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Monetary Policy Statement for November 2011

Inflationary pressures remained strong in October 2011, with annual headline and core inflation increasing to 30.5 percent and 30.8 percent respectively, from 28.3 percent and 27.5 percent in September. Non food items provided the main impetus to inflation in October, whereas food price inflation, for the first time in several months, fell in October. Annual non food inflation rose to 23.8 percent, mainly as a result of the exchange rate depreciation which has taken place over the last 12 months. However, monthly headline and core inflation rates of 1.3 percent and 1.1 percent respectively in October were the lowest since June, indicating that the surge in inflation which began at the end of 2010 may be starting to abate.

The priority of the Bank of Uganda is to prevent high inflation from becoming entrenched; this applies particularly to non food prices which are much more influenced by demand conditions in the economy than are food prices. It is necessary to cool the growth of aggregate demand in the economy if inflation is to be brought down over the next 12-18 months. The principal monetary policy tool is the Central Bank Rate (CBR), which was raised by 400 basis points to 20 percent in October 2011. The increase of the CBR in October has already had positive results in that it has helped to attract foreign capital inflows which contributed to a strengthening of the exchange rate against the US dollar in the second half of October. This exchange rate appreciation will help dampen inflationary pressures, especially for imported goods.

Nevertheless, bank credit growth remains very strong. In the year to September, commercial bank lending to the private sector expanded by nearly 47 percent. The rapid rate of credit expansion is contributing to demand pressures in the economy; hence a deceleration of credit growth is necessary to help cool inflationary pressures.

To strengthen incentives for a reduction of bank credit growth and to maintain support for the exchange rate, the Bank of Uganda will tighten monetary policy further in November 2011 by raising the CBR by 300 basis points to 23 percent. The band around the CBR will remain at plus/minus 400 basis points. The margin on the rediscount rate will remain at 500 basis points on the CBR. The rediscount rate and the Bank Rate have thus been increased to 28 percent and 29 percent, respectively.

The Bank of Uganda expects that inflation will peak in the coming months and will then decline during 2012, with core inflation reaching single digit levels at about the end of that year. Core inflation is projected to fall further to the Bank of Uganda's policy target of 5 percent in the medium term. However, should the upside risks to inflation increase, monetary policy will need to be tightened further.

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November 01, 2011