the disinflationary momentum to ensure that core inflation can be reduced to the target of 5 percent by mid 2013, while at the same time allowing scope for a recovery of aggregate demand growth to push real GDP back towards its potential growth rate in 2012/13. Boosting real output growth will require a resumption of private sector credit growth, through a gradual reduction of interest rates over the next 6-12 months. The BOU hopes that moderate rates of bank credit growth can be achieved in 2012/13 and that this will be consistent with both continued disinflation and stronger output growth.

Given the above, the BOU believes it is opportune to ease monetary policy slightly and will, therefore, reduce the Central Bank Rate (CBR) by one percentage point to 20 percent in June 2012. The band on the CBR will remain at +/-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 now be 24 percent and 25 percent, respectively in June 2012.

Prof. Emmanuel Tumusiime-Mutebile
GOVERNOR
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