Bank of Uganda

Monetary Policy Report

May 2013

Table of Contents

1 Overview

In April 2013, both annual headline and annual core inflation decreased to 3.4 per cent and 5.8 per cent respectively, from 4.0 per cent and 6.8 per cent in March. Annual headline inflation marked a record low over the ITL period, whilst annual core inflation remained within 1.0 percentage point of the inflation target. The disparity between the two was mainly on account of food crop prices, which remained in negative inflation in the month under review.

Similarly, global inflation remained subdued due to economic slack in advanced economies and declining commodity prices. Oil prices are expected to drop by 2.3 per cent in 2013 on account of strong growth in non-OPEC supply. These developments could further dampen food prices if food supply to markets remains stable. Over the month, the IMF credited developed countries' central banks for establishing credible monetary policies, which are judged to be containing inflation expectations.

Global economic growth continued to increase, albeit at a decreasing rate, on account of robust private demand in the US and strong economic activity in emerging and developing countries. US GDP is expected to be relatively strong over the coming years and to boost global GDP, even though it may be somewhat stifled by the ongoing fiscal adjustment. Yet fiscal adjustment has had a much more severe effect in the Euro zone, where it is expected to continue plaguing economic growth forecasts. Strong economic activity in emerging market and developing economies has been boosted by China, which has in turn been supported by highly accommodative macroeconomic policies. In Uganda, growth was supported by the agriculture and services sectors (in particular increased consumption in wholesale and retail trade).

Fiscal performance improved over the month, but it has still performed below the approved budget in both government revenue and expenditure. In order to increase government expenditure in light of reduced revenues and donor withdrawals, the issuance of government securities is expected to increase. If the value of government securities issued does increase beyond the budget, then the increased public debt may risk crowding out private sector credit and economic growth.

On a monthly basis, the Shilling continued to strengthen, appreciating by 2.2 per cent to a mid-rate of Shs. 2,578.01/US$. However it experienced a depreciation of 2.9 per cent on an annual basis. The continued appreciation since February 2013 was on account of increased inflows from portfolio investors and from remittances to NGOs, which offset the relatively subdued Shilling demand. Volatility, which had been anticipated due to protracted supply by offshore players, was largely offset by BoU intervention on the purchase side. On a regional basis, all currencies experienced heightened volatility over the month. Yet the direction of exchange rate movements was mixed; whilst the Kenyan and Ugandan Shillings appreciated over the month, the Tanzanian Shilling and the Rwandan and Burundi Francs depreciated over the same period. .

The Balance of Payments deteriorated to a deficit of US$ 61.28 million largely on account of the financial account. If the peaceful Kenyan elections result in increased imports and a shift in portfolio inflows from Uganda, the BoP may deteriorate further in the near-term. Nonetheless, increased growth prospects throughout Sub-Saharan Africa and COMESA, promise to boost exports by a larger amount in the long-term.

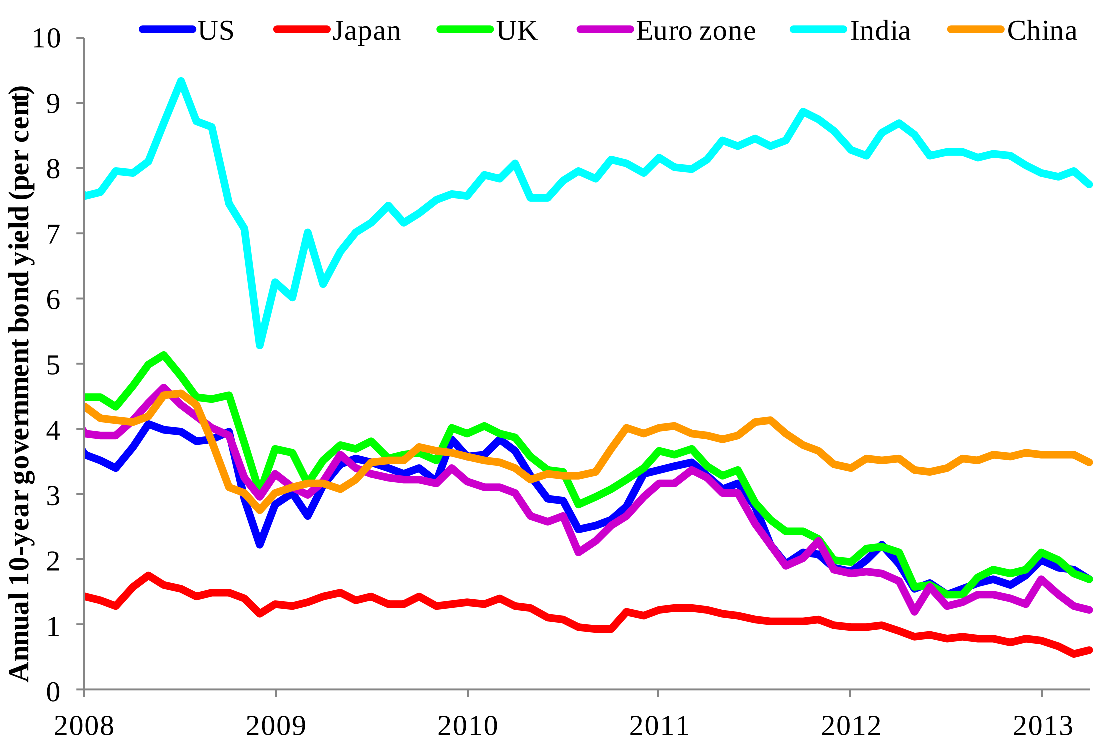
2 Money and credit

Financial markets have an enormous and increasing impact upon global economic activity. A well developed financial sector should improve the efficiency with which savings may be channelled into investment, and thereby promote economic growth. Furthermore, well developed financial markets allow enormous capital flows that suffer no national border constraints. However, financial markets are highly susceptible to investor sentiment and investments flow may be reversed or withdrawn immediately. Whilst the potential benefits that the financial sector promise are vital to economic growth in a globalised world, the destruction that they may also cause in terms of volatility and speculation are important to acknowledge. The following two sections will analyse the monthly developments in international (2.1) and domestic (2.2) financial markets.

2.1 Global financial markets

Strong actions undertaken by the European Central Bank (ECB) and the United States Federal Reserve towards the end of 2012 and the beginning of 2013 continue to boost market conditions, confidence and stability. Stability in global financial markets will benefit funding capabilities and support confidence, both of which will improve consumption and investment. As indicated in ***Figure 1***, the benchmark 10-year government bond yields declined across the US, UK, the Euro Zone, China, India and Brazil in April, although they remain persistently high in emerging market economies.

Figure 1: 10-year Treasury Bond yields



Source: Bloomberg

The 10-year government bond yields declined by 0.16 percentage points, to 1.69 per cent in April from 1.85 per cent in March in the US, and by 0.08 percentage points in both the Euro zone and the UK, to 1.21 per cent and 1.69 per cent in April from 1.28 per cent and 1.77 per cent in March respectively, which signals easier credit supply conditions and a reduction in perceived risk. In China, India and Brazil, 10-

year government bond yields also declined over the month to 3.49 per cent, 7.74 per cent and 9.68 per cent respectively. However, yields in China, India and Brazil, which average 6.97 per cent, are notably higher than in advanced economies, which average 1.29 per cent. The relatively higher yields in emerging market economies reflect previously tight monetary policies implemented to reign in second round effects stemming from the high inflation rates recorded in the latter half of 2011 and the first half of 2012. By contrast, most advanced economies are currently operating highly expansionary monetary policies in order to boost economic activity, which contain domestic government security yields.

In the currencies market, the US Dollar index, which measures the relative strength of the US Dollar against the British Pound, Yen, Euro, Canadian Dollar, Swedish Kroner and the Australian Dollar, declined by 0.1 per cent to 82.54 in April 2013, indicating a weakening of the US Dollar against other major currencies during the month. The weakening of the US Dollar during the month was largely on account of weak US economic data. While first quarter US GDP growth reached 2.5 per cent, the outturn was weaker than the market expectation of 3.2 per cent.

Across comparable African nations, one-year investment rates remained unsurprisingly above those in both advanced economies and in emerging market economies. However, one-year investment rates fell across all countries considered in ***table 1***, below. Ghana's investment rate remained the highest and considerably above the rest of the region. Her competitiveness was, however, largely eroded by the equally high inflation compared to other nations. The latest March data for Nigeria highlights a negative real interest rate when the 6.1 per cent investment rate is considered alongside the 8.6 per cent inflation rate. Uganda and Kenya presented the most competitive real investment rates in April. However, Uganda's investment rate is on a downward trajectory, which if it continues may lessen Uganda's competitiveness given that inflation is unlikely to fall further.

Figure 1: Regional indicators

	Inflation						Exchange Rate Movement (Domestic Currency to the US Dollar, Y-o-Y)					
	Uganda	Kenya	Tanzania	Ghana	Nigeria	Zambia	Uganda	Kenya	Tanzania	Ghana	Nigeria	Zambia
Jul 12	14.3	7.7	15.7	9.5	12.8	6.2	-4.4	-6.4	0.4	24.9	5.9	0.7
Aug	11.9	6.1	14.9	9.5	11.7	6.4	-9.5	-9.4	-2.3	25.2	3.4	-0.4
Sep	5.5	5.3	13.5	9.4	11.3	6.6	-10.6	-12.2	-3.8	24.6	0.7	2.2
Oct	4.5	4.1	12.9	9.2	11.7	6.8	-8.1	-16.0	-5.6	23.2	-1.6	4.4
Nov	4.9	3.3	12.1	9.3	12.3	6.9	1.6	-8.6	-5.6	22.1	-0.8	3.4
Dec	5.3	3.2	12.1	8.8	12.0	7.3	9.3	-0.8	-2.2	19.7	-4.3	1.8
Jan 13	4.9	3.7	10.9	8.8	9.0	7.0	11.2	0.6	-0.2	16.6	-3.8	3.1
Feb	3.5	4.5	10.4	10.0	9.5	6.9	14.2	5.1	0.3	13.3	-2.1	2.2
Mar	4.0	4.1	9.8	10.4	8.6	6.6	6.1	3.5	0.3	11.1	-1.6	1.9
Apr	3.4	4.1	-	-	-	6.5	2.9	1.2	0.9	12.2	-1.4	2.3
	Policy Rates						One Year Investment Rate (e.g 364-day Treasury Bill, Time Deposits)					
	Uganda	Kenya	Tanzania	Ghana	Nigeria	Zambia	Uganda	Kenya	Tanzania	Ghana	Nigeria	Zambia
Jul 12	19.0	16.5	-	15.0	12.0	9.00	17.5	13.0	13.8	22.0	6.6	12.5
Aug	17.0	16.5	-	15.0	12.0	9.00	14.3	12.9	12.9	22.5	6.9	11.6
Sep	15.0	13.0	-	15.0	12.0	9.00	11.4	10.3	13.4	22.0	6.8	10.7
Oct	13.0	13.0	-	15.0	12.0	9.25	12.2	10.6	13.4	22.8	6.2	10.5
Nov	12.5	11.0	-	15.0	12.0	9.25	15.0	11.9	13.3	22.9	6.2	13.0
Dec	12.0	11.0	-	15.0	12.0	9.25	15.2	11.7	13.7	22.9	10.6	11.7
Jan 13	12.0	9.5	-	15.0	12.0	9.25	15.4	11.7	14.5	22.9	6.1	10.2
Feb	12.0	9.5	-	15.0	12.0	9.25	14.4	11.7	14.1	22.9	5.7	12.1
Mar	12.0	9.5	-	15.0	12.0	9.25	12.2	12.6	13.7	22.6	6.1	12.5
Apr	12.0	9.5	-	15.0	12.0	9.25	11.6	12.4	14.2	22.2	-	12.5

2.2 Domestic financial markets

As previously explained, the importance of a well-developed financial system is to efficiently allocate savings and investments in order to achieve the maximum economic growth rate obtainable. In Uganda, the financial sector is highly concentrated and largely dependent upon commercial banks. The domestic financial sector will therefore promote economic growth if banks are able to balance their liquidity requirements efficiently; if they have easy access to external funds through markets such as the interbank money market or if they can invest excess liquidity in assets such as treasury securities and private sector lending.

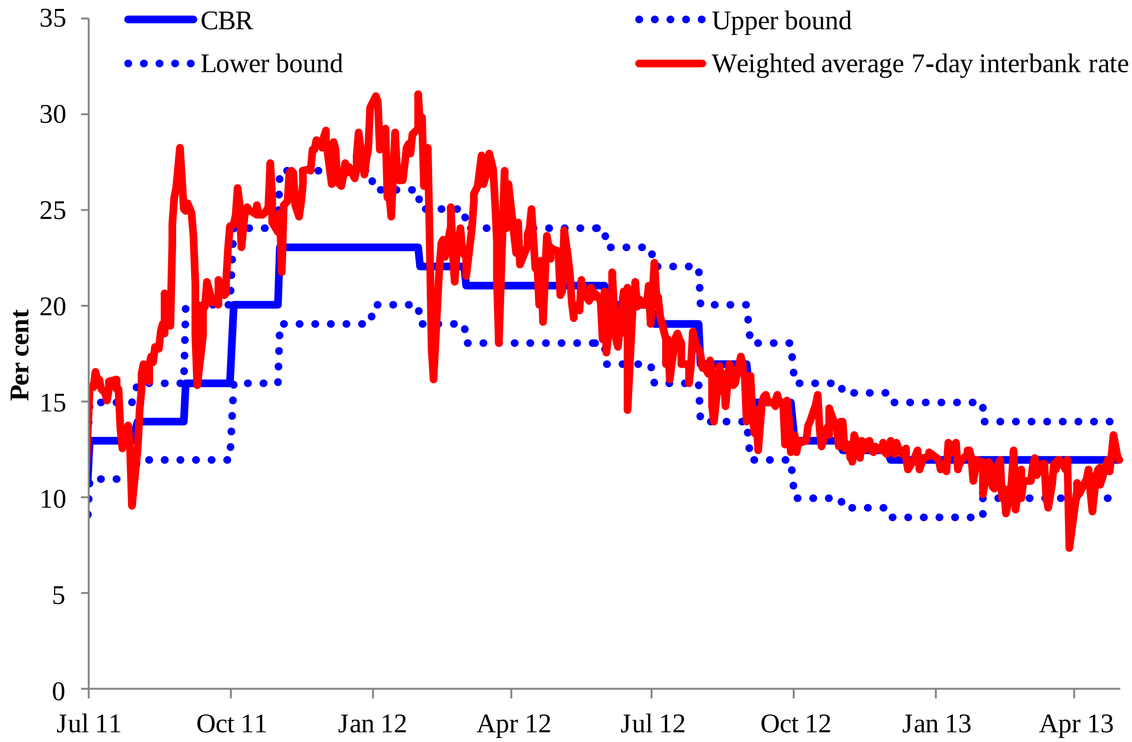
2.2.1 Interbank money markets

Commercial banks' activity in the interbank money market remained robust in April 2013 with the trade volume increasing significantly by 43 per cent to Shs. 1,868 billion from Shs 1,310 billion in March 2013. The 1-day trades dominated the trading activity with a share of 79 per cent, having increased to Shs. 1,482 billion from Shs. 1,021 billion in the previous month. The 7-day tenor, with a share of 15 per cent of total trading, increased to Shs. 271 billion from Shs. 249 billion during the same period. The dominance of overnight trading goes as far back as Q4 of 2012 and coincides with prevalence of structural liquidity surplus in the banking system.

In a bid to sterilize the structural liquidity surplus, BoU withdrew Shs. 1,766.6 billion from the market using the REPO and Deposit Auction instruments; Shs. 708 billion remained outstanding at the end of April. Consequently, liquidity conditions remained somewhat tightened as commercial banks' excess reserves fell to Shs. 60 billion in April, from Shs. 74 billion in March. Similarly, the monetary base fell by Shs. 315 billion, compared to a growth of Shs. 289 billion in the previous month.

Despite the fairly tight liquidity conditions during the month, the weighted average 7-day interbank rate continued to trend within the lower bound of the CBR, owing mainly to structural liquidity surplus. The 7-day weighted interbank money market rate averaged 11.4 per cent in April, compared to 11.3 per cent in March, amidst the CBR rate of 12.0 per cent. On the other hand, the overnight interbank and REPO rates were stable at 8 per cent and 12 per cent respectively in April. The rates for the 60-day deposit auction were also stable at 12.35 per cent, while those on the 30-day auction edged up slightly to 12.13 per cent from 12.10 per cent in the previous month. ***Figure 2,*** below, presents the evolution of the 7-day interbank money market rate with the monetary stance.

Figure 2: Evolution of the 7-day interbank rate

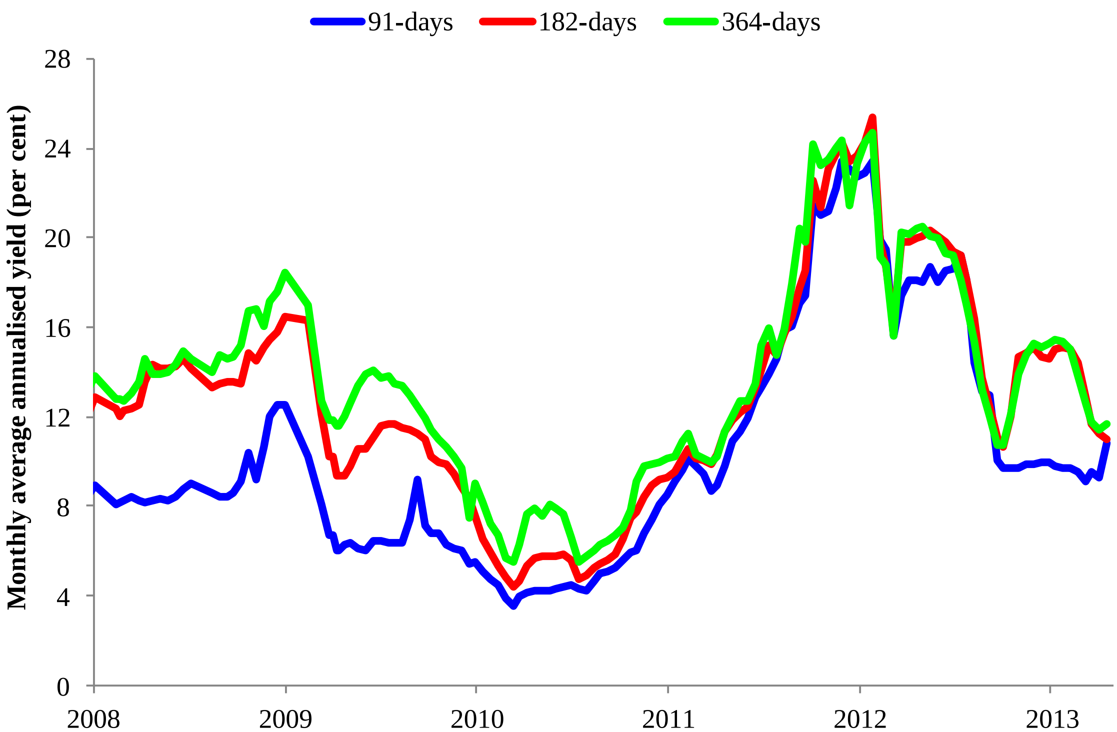


Source: Bank of Uganda

2.2.1 Treasury securities market

In line with fiscal financing needs, BOU conducted two Treasury bill auctions, one 3-year Treasury bond auction and one 10-year Treasury bond auction in the primary market. Lower yields were registered for all tenors' relative to previous auctions, except for the 91-day Treasury bill and the 3-year Treasury bond rates. Weighted average annualized yields for the 182-day and 364-day treasury papers fell to 11.1 per cent and 11.6 per cent respectively, from respective rates of 12.3 per cent and 12.2 per cent in March. 10-year Treasury bond yields declined to 14.1 per cent, from 14.7 per cent, while the 3-year Treasury bond yield rose to 12.3 per cent, from 11.8 per cent. Typically lower yields should reflect lesser inflation expectations over the next six months to 1 year. However, other unique factors may also have contributed towards the fall in yields over the month: structural liquidity and the BoU's act to publish a yield curve. The prevailing structural liquidity surplus in the banking system is likely to have increased demand for government securities, raised price quotations and thus lessened yields over the month. Furthermore, all yields appear to have moved more in line with what would be expected from the yield curve for government securities, which was published on the BoU website over the month. ***Figure 3,*** below, highlights the recent trend in Treasury bill yields.

Figure 3: Treasury bill yields



Source: Bank of Uganda

Similar to the primary market, secondary market yields for treasury securities of less than 182-days and less than 364-days fell in April, while those of less than 91-days rose. Annualized rates for securities of less than 182-days and less than 364-days fell to 10.9 per cent and 11.6 per cent respectively, compared to respective rates of 14.2 per cent and 12.1 per cent in the previous month. Secondary market yields fell broadly in line with those in the primary market over the month and thus may be indicative of improved market efficiency. The weighted average annualized yields for papers of less than 91-days to maturity increased to 13.1 per cent, from 9.5 per cent in March; whilst this represents a considerable monthly increase, the 91-day paper is little traded on the secondary market and thus the average rate may be heavily skewed by anomalies. The overall volume of Treasury bills traded in the secondary market increased marginally in April to Shs. 38.8 billion, from Shs. 38.2 billion in March, most of which was for the 364-day paper. ***Table 2*** presents a summary of secondary market activity for Treasury bills.

Table 2: Secondary Market Activity on Treasury bills

	91-days		182-days		364-days	
Bid and offer yield-to-maturity rates (per cent per annum)						
	Bid	Offer	Bid	Offer	Bid	Offer
Minimum	8.86	8.22	10.60	10.49	11.02	10.90
Maximum	9.29	9.18	11.33	11.16	11.49	11.37
Simple average	9.05	8.92	10.85	10.71	11.24	11.07
Total trading activity						
Transactions	1.63		1.38		35.80	
Horizontal repos	0.00		0.00		0.00	
Outright sales	1.63		1.38		35.80	
Average discount rate	12.08		10.15		10.42	
Average yield-to-maturity	13.12		10.94		11.55	

Source: Bank of Uganda

The effect of lower yields on secondary market trading was also registered amongst Treasury bonds. Secondary market trading for Treasury bonds fell significantly over the month to Shs. 7.8 billion, from Shs. 66.6 billion in March. The yield to maturity of Treasury Bonds of less than 2-years, less than 3-years and less than 5-years fell to 11.9 per cent, 12.1 per cent and 12.5 per cent respectively relative to respective rates of 12.5 per cent, 12.6 per cent and 12.8 percent in the previous month. There were no secondary market trades for bonds of 5 to 10-years maturity in April. ***Table 3*** presents a summary of indicative bid and offer quotes and the Treasury bond secondary market trading.

Table 3: Summary of rates in the Treasury bond secondary market

	2-year		3-year		5-year		10-year	
Bid and offer yield-to-maturity rates (per cent per annum)								
	Bid	Offer	Bid	Offer	Bid	Offer	Bid	Offer
Minimum	11.90	11.50	12.10	12.00	12.50	11.60	14.00	13.85
Maximum	12.15	12.00	12.40	12.30	12.80	12.70	14.10	13.95
Simple average	11.98	11.86	12.17	12.03	12.56	12.39	14.01	13.90
Total trading activity								
Outright sales	3.20		0.12		4.50			
Average yield-to-maturity	11.89		12.06		12.47			

Source: Bank of Uganda

2.3 Monetary aggregates and private sector credit

Responsible credit growth is also necessary to economic expansion, as may be evaluated with respect to lending and deposit rates and credit growth. . Very low commercial bank interest rates are likely to increase credit demand, but also credit demand for risky projects, as the borrower has less to lose. However, very high interest rates will stall credit growth, and thereby investment and ultimately economic growth, by elevating the cost of borrowing. Developments in the overall stock of loans, as illustrated through private sector credit , are also crucial to analyse, particularly to infer the position of bank balance sheets and for the expected growth of the real economy.

2.3.1 Lending and deposit interest rates

The cost of borrowing in foreign currency remains cheaper than borrowing in local currency despite the gradual fall of the latter throughout 2012 and 2013 to date. In March, the weighted average lending rates on Shilling loans fell by 0.3 percentage points to 24.0 per cent, from 24.3 per cent in February, while the rate on foreign currency loans edged up by 0.6 percentage points to 9.9 per cent, from 9.3 per cent previously. Banks continue to attribute expensive Shilling denominated loans to the high cost of deposit mobilization; the Shilling time deposit rate for March was 11.9 per cent and has averaged 12.8 per cent over January to March, creating an average spread of 11.4 percentage points over Q1 of 2013. Deposit mobilisation is necessary for banks to expand their loan portfolios in the future. From July 2012 to March 2013, the loan to deposit ratio for all deposit-taking institutions supervised by the BoU has averaged 78.2 per cent; given that the permitted maximum ratio is 80 per cent, banks will soon be unable to lend unless they expand their deposit base. However, the interest rate for foreign currency time deposits indicates that deposit mobilisation need not be expensive; foreign currency time deposits have comparatively averaged 5.5 per cent over January to March. In March, the weighted average foreign currency time deposit rate was 5.0 per cent and the depreciation trend was 3.0 per cent, which presents more favourable interest rates to the borrower. ***Table 4*** presents commercial banks' monthly weighted average interest rates.

Table 4: Banks' weighted average lending and deposit rates

	Domestic currency denominated loans			Foreign currency denominated loans		
	Average lending rate	Time deposit rate	Spread	Average lending rate	Time deposit rate	Spread
Jul 12	26.9	17.8	9.1	9.0	3.0	6.0
Aug	26.4	15.2	11.2	9.1	5.0	4.2
Sep	25.7	11.9	13.8	8.7	2.7	6.1
Oct	24.9	12.8	12.1	10.7	4.5	6.2
Nov	23.7	10.8	12.9	10.4	2.6	7.8
Dec	24.8	12.7	12.1	8.8	4.4	4.4
Jan 13	24.2	13.4	10.9	9.8	6.8	3.0
Feb	24.3	13.2	11.1	9.3	4.8	4.5
Mar	24.0	11.9	12.1	9.9	5.0	4.9
Average rates						
2012	26.5	16.2	9.9	9.4	4.2	5.2
Jul - Dec 2012	25.4	13.3	12.1	9.5	3.7	5.8
Oct - Dec 2012	24.5	12.1	12.4	10.0	3.8	6.1
Jan - Mar 2013	24.2	12.8	11.4	9.7	5.5	4.2

Source: Bank of Uganda

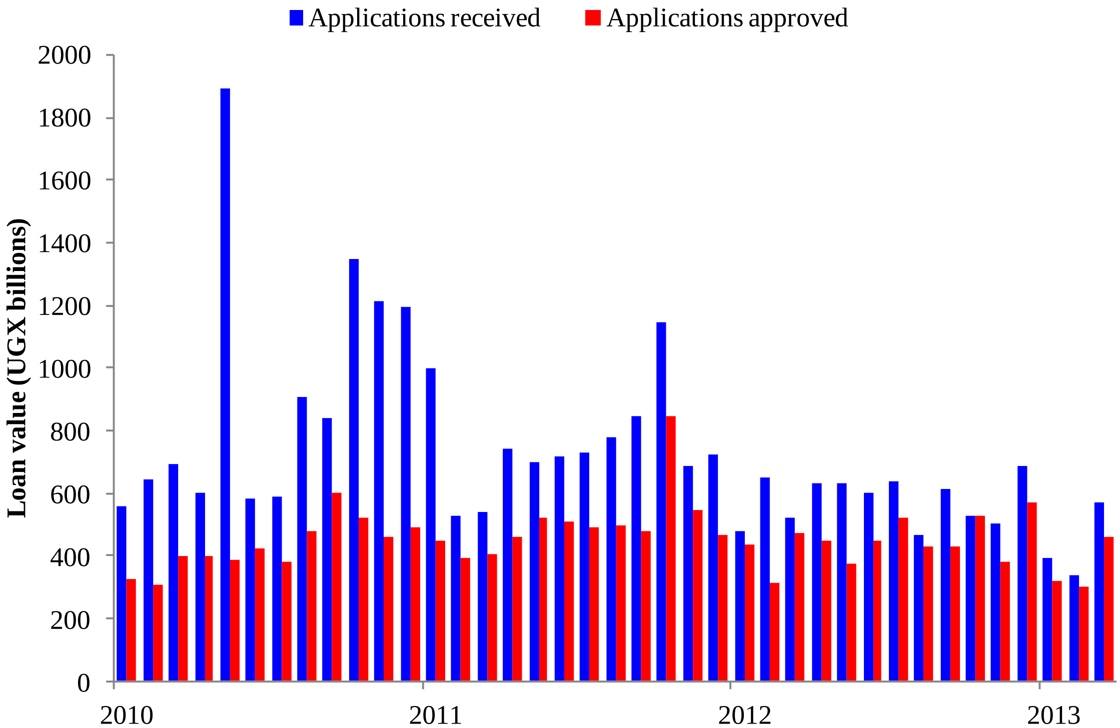
In April, commercial banks, with the exception of only five banks[1], stated that they intended to keep their prime lending rates[2] (PLRs) stable, which implies that lending rates are likely to remain sticky in the near term. Persistently high lending rates on Shilling denominated loans are not only a threat to private investment, and thus a downside risk to economic activity, but also pose a risk of dollarization to the economy. The BoU has therefore intensified moral suasion as way of persuading banks to reduce lending rates on shilling denominated loans.

2.3.2 Loan supply and demand

In March, the number of loan applications and loan approvals fell by 8.2 per cent and 11.6 per cent respectively to 34,083 and 32,449 loans. On the other hand, the value of loan applications and loan approvals increased significantly by 68.4 per cent and 54.8 percent respectively to Shs. 570 billion and Shs. 463 billion. The simultaneously smaller number of loan applications and approvals and higher values of applications and approvals indicate favourable lending to large borrowers. Given that large borrowers mainly include corporations who are low risk clients and usually have other collateral in addition to mortgages the increased lending to large borrowers could be related to the temporary closure of the land office. The closure of the land registry office in recent months has delayed mortgage approvals resulting into the delayed disbursement of Shs. 237 billion worth of loan applications as at March 2013. A summary of loan applications and approvals is shown in ***figure 4.***

[1] These five banks are to reduce their prime lending rate by 1 percentage point each on average.
[2] The interest rate commercial banks charge their best customers.

Figure 4: Loan applications and approvals



Source: Bank of Uganda

Private Sector Credit (PSC) declined in March compared to the previous month, and was mostly driven by a growth slowdown in foreign currency denominated loans. Annual PSC growth stood at 8.1 per cent in March, compared to 12.9 per cent in February. Foreign currency denominated loans grew by 31.2 per cent on an annual basis in March, much lower than the 52.1 per cent growth registered in February, whilst Shilling denominated loans declined further by 5.2 per cent from a 3.3 per cent decline over the same period.

Likewise, monthly PSC declined by 1.5 per cent in March, from an unchanged position the previous month, in light of declines by 3.3 per cent and 2.8 per cent in foreign currency and Shilling denominated loans respectively. The fall in PSC in March was largely attributed to the closure of the land registry office, and credit supply would have been higher had the Shs. 237 billion, that was pending approval, been cleared. Further, it was expected that foreign currency lending would continue to grow at the cost of domestic currency lending due to the lending cost differential, as explained above. However, the Shilling appreciation against the US Dollar in March, which also may have contributed to lesser foreign currency lending; foreign currency lending fell by only 1.5 per cent m-o-m in US dollar terms, compared to the 3.3 per cent decline noted in Shilling terms. ***Table 5***, below, presents lending to the private sector.

Table 5: Private Sector Credit Growth by Currency

	Monthly data				Annual data			
	PSC	Shilling denominated loans	Forex denominated loans (UGX)	Forex denominated loans (USD)	PSC	Shilling denominated loans	Forex denominated loans (UGX)	Forex denominated loans (USD)
Jul 12	-0.3	-0.2	-0.4	-0.6	10.4	1.0	34.2	41.4
Aug	0.6	0.0	1.9	0.7	6.6	-2.2	28.5	44.5
Sep	1.3	-0.3	4.4	2.9	4.4	-5.0	27.1	42.1
Oct	1.7	-1.5	8.0	6.3	7.5	-7.7	48.5	49.0
Nov	2.5	1.0	4.9	0.8	9.0	-7.1	50.2	43.3
Dec	1.7	0.2	4.2	4.3	11.8	-5.9	56.3	45.0
Jan 13	-0.2	0.4	-0.5	0.3	13.4	-3.9	58.6	38.5
Feb	0.0	-1.3	1.9	2.8	12.9	-3.3	52.1	36.5
Mar	-1.5	-2.8	-3.3	-1.5	8.1	-5.2	31.2	27.3

Source: Bank of Uganda

Alternative loan analysis also confirms that foreign currency lending was the main driver of the PSC decline in March. Foreign currency lending presented positive net recoveries equal to Shs. 150 billion in March, as loan recoveries increased and loan extensions fell. Shilling denominated lending, on the other hand, reflected a net extension of Shs. 34 million in March, driven by greater loan extensions versus lesser loan recoveries. The lesser loan recoveries in Shilling denominated loans contributed to the increase in the NPA[3] ratio; to 4.7 per cent in March from 4.2 percent in December 2012. The growth of Shilling denominated loan extensions versus the decline in foreign currency denominated loan extensions notwithstanding, increasing disbursement of foreign exchange loans could expose businesses to exchange rate depreciation risks. ***Table 6*** presents net loan extensions in foreign and domestic currency.

Table 6: Loan Recoveries and Extensions

	Domestic currency denominated			Foreign currency denominated			
	Extensions	Recoveries	Net extensions	Extensions	Recoveries	Net extensions	NPAs
Jul 12	405.8	-365.2	40.6	324.5	-381.4	-56.4	-
Aug	527.1	-484.1	43.0	367.0	-326.8	42.8	-
Sep	418.3	-431.9	-13.5	323.3	-324.7	-0.3	4.7
Oct	529.4	-516.5	12.9	370.9	-236.4	135.3	-
Nov	439.6	-404.0	35.5	438.2	-436.6	2.4	-
Dec	508.4	-518.2	-9.8	540.8	-494.0	47.2	4.2
Jan 13	432.0	-349.9	82.1	395.6	-436.6	-41.0	-
Feb	409.2	-426.7	-17.5	405.3	-364.8	40.5	-
Mar	376.0	-342.2	33.8	323.8	-474.0	-150.2	4.7

Source: Bank of Uganda

[3] NPA Ratio is the share of Non Performing Loans in Total Loans.

2.3.3 Monetary aggregates

Growth of the financial sector may be captured through growth in monetary aggregates, as lending allows commercial banks to create money on their balance sheet portfolios. Stable growth in monetary aggregates tends to enable stable inflation and economic growth, whereby rapid money growth is likely to be reflected in elevated inflation as well as poor economic growth.

In line with BoU's monetary operations in March that resulted into increased liquidity from REPO maturities, base money grew by 9.9 per cent, compared to a decline of 4.9 per cent in February, whilst monetary aggregates declined. On a monthly basis, M1, M2 and M3 fell by 0.8 per cent, 0.3 per cent and 1.4 per cent respectively in March, compared to respective growths of 1.3 per cent, 2.4 per cent and 2.0 per cent respectively in February. The decline in monetary aggregates in March was largely due to a fall in demand deposits of 2.3 per cent, as a result of huge local government withdrawals that had led to the increase the previous month and a decline of 4.4 per cent in foreign currency deposits following an exchange rate appreciation. Time and savings deposits however, increased by 0.4 per cent in March. Monthly developments in monetary aggregates are shown in ***table 7***.

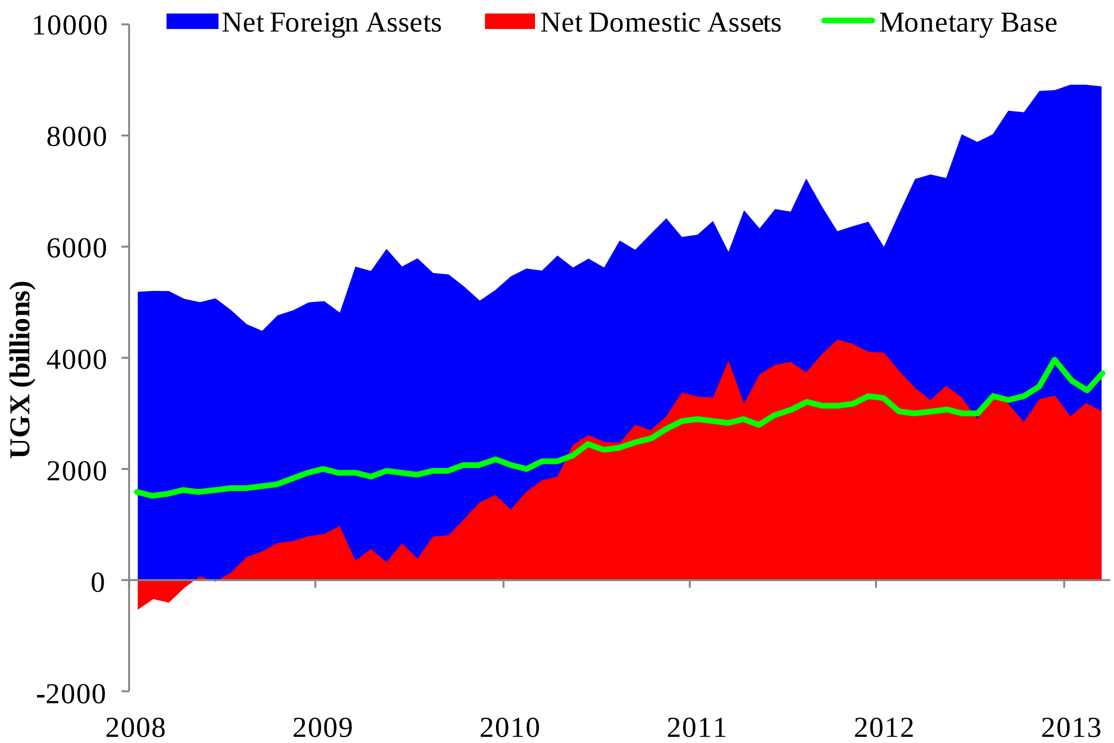
Table 7: Evolution of Monetary Aggregates and Private Sector Deposits

	Monetary aggregates			Currency in circulation	Demand deposits	Time & savings deposits	Foreign deposits
	M3	M2	M1				
Jul 12	-4.7	-1.2	-4.0	-1.8	-5.8	2.6	-12.1
Aug	5.8	7.2	9.5	4.4	13.6	4.3	2.4
Sep	1.9	0.7	2.8	-0.7	5.5	-2.2	4.9
Oct	-3.1	-2.7	-0.9	-1.3	-0.6	-5.2	-4.0
Nov	7.1	8.8	12.7	8.9	15.4	3.1	2.7
Dec	0.7	1.5	1.3	5.8	-1.7	1.8	-1.5
Jan 13	-2.3	-2.6	-2.2	-2.2	-2.2	-3.2	-1.5
Feb	2.0	2.4	1.3	-3.4	4.7	4.1	1.0
Mar	-1.4	-0.3	-0.8	1.4	-2.3	0.4	-4.4

Source: Bank of Uganda

A similar trend in monetary aggregates was registered on the quarterly and annualized basis, which saw M2 and M3 fall by 0.6 per cent and 1.8 per cent respectively on a quarterly basis, and grew by a lesser rate of 13.0 per cent and 11.6 per cent respectively on an annual basis. Likewise, M1 fell on a quarterly basis by 1.7 per cent but grew by a higher rate of 16.4 per cent on an annual basis. The annual growth in monetary aggregates since November 2012 has to a large extent been driven by the Central Banks' Net Foreign Assets (NFA) over the period under review. In March 2013, NFA of BoU grew by 21.7 per cent while NFA of other deposit-taking Institutions grew by 6.0 per cent. The trend of base money versus the banking system's NFA and NDA is shown in ***figure 5.***

Figure 5: Evolution of base money and its components



Source: Bank of Uganda

3 Economic activity

3.1 Global economic activity

Strong global economic confidence and activity and a favourable exchange rate all tend to increase domestic export demand. Greater global demand will thus boost domestic production, create employment and encourage economic growth. Furthermore, a multiplier effect should accentuate production, employment and growth beyond that to satisfy the increased export demand.

3.1.1 Real economic activity

Although outside the control of Ugandan policymakers and business leaders, global economic forces play a critical role within the Ugandan economy. The small size and relatively open nature of the Ugandan economy make it highly vulnerable to global economic developments, particularly via financial flows, demand, exchange-rate and inflationary pressures. The most relevant developments to Uganda will be developments in the world's largest markets: advanced markets such as the Euro zone, Japan, UK and US and increasingly in emerging economies such as Brazil, China, India and South Africa, as well as developments in the East African Community and the COMESA region.

Although global economic prospects remain positive, risks in the Euro zone and the United States continue to blur earlier optimism for stronger economic recovery in 2013. In the World Economic Outlook for April 2013, the IMF further reduced its world economic growth forecast for 2013 down to 3.3 per cent, from 3.5 per cent projected in January 2013 and 3.6 percent projected in October 2012. Anticipated positive world economic growth is expected to stem from robust private demand in the US and strong economic activity in emerging market and developing countries. ***Table 8*** below highlights the trend of the forecasts for growth since October 2012.

Table 8: IMF World Economic Outlook Projections: Annual GDP growth

	Oct 2012 Projections		Jan 2013 Projections		Apr 2013 Projections	
	2013	**2014**	**2013**	**2014**	**2013**	**2014**
World	3.6	4.2	3.5	4.1	3.3	4.0
Advanced economies	1.6	2.3	1.4	2.2	1.2	2.2
US	2.1	2.9	2.0	3.0	1.9	3.0
Euro zone	0.1	1.1	-0.2	1.0	-0.3	1.1
Japan	1.2	1.1	1.2	0.7	1.6	1.4
UK	1.1	2.2	1.0	1.9	0.7	1.5
Emerging and developing economies	5.6	5.9	5.5	5.9	5.3	5.7
China	8.2	8.5	8.2	8.5	8.0	8.2
India	6.0	6.4	5.9	6.4	5.7	6.2
Brazil	3.9	4.2	3.5	4.0	3.0	4.0
Sub-Saharan Africa	5.8	5.7	5.8	5.7	5.6	6.1
South Africa	3.0	3.8	2.8	4.1	2.8	3.3

Source: IMF

In the US, GDP is projected to grow by 1.9 per cent in 2013, from 2.2 per cent recorded in 2012. This represents a downward revision from the growth projections of 2.0 per cent and 2.1 per cent in January

2013 and October 2012 respectively. The relatively lower growth is on account of the fiscal adjustment underway in the US. Furthermore, the advance US estimate of GDP for Q1 of 2013 indicates an expansion of 2.5 per cent (Q-o-Q), from 0.4 per cent recorded in Q4 of 2012. This represents an annual GDP growth of 1.8 per cent. Unlike most advanced countries, US GDP growth has managed to remain relatively resilient to federal, state and local government spending cuts, and was boosted by acceleration in consumer and residential investment spending over the quarter.

Emerging-market and developing countries are projected to grow by a lesser extent in 2013, at 5.3 per cent, supported mainly by China's accommodative macroeconomic policies and revival of exports. Although lower than expected, China's projected growth of 8.0 per cent in 2013 is still sufficiently large to support the positive GDP growth in emerging markets, above the world average.

In the Euro zone, the latest projection for GDP growth is a contraction of 0.3 per cent over 2013, which is a higher contraction than earlier projected, on account of fiscal adjustment, emerging political and financial risks and persistent weaknesses in banks' balance sheets that have delayed the pass-through of monetary expansion to the wider economy.

3.2 Domestic economic activity

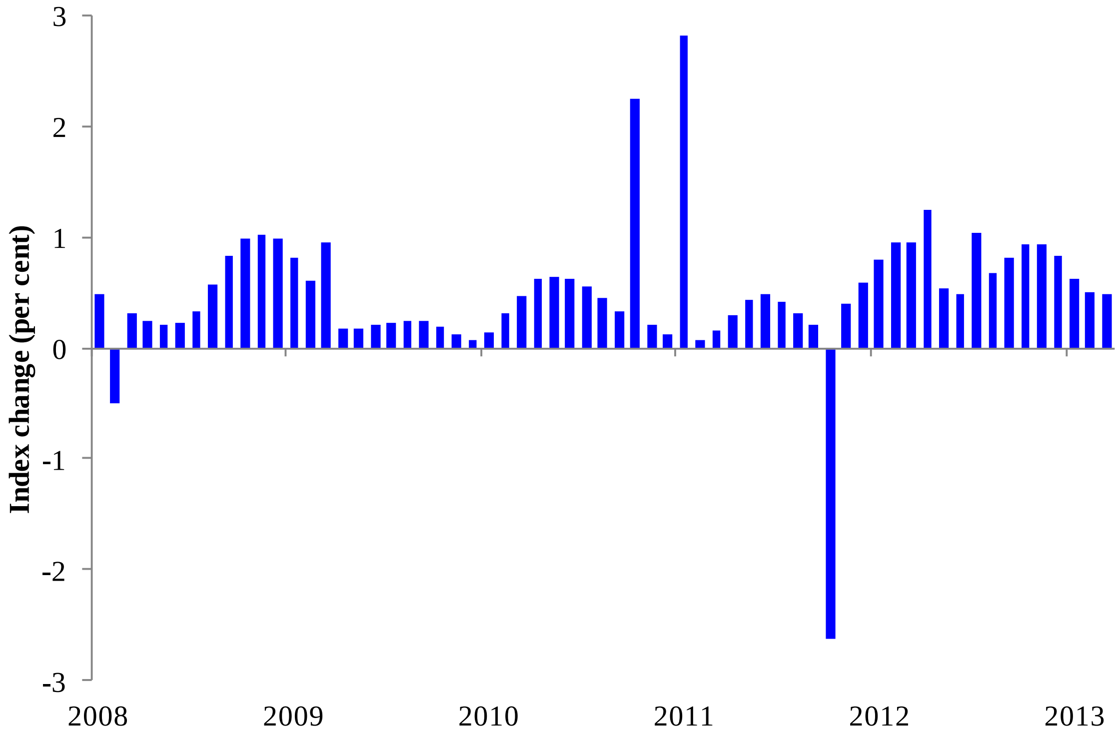
Growth in domestic demand, often reflected in an expansion in output, may be attributed to an increase in consumption, investment or government expenditure. An increase in any of the above should increase employment, as more workers are needed in the production process and more income is available to pay wages, which will in turn further increase aggregate demand. A multiplier effect should emanate from increased production, unless otherwise disrupted.

3.2.1 Real economic activity

Economic activity is measured using GDP figures. Within Uganda, the services sector is the dominant source of real economic activity, contributing to approximately 52 per cent of GDP. The industrial sector makes up approximately 25 per cent of GDP, whilst agriculture comprises approximately 14 per cent; the remaining 9 per cent arises from net taxes. Whilst agriculture is the smallest real sector, it is comparatively large when compared to other economies, and is where the majority of the population are l employed. Furthermore, it is particularly relevant to monetary policy in that it is the one sector that monetary policy is least able to affect, yet economic development is widely believed to stem from agricultural development. Therefore, this section will evaluate domestic GDP developments across all of the real sectors of the economy.

The composite index of economic activity (CIEA) is a measure which provides information on economic developments in the country on a more timely and frequent basis compared to actual GDP. Analysis of CIEA for March 2013 indicates relatively stable growth in comparison to February 2013. The monthly CIEA rose by 0.5 per cent to 160.3 in March from 159.5 recorded in the previous month, which implies that GDP growth will continue to rise throughout 2012/13. The observed improvement in monthly economic activity is largely due to increased consumption, as shown by an increase in wholesale and retail trade, which contributed 0.2 per cent to aggregate growth. On a quarterly basis, the level of economic activity is estimated to increase, albeit at a slightly slower pace of 2.0 per cent in the first quarter of 2013, compared to 2.1 per cent growth in the same period of the previous year. ***Figure 6***, below, illustrates monthly CIEA growth in Uganda.

Figure 6: Monthly changes in the CIEA



Source: Bank of Uganda

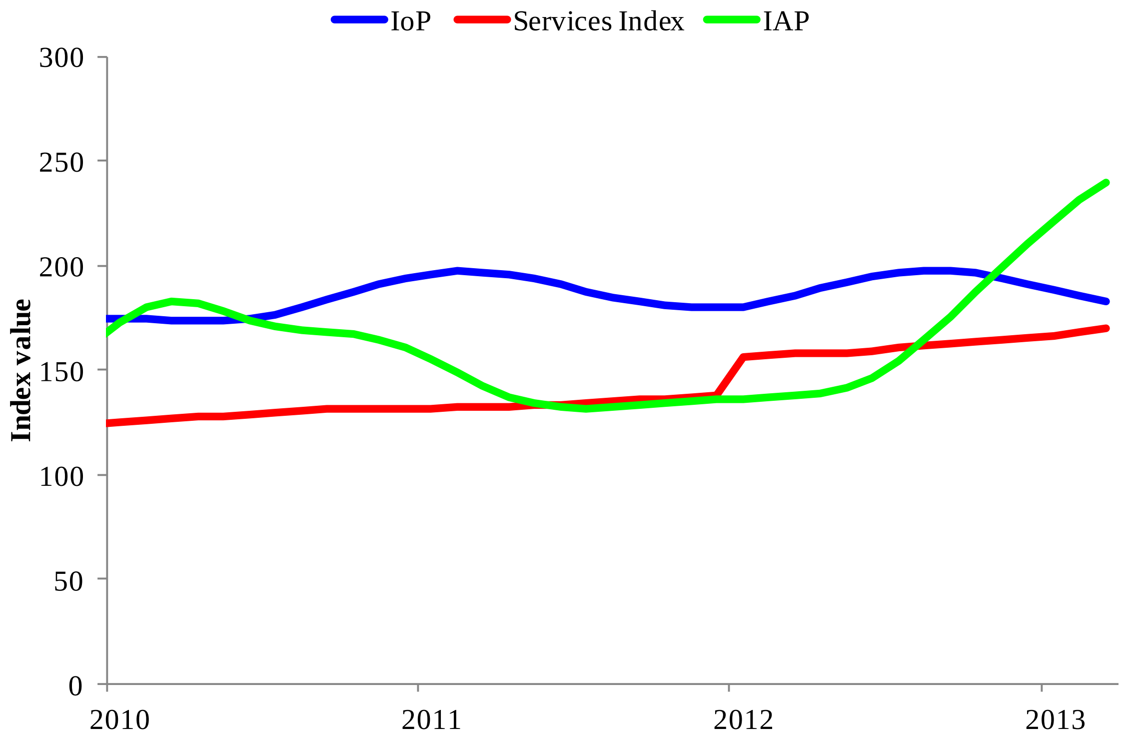
Growth in activity in the three major sectors (Services, Industry and Agriculture) is compared using the Services Index, Index of Industrial Output (IOP) and Index of Agricultural Production (IAP). These are obtained using seasonally adjusted data to filter out the combined seasonal and calendar effects.

Figure 7 illustrates that during February 2013, the industrial sector estimated by the IOP posted negative growth, while the services and agricultural sectors registered increases in growth. The IOP is estimated to have declined by 1.3 per cent in March to 183.2, from 185.6 recorded in February. With the exception of the Textiles, Clothing and Footwear subsector, which is estimated to have grown by 2.4 per cent, all the other subsectors are estimated to have declined over the month. On an annual basis, the industrial sector is estimated to have declined by 1.5 per cent during March when compared to the same period last year.

The monthly services index rose by 1.0 per cent to 169.9 in March, from 168.3 the previous month, suggesting continued growth of the sector. The observed improvement in economic activity in this sector was mainly due to the transport and communications, hotel and restaurants and wholesale and retail trade sectors, which contributed 0.75 per cent, 0.34 per cent and 0.17 per cent respectively to overall growth. On an annual basis, the services sector is estimated to have grown at a rate of 7.7 per cent.

The monthly IAP rose by 3.5 per cent in March to 239.8, from 231.3 in February, which captures an increase in the trend cycle for agricultural production. In particular, beans recorded a significant increase in market deliveries. ***Figure 7***, below, illustrates sectoral economic growth, according to the respective indices.

Figure 7: Sectoral indices



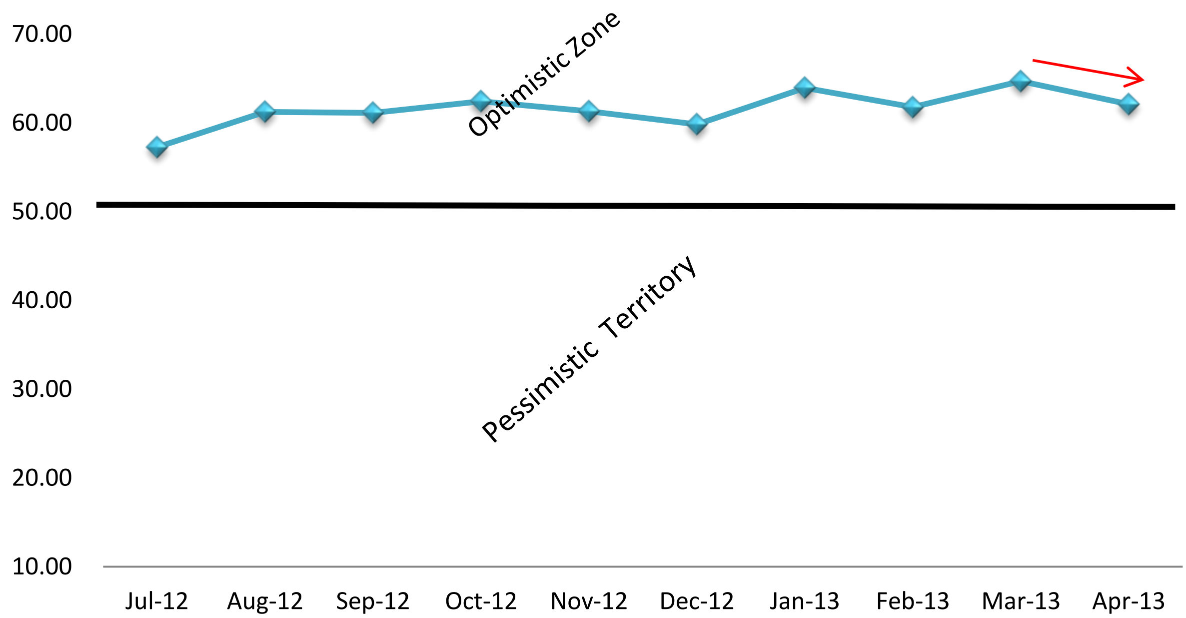
Source: Bank of Uganda

Business confidence continues to be favourable in April 2013, with an increasingly optimistic outlook ahead. However, the overall confidence index (CI) fell to 62.1 points over the month, lower than the 64.7 points recorded in March 2013.

The decline in optimism spread across all sectors, except for wholesale and retail trade. In April, the 'other services' sector declined considerably to 65.0 points, down from 70.6 points in March. The business confidence index for the construction and manufacturing sectors stood at 56.6 and 61.3 points respectively, down from 56.8 and 62.6 points in March. Conversely, the confidence index for wholesale and retail trade increased to 58.8 points, from 56.5 points in the preceding month.

The business outlook for the next three months, according to interviewed firms' sentiments generally remained optimistic, but less so than previously. The confidence indices for the construction, manufacturing, wholesale and retail trade and 'other services' sectors stood at 66.2, 75.5, 71.1 and 78.7 points respectively. However, firms cited weak domestic demand, competition and high costs of borrowing as constraints to businesses. ***Figure 8,*** below, presents the overall business confidence index.

Figure 8: Overall Business Confidence Index



Source: Bank of Uganda

3.2.2 Fiscal activity

Fiscal performance in the first nine months of 2012/13 improved, but still registered an underperformance in both government revenue and expenditure, relative to 2011/12. On a monthly basis, government execution of the approved budget represented by Government expenditure improved from 62.1 per cent in the previous month to 68.8 per cent currently. Nevertheless, the fiscal performance has continued to fall short of the eased fiscal stance in the approved budget for 2012/13. This, however, may be expected to change, and fiscal performance may boost aggregate demand in the remaining months of 2012/13, if fiscal operations maintain the improved performance observed in March 2013.

The increased issuance of government securities, however, continues to be a key risk to the execution of the approved budget. In March 2013, Government recurrent expenditure registered better performance, largely on account of higher interest payments (both foreign and domestic). The stock of public domestic debt, although still within the 2007 domestic debt strategy threshold, has increased rapidly in 2012/13 and is edging closer to the threshold, thus posing a risk to private sector credit and economic growth.

Table 9 illustrates Government expenditure against the approved budget for the first nine months of financial year 2012/13.

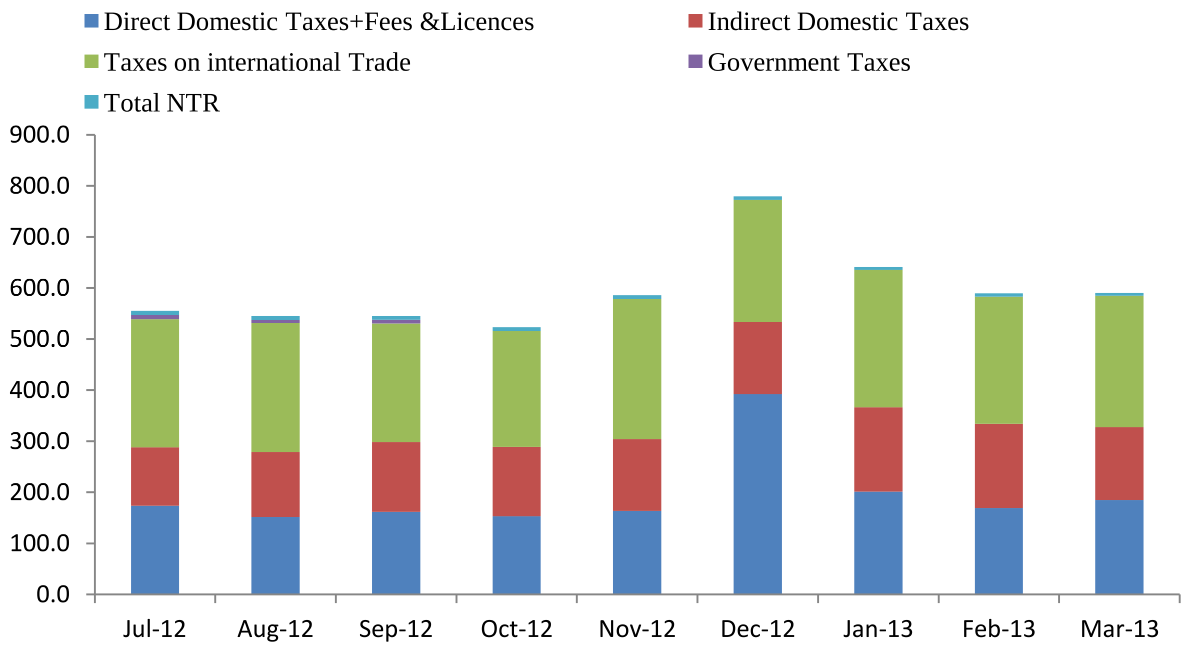
Table 9: Summary of fiscal operations (UGX billions)

	Approved Budget 2011/12	Cummulative July 2011 –		Approved Budget 2012/13	Cummulative July 2012 –	
		UGX billions	*Per cent of approved budget*		*UGX billions*	*Per cent of approved budget*
Revenues and grants	**7756.0**	**5783.4**	**74.6**	**8698.5**	**6148.7**	**70.7**
Revenues	**6402.0**	**4866.4**	**76.0**	**7455.8**	**5296.8**	**71.0**
URA	6169.0	4399.7	71.3	7284.7	5144.0	70.6
Non-URA	121.0	74.3	61.4	171.1	152.8	89.3
Oil revenues	-	392.3		-	0.0	
Grants	**1466.0**	**917.1**	**62.6**	**1242.8**	**851.9**	**68.5**
Budget support	635.0	534.6	84.2	480.7	153.2	31.9
Project support	831.0	382.5	46.0	762.1	698.7	91.7
Expenditure and lending	**9869.0**	**6852.7**	**69.4**	**10926.5**	**7519.6**	**68.8**
Current Expenditures	**4963.0**	**3985.7**	**80.3**	**5606.9**	**4257.8**	**75.9**
Wages and salaries	1809.0	1345.1	74.4	2140.8	1598.1	74.6
Interest payments	520.0	420.6	80.9	840.4	675.8	80.4
Domestic		360.5		713.9	596.6	83.6
External		60.1		126.5	79.2	62.6
Other recurrent expenditures	2114.0	2220.0	105.0	2625.6	1919.8	73.1
Development expenditures	**4667.0**	**2624.4**	**56.2**	**5296.3**	**3223.8**	**60.9**
Domestic development	2790.0	1465.7	52.5	3303.6	1588.9	48.1
External development	1877.0	1158.7	61.7	1992.7	1635.0	82.0
Net lending/repayments	39.0	-31.5	-80.7	-11.8	-0.6	5.5
Domestic arrears repayment	279.0	274.1	98.2	35.0	38.5	110.1
Overall fiscal balance (excluding grants)	**-3580.0**	**-1986.3**	**55.5**	**-3470.7**	**-2222.7**	**64.0**
Overall fiscal balance (including grants)	**-2114.0**	**-1069.2**	**50.6**	**-2228.0**	**-1370.8**	**61.5**
Financing:	**2114.0**	**-1069.2**	**50.6**	**2228.0**	**1365.7**	**61.5**
External financing (net)	**1176.0**	**1069.2**	**55.6**	**1249.1**	**657.0**	**52.9**
Disbursements	1411.0	820.1	58.1	1499.5	818.0	54.5
o/w Budget support loans	*366.0*	*125.7*	*34.3*	*268.8*	*22.4*	*8.3*
o/w Project support loans	*1045.0*	*694.5*	*66.5*	*1230.7*	*795.5*	*64.6*
Amortization (net)	-189.0	-165.8	87.7	-250.4	-151.6	60.5
Domestic financing (net)	**938.0**	**174.2**	**18.6**	**978.8**	**417.4**	**42.6**
Bank financing (net)	838.0	-927.8	-110.7	753.8	247.9	32.9
Non-bank financing (net)	100.0	1101.9	1101.9	225.0	169.4	75.3

Source: MoFPED and BoU

Total Government revenue registered lower performance relative to the approved budget than in 2011/12, on account of lower performance of domestic revenue, in particular tax revenue. Non-tax revenues posted a surplus of 0.7 per cent and performed strongly relative to 2011/12. Tax collections fell short of the target by 2.4 per cent, owing to shortfalls from international trade, in particular petroleum duty, VAT on imports, excise duty, and temporary road licenses. The shortfall in international trade tax collections, which accounted for the largest portion of total tax collections, was largely a consequence of a combination of illicit trade, which reduced petroleum duty collections, and lower than projected fuel imports; Kerosene and Diesel in particular, noted lower import amounts on account of the ongoing repairs to the offloading jetty in Mombasa. Direct and indirect tax collections, however continued to register surpluses. ***Figure 9*** shows the categories of taxes and their contribution to overall tax revenue.

Figure 9: Tax revenue performance



Source: MoFPED and BoU

Despite cuts in donor disbursements, total grants performed better than in 2011/12, aided by a strong performance in project support grants, equal to 91.7 per cent of the approved budget. This helped to moderate the strong underperformance of budget support grants relative to both the approved budget and to 2011/ 12.

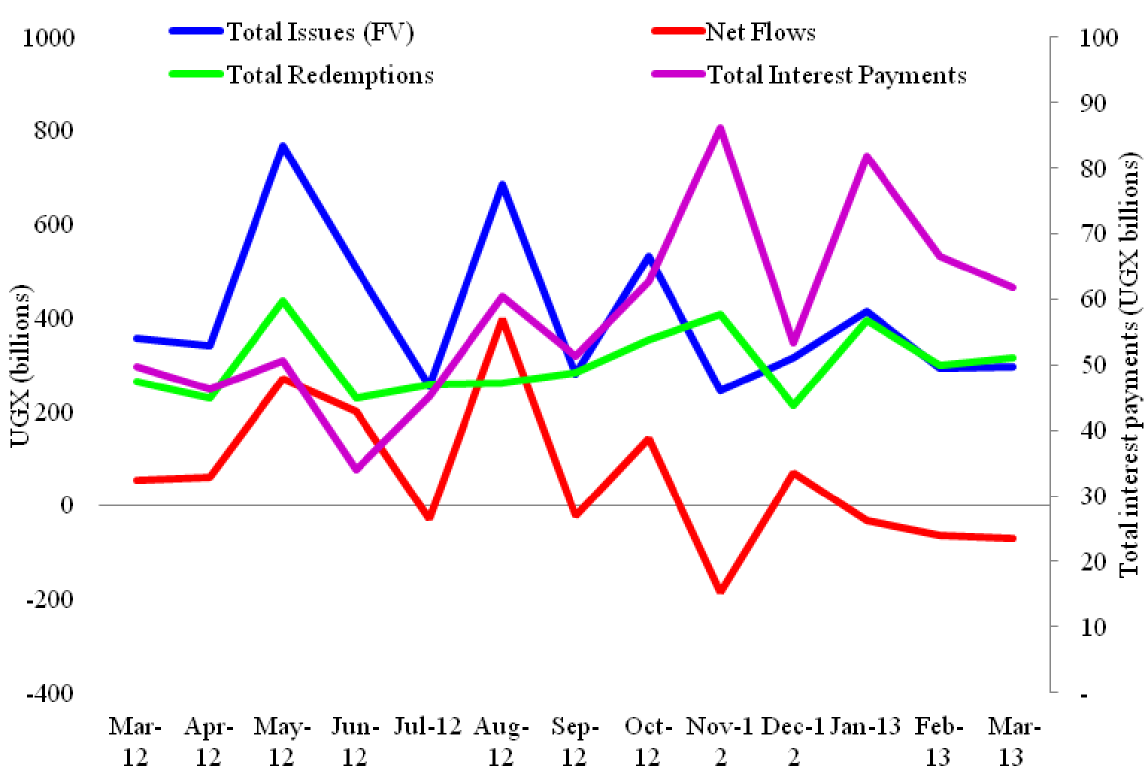
Although government expenditure continued to register an underperformance, expenditure increased somewhat in March on account of stronger performance in both current and development expenditure. The improved performance in current expenditure was facilitated by higher domestic and foreign interest payments. In particular, wages and salaries performed strongly in March, at 74.6 per cent of that expected in the budget for the first nine months of 2012/13. The improved performance in development expenditure relative to the budget was supported by a strong performance in externally funded development expenditures, which reflects the outturn of project support grants and loans.

Fiscal financing over the first nine months of 2012/13 amounted to 61.5 per cent of the approved budget, an improvement upon the 57.0 per cent registered in the preceding month, and above that achieved in 2011/12. The improved performance in fiscal financing was on account of higher domestic financing.

External financing registered an underperformance, mainly on account of donor withdrawal of budget support loans. However, reduced budget support loans were compensated for by strong performance in project support loans**.** ***Table 10*** provides a summary of overall external assistance, and illustrates that despite the cuts in donor disbursements, particularly budget support, the external assistance performance does not vary much from 2011/12, aided by the strong performance in project support loans and grants.

Domestic financing performance improved in March, but still remained far below the approved budget at 42.6 per cent. Developments in the Government securities market between June 2012 and March 2013 culminated into a net accumulation of public domestic debt by Shs. 208.2 billion. Consequently, the public domestic debt stock increased from Shs. 2,934 billion to Shs. 3,978 billion, representing a 35.6 per cent increase over the nine months. The public domestic debt stock also grew by 20 per cent over the month, and 23.4 per cent compared to March 2012. Increased issuances of Government securities entail an additional pressure on the fiscal budget. Although public domestic debt is still within the 2007 debt strategy macro sustainability benchmarks, it has grown quite rapidly in 2012/13 and is edging closer to the debt sustainability threshold. ***Figure 10*** shows the domestic debt flows between March 2012 and March 2013.

Figure 10: Public domestic debt flows



Source: BoU

Given the fiscal performance so far, fiscal operations may be expected to continue to improve and to perform more buoyantly in the remaining quarter of 2012/13, if the budget is executed as planned. Current Government expenditure may be expected to perform more strongly over the coming months partly as the delays observed in February are overcome, in particular the reduced payments of wages and salaries over the recent period. Anticipated fiscal performance may be expected to boost aggregate demand in the last quarter of 2012/13. However, higher domestic interest payments, resulting from higher issuance of Government securities, may dampen fiscal performance. The redemption profile, which indicates an increasingly higher level of redemptions in the remaining months of 2012/13, poses an additional risk to the execution of the approved budget.

As reported in the previous month, budget support performance so far indicates that US$42.7 million may be expected to be spent in the remaining part of 2012/13. However, these funds are unlikely to be realized, given donor withdrawal of budget support in favour of project support grants and loans.

4 Exchange rates and balance of payments

4.1 Exchange rates

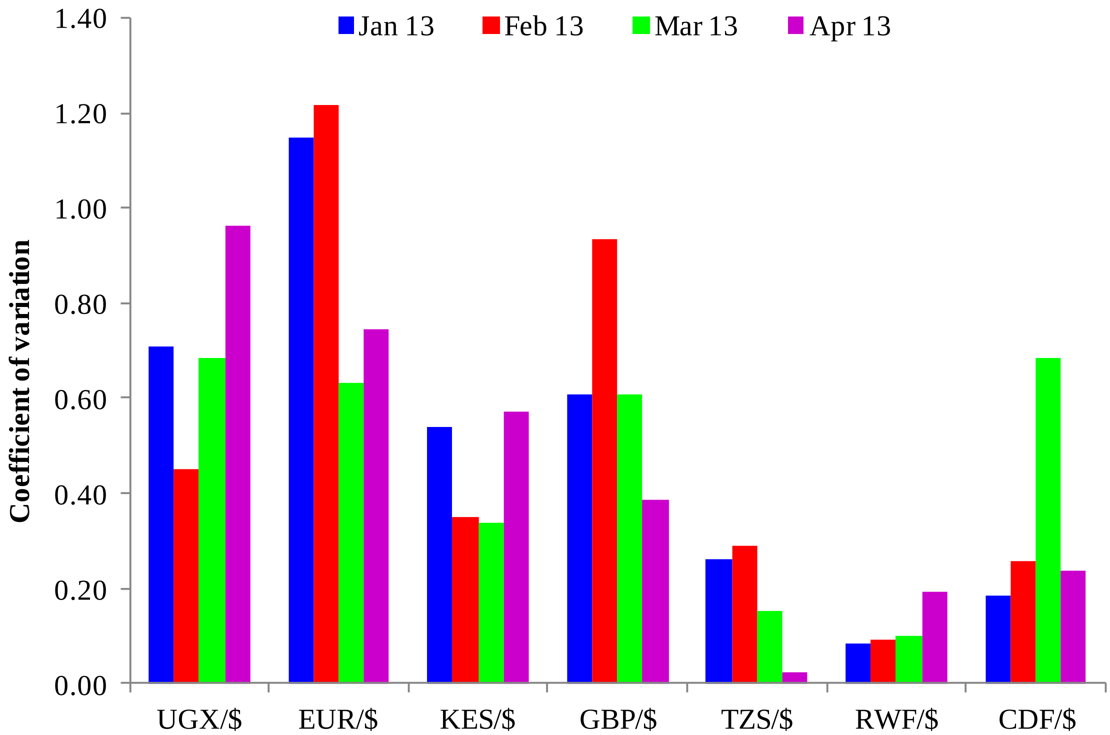
Exchange rate movements stem from changes to interest rates and inflation; high interest rates or inflation will create exchange rate depreciation, as explained through the interest rate parity condition. A domestic depreciation should improve competitiveness within Uganda's export sector and therefore improve the trade deficit, whilst a domestic appreciation will have the opposite effect. Furthermore, depreciation will make international goods more expensive to consumers and vice versa. The effect of the exchange rate upon net exports may also be captured through developments in the terms of trade.

Exchange rate movements may also affect Uganda through rendering other national trade partnerships more or less favourable. For example, if the Ugandan exchange rate remained stable, but the Kenyan exchange rate depreciated, then Uganda may lose trade to Kenya. Therefore, an appraisal of international exchange rates is necessary to explain international trade, and thus growth patterns. Finally, the nominal effective exchange rate (NEER) determines the cost of imports to Uganda, whilst the real effective exchange rate (REER) simply adjusts for the cost for inflation. A depreciation of the nominal effective exchange rate will increase the cost of imports, which is likely to feed through to domestic price and reduce aggregate demand.

In April 2013, the Uganda Shilling appreciated against the US Dollar by 2.2 per cent month-on-month, but depreciated by 2.9 per cent year-on-year to a mid-rate of 2,578.01/US$ in the Interbank Foreign Exchange market (IFEM). April's appreciation represents the third consecutive month of appreciation, with the magnitude of monthly appreciation being the largest since March 2012. In addition, the annualised depreciation is the lowest in the last two quarters (see ***figure 2***). The basis of the appreciation was increased inflows from portfolio investors and remittances, especially to NGOs, combined with relatively subdued demand.

The buoyant dollar supply by offshore players during the month facilitated bullish sentiment in the Forex market, which triggered volatility of the exchange rate. This prompted BoU to intervene and purchase US$32.25 million in the Interbank Foreign Exchange Market (IFEM). As a consequence, volatility (measured by the coefficient of variation), which had reached 1.0 per cent during the month, was dampened to 0.96 per cent; however, this remains much higher than the 0.68 per cent recorded the previous month (see ***figure 11***).

Figure 11: Volatility of selected currencies



Source: Bank of Uganda

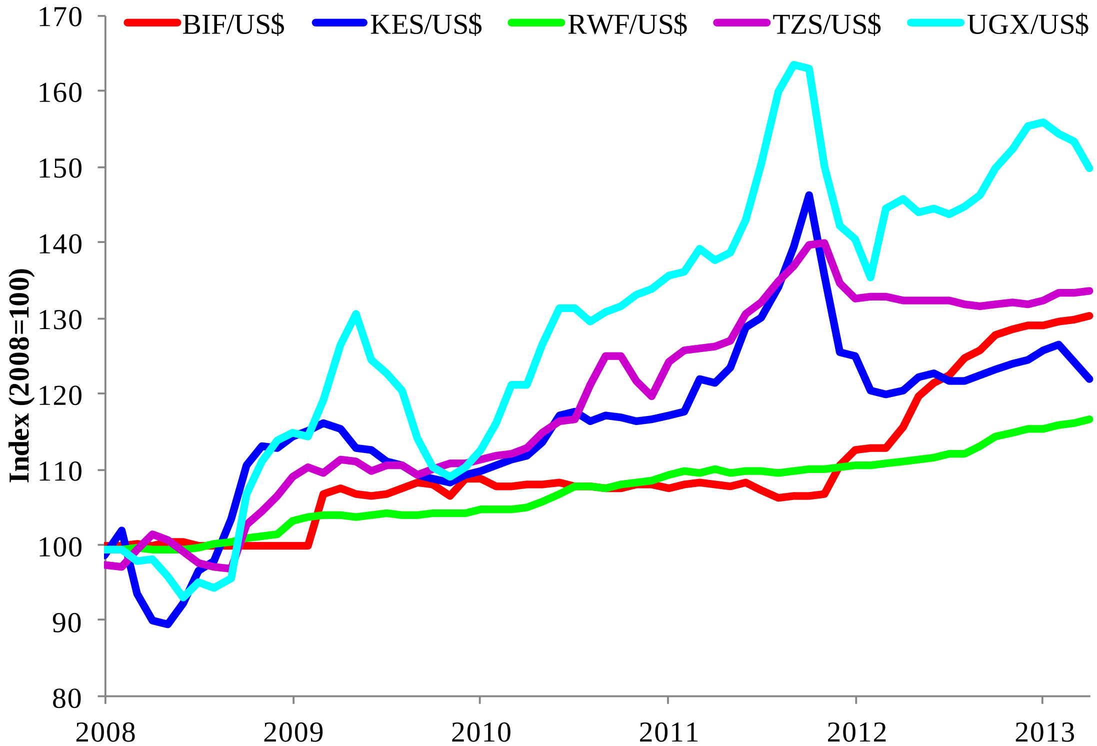
The Bank also purchased dollars for reserve build-up, amounting to US$20.0 million, and conducted targeted sales, amounting to US$ 15.42 million. Intervention by the BoU in the IFEM during the month resulted in a net purchase of US$ 36.83 million.

On a regional front, all other currencies in the EAC experienced increased volatility over the month, apart from the Tanzanian shilling, although to a lesser extent than the Ugandan shilling.

Similar to the Ugandan shilling, the Kenyan shilling gained 1.2 per cent against the US dollar on a monthly basis, to a monthly average of KES 84.22/US$ in April 2013. However, it also depreciated by 1.2 per cent on an annual basis.

Other currencies in the region all depreciated against the US Dollar over the month; the Tanzanian shilling weakening by 0.2 per cent to an average of TZS 1,598.81/US$, whilst the Rwandan and Burundi Francs both lost 0.4 per cent to averages of RWF 637.39/US$ and BIF 1486.55/US$ respectively (see ***figure 12***).

Figure 12: Movement in EAC currencies against the US Dollar



Source: BoU

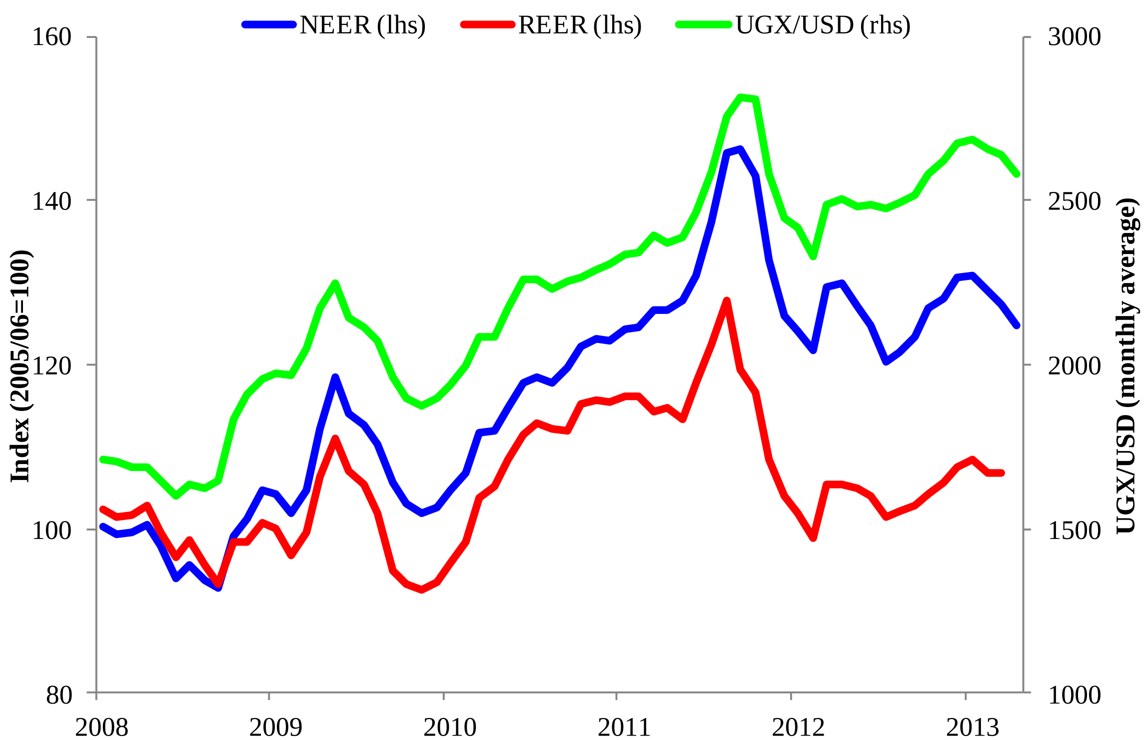
4.1.1 Nominal and real effective exchange rate

In April 2013, the Nominal Effective Exchange Rate (NEER) appreciated by 2.1 per cent on a monthly basis, contrary to a 4.0 per cent depreciation on an annual basis. Month-on-month, the appreciation of the NEER reflects an improvement in the strength of the Uganda shilling relative to her main trading partners and furthermore presents acceleration in appreciation momentum when compared to the 0.9 per cent appreciation recorded in March 2013.

On a bilateral level, the Shilling appreciated against the Euro (by 1.8 per cent), the British Pound (by 1.4 per cent), the South African Rand (by 1.7 per cent) and the Kenya Shilling (by 0.4 per cent) over the month.

In March 2013, the Real Effective Exchange Rate (REER) appreciated by 0.1 per cent over the month, but depreciated by 1.2 per cent on an annual basis. The monthly REER appreciation was driven by the monthly appreciation in the NEER, which more than offset the increasing price differential, while the annual depreciation was similarly driven by the REER. The exchange rate developments present a reduced ability to compete within Uganda's export sector over the month, however over the year the export sector appears more competitive. ***Figure 13*** below shows the evolution of the effective exchange rates.

Figure 13: Evolution of the NEER and REER



Source: BoU

Expected inflation stability and maintenance of the CBR at 12 per cent over May, might uphold buoyant portfolio inflows and consequently strengthen the Shilling. The major down side risk would be a rebound in import demand, which might be expected in line with the anticipated narrowing of the output gap, and a reduction in the interest deferential with Kenya following the post-election peace, which could trigger portfolio reversals.

4.2 Balance of payments

Increased economic activity, deeper financial market structure, stable and positive inflation and exchange rate depreciation will act to attract capital inflows and increase export demand, thereby contributing to a balance of payments surplus. In the long-term, the balance of payments should be neutral, however short-term deviations are to be expected and a surplus is favourable to economic growth. Uganda typically suffers a trade deficit, which consequently demands a net surplus in the capital and financial accounts. However, capital and financial flows tend to be volatile and thus may not necessarily be relied upon to uphold the balance of payments. This section presents the interaction between the current, capital and financial accounts in order to present the overall balance of payments position.

Preliminary data indicates that the Balance of Payments deteriorated to a deficit of US$61.28 million in March, from a revised surplus of US$80.38 million recorded in February. This resulted into a drawdown of International reserves by US$59.65 million, creating an international reserve position of US$2,988.68 million: equivalent to 4.3 months cover of future imports of goods and services. The deterioration in the overall balance of payment position was largely due to a weaker financial account and, to a limited extent, a weaker current account. ***Table 10,*** below, presents monthly balance of payments developments.

Provisional numbers indicate that the financing side of the balance of payments weakened by 45.6 per cent over the month, largely on account of banks' accumulation of foreign deposit assets, a reduction in loan disbursements in the form of project support to general government and of non-residents drawing down on their deposits. Banks increased their foreign currency deposits abroad by US$74.93 million in March, compared to a reduction of US$2.75 million the previous month; while disbursements in the form of project support contracted to US$24.42 million, from US$73.74 million during the same period. Moreover, the non-residents drew down on their currency deposits by US$11.53 million in March, compared to a build-up of US$10.55 million in February. Finally, portfolio investment inflows declined by 52.9 per cent over the month, mainly due to debt securities net maturities amounting to US$4.55 million.

In March, the current account deteriorated to a deficit of US$77.14 million, from a deficit of US$47.14 million recorded in February. This was to a large extent on account of deterioration in the services and income accounts, augmented by a worsened trade balance. The deterioration in the services, income and goods accounts more than offset the positive performance of current transfers.

The services account plunged into a deficit of US$21.14 million, from a surplus of US$14.13 in February, due to an 83.0 per cent contraction of transport services inflows. This somewhat offset the reduced service payments experienced over the month. The income account also worsened to a deficit of US$33.88 million, from US$30.78 recorded in February, as interest payments on public debt expanded.

Regarding the goods account, the trade balance, although better over March than the average from January 2012 to date, deteriorated to a deficit of US$123.37 million, from US$119.80 million recorded in February. The deterioration was due to a 7 per cent reduction in exports, which muted the 4 per cent decline in imports. The fall in exports was driven by reduced demand from the European Union and external African countries. Coffee exports, mostly destined to the European Union, decreased by 10 per cent to US$38.04 million; coffee volumes also fell by the same magnitude. Non-coffee exports also declined by 8.1 per cent to US$161.7 million.

Imports contracted by 3.7 per cent to US$371.5 million, from US$385.76 million registered in February. Import performance was 14.0 per cent below the average performance for 2012, mostly on account of the reduction in government project imports. Project imports fell by 57.0 per cent over the month to US$ 16.68 million. Private sector imports, supported by production imports in capital equipment and oil, increased by 9.1 per cent, despite a 13.0 per cent fall in the imports of consumption goods. This is supportive of an improved economic outlook. Oil imports increased by 10.1 per cent, while capital imports increased by 25.6 per cent. Production imports comprised over 72.0 per cent of total private sector imports in March, which is slightly above the average observed in 2012. The overall decline in imports was driven by the fall in import demand from Asia, Uganda's chief source of imports, and augmented by falls in import demand from COMESA and Europe. Import demand increased from the Middle East, yet this was not sufficient to overcome the wider falling trend.

Under the worsening trade balance, the terms of trade improved by 5.0 per cent in March as export prices rose and import prices fell. The fall in import prices was mainly driven by a fall in oil prices; the price of UK Brent Oil fell from US$116.4/barrel in February to US$103.8/barrel in March. Nonetheless, the trade balance may be expected to improve as the effect of the improved terms of trade balance filters through to the real sector.

On a positive note, current transfers improved by 14.0 per cent to a net credit of US$102.26 million, due to strong inward personal transfers, which more than offset the tripling of outward personal transfers. Personal transfers posted a 36.4 per cent increase to US$98.59 million in March, from US$72.29 million in February. In addition, inward transfers to NGOs also rose by 8.8 per cent over the month.

Given the peaceful elections and transition of the government in Kenya, it is expected that imports will rebound to higher levels. This might also negatively affect portfolio inflows if offshore investors opt to invest more in the Kenyan market. These factors, coupled with subdued donor disbursements, are likely to stress the BoP in the short term. The medium to long-term outlook for the BoP is more optimistic however, mainly on account of higher growth prospects in sub-Saharan Africa, especially within COMESA countries, which are a major destination for Ugandan exports.

Table 10: Monthly Balance of Payment developments

	Jul 12	Aug	Sep	Oct	Nov	Dec	Jan 13	Feb	Mar
Current account balance	**-282.75**	**-194.28**	**-168.08**	**-117.18**	**-147.2**	**-100.67**	**-119.58**	**-47.36**	**-77.14**
Goods account (trade balance)	**-161.77**	**-215.06**	**-185.38**	**-175.35**	**-195.07**	**-138.65**	**-138.5**	**-119.8**	**-123.37**
Total exports (fob)	245.17	242.4	231.78	227.63	242.86	227.79	250.72	265.96	248.13
Total imports (fob)	-406.94	-457.47	-417.16	-402.97	-437.93	-366.44	-389.22	-385.76	-371.5
Services account (services net)	**-60.66**	**-55.22**	**-62.41**	**-18.28**	**-37.11**	**4.3**	**-36.9**	**14.13**	**-21.14**
Income account (Income net)	**-128.54**	**-41.87**	**-36**	**-34.61**	**-38.13**	**-48.85**	**-34.73**	**-30.78**	**-33.88**
Current transfers (net)	68.22	117.87	115.71	111.06	123.1	82.52	90.54	89.08	101.26
Capital and financial account balance	**360.21**	**89.53**	**77.84**	**216.31**	**1.52**	**268.16**	**254.03**	**304.8**	**165.67**
Capital account	**1.58**	**14.82**	**0.34**	**0**	**0.7**	**8.22**	**12.78**	**8.42**	**8.39**
Financial account (excluding financing	**358.62**	**74.71**	**77.5**	**216.31**	**0.81**	**259.94**	**241.25**	**296.38**	**157.28**
Direct investment	98.74	98.74	163.19	98.74	98.74	98.74	155.19	155.19	155.19
Portfolio investment	-8.2	-28.4	-29.79	-18.61	-21.64	21.16	17.73	19.52	6.02
Financial derivatives (net)	0.69	-0.31	0.19	-0.24	-1.94	0.53	0.55	0.11	1.09
Other investment	267.39	4.68	-56.08	136.42	-74.35	139.51	67.78	121.55	-5.02
Overall balance	**172.33**	**-0.16**	**24.9**	**14.31**	**-57.41**	**92.39**	**81.33**	**80.38**	**-61.28**
Reserves and related items	**-172.33**	**0.16**	**-24.9**	**-14.31**	**57.41**	**-92.39**	**-81.33**	**-80.38**	**61.28**

5 Inflation

5.1 Global inflation

Global inflation tends to have a particularly strong effect upon Ugandan inflation, due to Uganda's trade deficit position. High global inflation may be detrimental to Uganda as it is likely to filter into import and production-input prices, thereby instigating domestic inflationary pressures. Furthermore, if high global inflation raises international interest rates, then in the short-term it may reduce the appeal of international investment in Uganda, favouring instead nations offering relatively higher interest rates.

Global inflation may also have an indirect effect upon Uganda through affecting global economic activity and investor sentiment. High and volatile inflation tends to reduce market confidence globally.

Commodity prices are typically the largest contributor to global inflation, and may depict a sensible forecast for future inflationary pressures. Therefore, an analysis of monthly commodity prices is also important to understand global inflationary patterns. The overall effect of global inflationary developments to the Ugandan economy depends upon the underlying inflationary pressures, as will be discussed in the remainder of this section, with particular relevance to commodity prices.

Global inflation remains subdued on account of economic slack in advanced economies, improvement in central bank credibility and declining commodity prices. The IMF asserts that central bank success in delivering low and stable inflation over the past decade has led to better anchored inflation expectations, hence the prevalence of low inflation, especially in advanced economies. Subdued inflation provides central banks with room to support economic activity. ***Table 11,*** below, summarizes inflation developments in selected countries.

Table 11: Consumer price inflation developments

	2012				2013	2013		
	Q1	Q2	Q3	Q4	Q1	Jan	Feb	Mar
Japan	0.3	0.2	-0.4	-0.2	-0.6	-0.3	-0.6	-0.9
Euro zone	2.7	2.5	2.5	2.3	1.9	2	1.9	1.7
United Kingdom	3.5	2.8	2.4	2.7	2.8	2.7	2.8	2.8
United States	2.8	1.9	1.7	1.9	1.7	1.6	2	1.5
Brazil	5.8	5	5.2	5.6	6.4	6.2	6.3	6.6
China	3.8	2.9	1.9	2.1	2.4	2	3.2	2.1
India	7.2	10.1	9.8	10.1	11.7	11.6	12.1	11.4
South Africa	6.3	5.8	5.2	5.7	5.8	5.5	5.9	6

Source: OECD Statistics & Eurostat

In March inflation declined in the US, the Euro Zone, Japan and China, rose in Brazil and remained stable in the UK.

In the US, inflation declined to 1.5 per cent in March, from 2.0 per cent in February, largely on account of a decline in the price of gasoline, fuel, oil and electricity. Similarly, inflation declined to 1.7 per cent in the Euro zone in March, from 1.9 per cent in February, due to a decline in the price of fuel, transport and telecommunications. In Japan, the pace of deflation accelerated to -0.9 per cent in March, from -0.6 per cent in February, as the prices of culture, recreation, furniture, household utensils and food all fell over the month. Inflation in the UK remained stable at 2.8 per cent in March.

In China, inflation declined to 2.1 per cent, from the heightened level of 3.2 per cent observed in February, largely on account of a decline in the prices of food and consumer goods. In Brazil, inflation rose above the central bank target of 4.5 per cent (+/-2 percentage points), to 6.6 percent in March, from 6.3 per cent in February, mainly due to increases in the prices of food and beverages.

Following inflation developments and forecasts, the respective central banks of the US, Euro zone, UK, Japan, India and Brazil took the following monetary policy stances over the month: on March 20, 2013 the US Federal Open Market Committee (FOMC) voted to maintain the Federal funds rate at 0-0.25 per cent and maintain the size of its asset purchase program at $85.0 billion per month; on May 02, 2013, the ECB cut its key policy rate to 0.5 per cent, while the Bank of England maintained its key policy rate at 0.5 per cent and also maintained the size of its asset purchase programme at £375 billion; the Bank of Japan announced the commencement of an aggressive monetary easing program in April 2013; the Central Bank of Brazil increased its key policy rate to 7.5 per cent in April, from 7.25 per cent set in July 2011, in response to inflation that has steadily been on the rise since July 2012; and on May 03, 2013, the Reserve Bank of India reduced its policy repo rate to 7.25 per cent from 7.5 per cent.

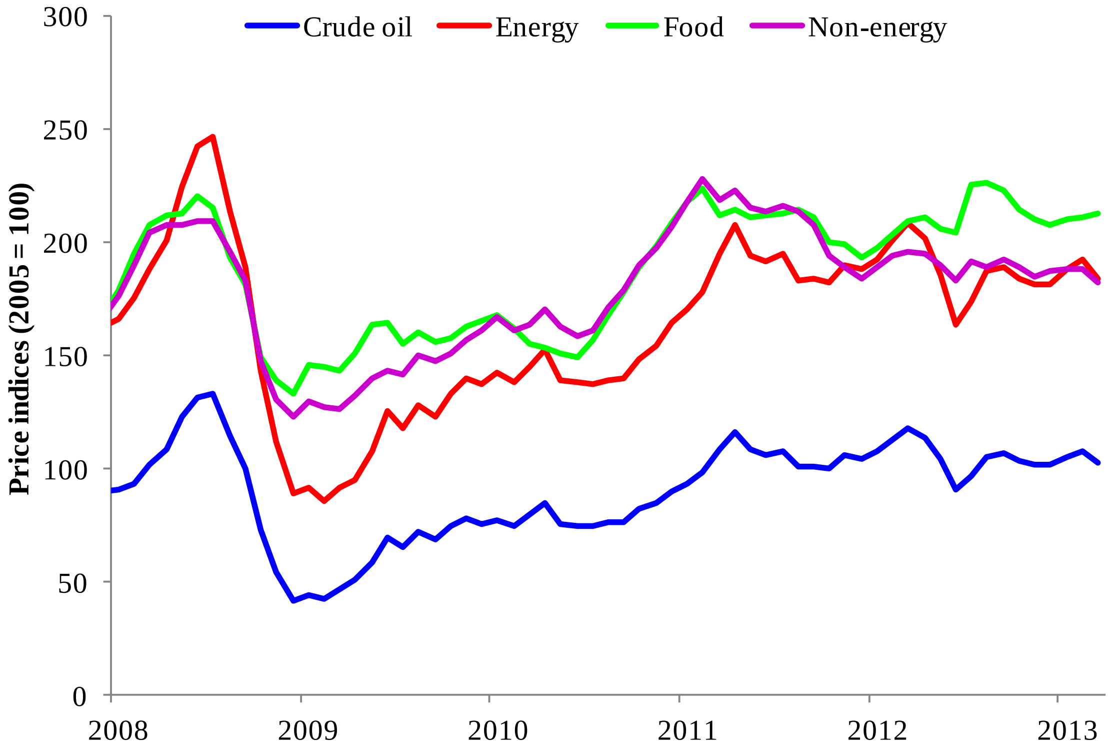
Within the East African Community, annual inflation typically fell in April. However, policy rates remained unchanged over the year to-date in response to relatively stagnant underlying inflationary pressures across the region. Whilst policy rates may be considered high on a global basis, for the region, and particularly when compared with the past two years, they demonstrate expansionary policy set to further stimulate economic activity.

In Kenya, the onset of the rainy season contained inflation pressures and held inflation at 4.1 per cent over the month. Similarly in Zambia, inflation ticked down by 0.1 percentage point to 6.5 per cent in April. The most recent inflation releases for Ghana, Nigeria and Tanzania present the March outturns. In Nigeria and Tanzania, annual inflation fell by 0.9 and 0.6 percentage points to 8.6 and 9.8 per cent respectively. Ghana was the only country considered whereby inflation rose in the region; in March inflation in Ghana rose by 0.4 percentage points to be the highest out of the countries considered at 10.4 per cent.

5.1.1 Commodity prices

Commodity prices generally declined in March, both on monthly and annual bases, mainly on account of weak global demand and positive supply. Notably however, prices remain elevated compared to the recent period, as shown in ***Figure 14*** below.

Figure 14: Trend of commodity prices



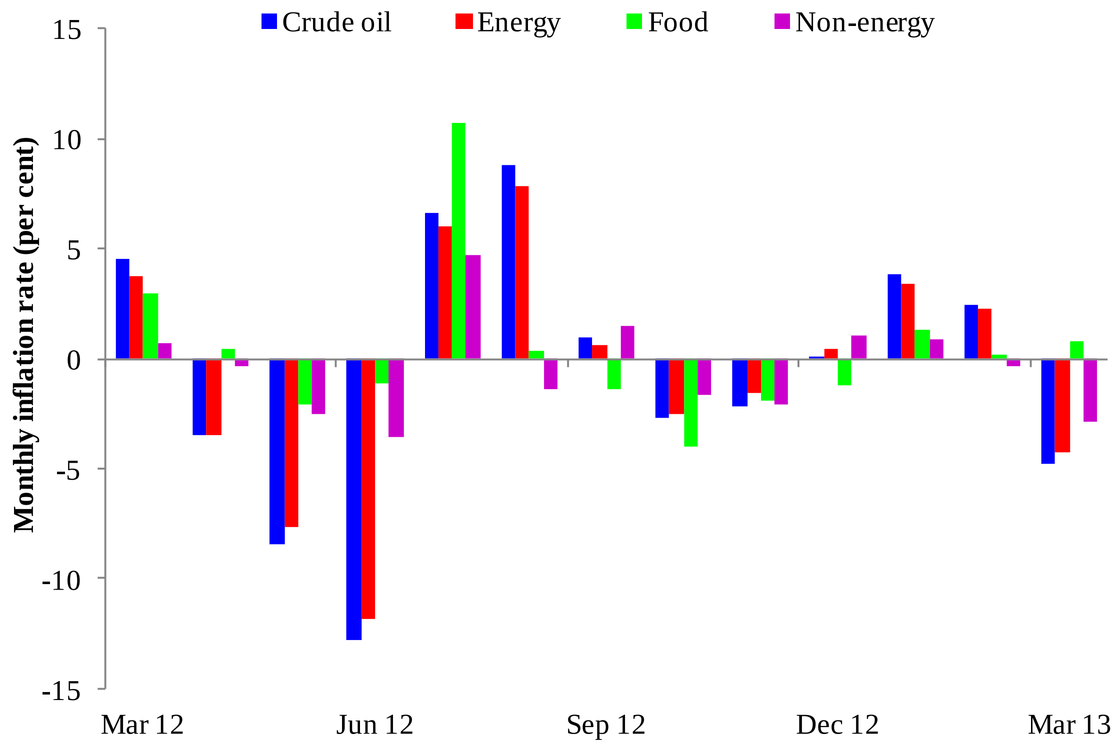
Source: World Bank Database & FAO Statistics 2013

On a monthly basis, energy, non-energy and crude oil prices all declined in March, although food prices rose. Energy prices declined by 4.2 per cent, non energy prices by 2.9 per cent and crude oil prices by 4.8 per cent in March. US Energy Information Agency (EIA) weekly data indicates expected further decreases in crude oil prices in April. The average price from April 1st -19th shows that West Texas Intermediate (WTI) has declined by 1.0 per cent to US$92/barrel over April to-date and Brent crude oil declined by 5.0 per cent to US$ 103/barrel over the month to-date.

On an annual basis, prices declined across all commodities.

On the other hand, food prices rose by 0.8 per cent in March, pushed by increases in dairy and sugar prices. ***Figure 15,*** below, shows monthly price changes across commodities.

Figure 15: Main developments in commodity prices



Source: World Bank Database & FAO Statistics 2013

5.2 Domestic inflation

Domestic inflation is necessary to encourage economic growth through promoting investment, employment and monetary policy efficiency. Investment should expand if inflation increases the opportunity cost of holding money. If wages rise, but at a lesser rate than inflation, firm profitability should increase, thereby firms may afford more workers and employment will grow, according to the Philip's Curve. Furthermore, inflation tends to justify slightly elevated interest rates, which creates a larger space for monetary policy to operate, and so adds to its effectiveness. Whilst inflation is necessary to growth, high and volatile inflation may be detrimental through exacerbating shoe-leather and menu costs, through eroding an individual's purchasing power and through destroying international confidence in the domestic economy.

In Uganda, 5 per cent inflation is targeted to achieve optimal economic growth. However, the stability and predictability of inflation is likely to have larger growth effects. Monetary policy may only affect demand-side inflationary influences, and is unable to alter supply-side-induced inflationary pressures, such as shocks to food production. Yet, if an inflation breakdown illustrates that monetary policy has effective control over demand-induced inflation, supply shocks may have a limited effect upon credibility allowing a stable inflation trajectory. This section will explain the domestic inflation developments upon the month according to demand and supply side influences.

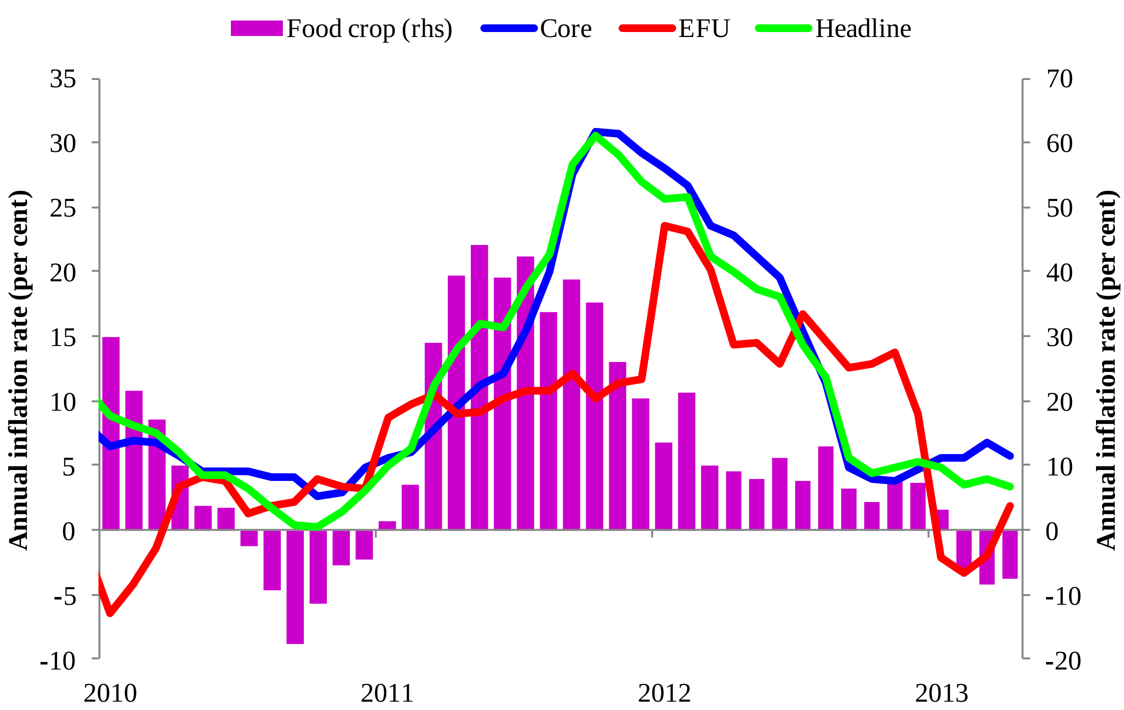
5.2.1 Consumer prices

Core and headline inflation both decreased over the month; annual headline inflation fell from 4.0 per cent in March to 3.4 per cent in April, which marks a record low since the onset of the inflation targeting regime, whilst annual core inflation fell from 6.8 per cent in March to 5.8 per cent in April. Although the annual headline inflation outturn is the lowest recorded in the recent period, the annual core inflation outturn lies above that announced from September 2012 to February 2013; nonetheless April's core inflation outturn remains within 1 percentage point of the BoU inflation target.

The disparity between the annual core and headline figures in March is largely on account of food crop prices, which although increasing, remained in negative inflation throughout April; annual food crop prices increased from 8.5 per cent deflation in March to 7.5 per cent deflation in April. However, the headline inflation figure was also slightly propped up by inflation in energy, fuel and utilities (EFU); annual EFU inflation turned positive in April, for the first time in 2013 to date, increasing from -2.0 per cent in March to 1.8 per cent in April. Favourable climatic conditions have contributed towards healthy harvests and thus an improvement in overall food supply to markets and minimal food crops inflationary pressures. Furthermore, the turnaround in EFU inflation may be largely the result of a base effect, as the peak in EFU inflation experienced in the first three months of 2012 has fallen out of the measurement basket.

Figure 16, below, presents annual inflation developments since 2010, and illustrates how very low, or negative, inflation outturns in EFU and food crops throughout 2013 to date has reduced headline inflation persistently below core inflation.

Figure 16: Annual inflation developments



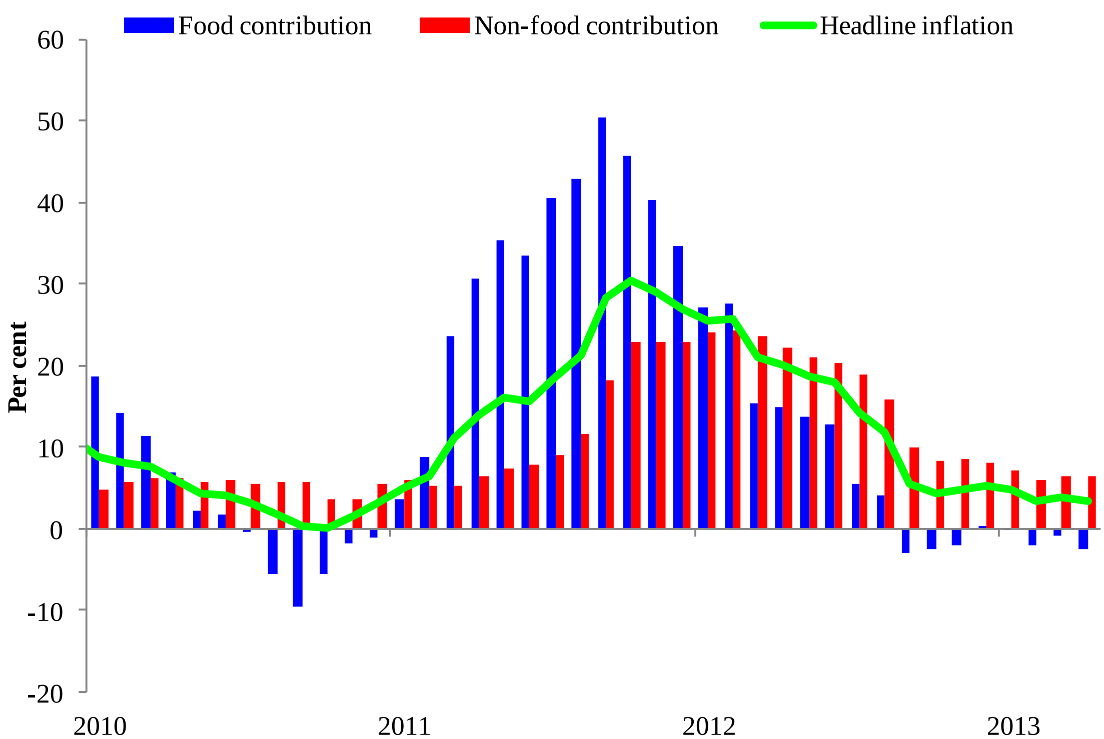
Source: BoU and UBOS

Food prices represent the largest component of the inflation basket: 27.2 per cent, and experienced considerable annual deflation over the month, from 0.9 per cent deflation in March to 2.6 per cent deflation in April, thus contributing to the overall fall in both core and headline annual inflation.

The largest remaining sectors in the inflation basket, with the exception of rent, fuel and utilities, also experienced disinflation or no inflationary changes over the month. Annual prices for transport and communications slowed from 4.7 per cent inflation in March to 4.2 per cent inflation in April; similarly, annual inflation in the 'health, entertainment and others' sector fell from 10.2 per cent in March to 9.0 per cent in April; whilst annual education inflation remained unchanged at 8.2 per cent in April. However, annual rent, fuel and utilities inflation increased from 3.8 per cent in March to 4.8 per cent in April.

Figure 17, below, decomposes the food and non-food contributions to headline inflation and presents the persistently low, and frequently negative, annual food price inflation experienced over the past eight months.

Figure 17: Annual food and non-food inflation developments



Source: BoU and UBOS

As in March, the monthly headline inflation figures continue to indicate underlying inflationary pressures in April. Monthly core inflation fell marginally from 0.3 per cent in March to 0.2 per cent in April, which if continued would represent an annual inflation rate of 2.4 per cent, below the annual core inflation target. However, the monthly headline inflation figure increased by 0.5 percentage points, from 0.9 per cent in March to 1.4 per cent in April, which if continued would in contrast represent a much higher annual inflation rate of 18.2 per cent.

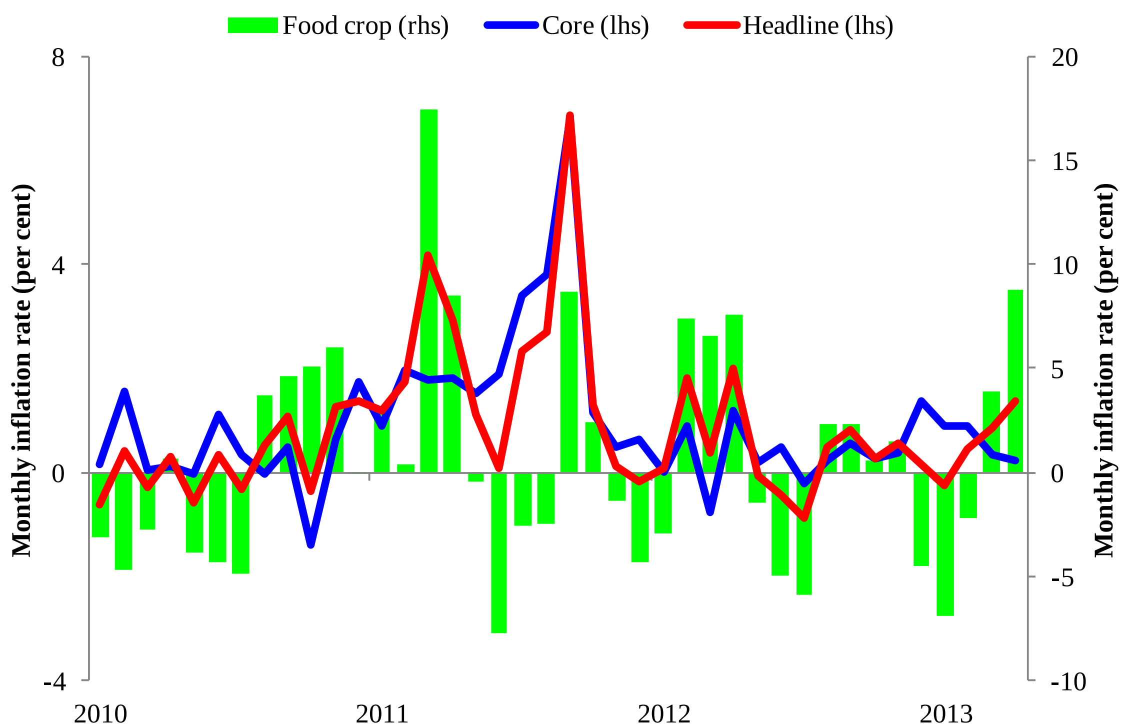
The increase in monthly headline inflation was entirely driven by monthly food crops inflation, which rose by 4.9 percentage points: from 3.9 per cent in March to 8.8 per cent in April. Meanwhile, monthly

EFU inflation contained headline to some degree, as it fell from 0.9 per cent in March to 0.1 per cent in April.

Overall food prices continued to rise in April, from 2.3 per cent inflation in March to 3.7 per cent inflation in April. The inflationary food price pressures were mostly experienced for matooke, Irish potatoes, sweet potatoes, cabbages, tomatoes, pineapples, beans and fish, whilst falling prices for sweet bananas, passion fruits, avocado, onions, green pepper, bitter tomatoes, carrots, maize flour, bread and sugar somewhat contained food price inflation.

Figure 18, below, presents monthly core and headline inflation developments, and illustrates how rising food crop prices in March and April have pushed up monthly headline inflation.

Figure 18: Monthly inflation developments



Source: BoU and UBOS

Finally, ***table 12,*** below, presents annual and monthly inflation developments over the past 6 months and over the first 4 months of 2012 for comparison.

Not only does the table capture the recent divergence in monthly and annual food and headline inflation, but it also illustrates how inflation has been rapidly lessened to single digits, broadly in line with the inflation target, when compared to early 2012.

Table 12: Inflation dissection

	2012						2013			
	Jan	Feb	Mar	Apr	Nov	Dec	Jan	Feb	Mar	Apr
	Monthly									
Food crops	-3.0	7.4	6.5	7.6	1.5	-4.5	-6.9	-2.2	3.9	8.8
EFU	11.8	1.0	-0.5	-3.7	0.8	-4.1	0.4	-0.2	0.9	0.1
Core	0.0	0.9	-0.8	1.2	0.4	1.4	0.9	0.9	0.3	0.2
Headline	0.1	1.8	0.4	2.0	0.6	0.2	-0.3	0.4	0.9	1.4
Food	-2.3	2.3	1.1	5.5	0.2	-2.0	-2.4	0.2	2.3	3.7
Non-food	1.3	1.7	-0.2	0.3	0.7	1.2	0.6	0.6	0.3	0.4
	Annual									
Food crops	13.5	21.4	10.1	9.1	7.5	7.3	3.0	-6.2	-8.5	-7.5
EFU	23.5	23.1	20.2	14.3	13.8	9.0	-2.1	-3.3	-2.0	1.8
Core	28.1	26.7	23.6	22.8	3.9	4.6	5.6	5.6	6.8	5.8
Headline	25.6	25.7	21.1	20.0	4.9	5.3	4.9	3.5	4.0	3.4
Food	27.2	27.6	15.4	15.0	-2.0	0.0	0.0	-2.0	-0.9	-2.6
Non-food	24.2	24.3	23.7	22.3	8.6	8.0	7.2	6.0	6.5	6.6

Source: BoU and UBOS

As mentioned in the March report, the rising food price monthly inflation figures might present an alarming inflationary outlook, particularly given that food prices largely fall outside the control of monetary policy. However, the BoU expect the current inflationary pressures, at present only circulating on a monthly basis, to be a temporary phenomenon. Core inflation is anticipated to fall within the medium-term target over 2013.

6 Economic outlook

It takes approximately two years for the effect of monetary policy to be fully realised in an economy like Uganda where the financial sector suffers from structural inefficiency, and consequently policymakers require a long-term forecast in order to determine the optimal policy framework. Therefore, all economic influences to the Ugandan economy must be appraised to determine the likely economic trajectory and appropriate policy response. This chapter presents the global and domestic economic outlook in order to determine the optimal monetary policy response and to explain the actions taken on the month.

6.1 Global economic outlook

6.1.1 Outlook for economic activity

The current outlook suggests continued stability in global financial markets. In the April 2013 World Economic Outlook (WEO April 2013), the IMF forecasts the continuance of low policy rates in advanced economies, which is expected to slowly translate into strong credit supply. In emerging market and developing economies, policy rates are expected to be held or cut further, to boost economic activity under the presence of low global inflation. Consequently, the positive interest rate differential is expected to encourage portfolio inflows into emerging market and developing economies.

The outlook for global economic activity assumes a continued improvement in activity, provided policy makers favour growth, which is expected to deliver global real activity growth of 4.0 per cent in 2014. Global growth for 2014 is expected to be boosted by strong US economic growth, which is projected at 3.0 per cent over the year. US economic activity is however dependent upon a timely revision of the debt ceiling.

Given the outlook for global economic activity, Uganda's export demand might be expected to remain lacklustre. However, economic growth is forecast to be most subdued in the advanced economies. Given that the majority (58.0 per cent) of Uganda's exports are demanded from emerging market and developing countries: COMESA, Sub-Saharan Africa, Asia and the Middle East, it is possible that export demand may remain somewhat resilient.

6.1.2 Inflation outlook

Global inflationary pressures are expected to be minimal throughout 2013, although pick up marginally towards 2014. The dominant catalysts behind the anticipated low inflation are food and fuel prices, which are expected to remain suppressed due to decent harvests and low global demand respectively.

The April 2013 WEO estimates that inflation in the advanced economies will average 1.7 per cent in 2013 and 2.0 per cent in 2014. This presents a slight upwards revision when compared to the January 2013 projections of 1.6 per cent and 1.8 per cent respectively. The upward revision stems from the Bank of Japan's increasingly expansionary monetary policy, which is expected to support a steady rise in domestic inflation, with global consequences. Inflation in the emerging market and developing economies is expected to be relatively contained over the next two years, averaging 5.9 per cent in 2013 and 5.6 per cent in 2014, attributed largely to lower food and energy prices.

Given that 83.0 per cent of Uganda's imports originate from emerging market and developing economies, the global inflation outlook poses only a minimal saving in Uganda's import bill. Nonetheless, the global inflation outlook should improve Uganda's balance of payments to some degree.

Commodity prices are expected to fall very slowly over 2013, but to fall considerably over 2014 as global oil supply escalates; oil prices are estimated to decline by 2.3 per cent in 2013 and by 4.9 per cent in 2014 on account of strong growth in non-OPEC supply. However, the rate of decline in oil prices has slowed from the January WEO, which forecast oil prices to fall by 2.9 per cent and 5.1 per cent in 2013 and 2014 respectively. Non-fuel commodity prices are also projected to decline in over the next two years, by 0.9 per cent in 2013 and 4.3 per cent in 2014, on account of anticipated good weather. Reduced international commodity prices, particularly low oil prices, should ease Uganda's import bill somewhat.

6.1.3 Key risks and uncertainties

Global financial market stability might be threatened by rapid credit expansion in the advanced economies, particularly given their extremely expansionary monetary policies, and by the reversal of capital flows in emerging market and developing countries, given that short-term capital flows tend to be highly volatile and risk-sensitive.

Similarly, global economic activity might be immediately threatened by adjustment fatigue in the Euro Zone and failure to raise the debt ceiling in the US. In the medium term, limited policy space in US and insufficient institutional progress in Euro Zone may also threaten global economic activity.

Finally, global inflation might rise if the rising domestic inflation in many emerging economies, particularly in Brazil, China and India, affects traded prices or if the current geopolitical tensions in the Middle East and North Africa (MENA) escalates and affects commodity prices.

6.2 Domestic economic outlook

6.2.1 Outlook for economic activity

The monthly outlook for domestic economic activity remains largely unchanged to that in March: CIEA data points to an increase in economic activity. Yet, the current growth in monetary aggregates and personal consumption also points to increasing aggregate demand and therefore underlying inflationary pressures, although falling domestic currency denominated lending may contain these. The current growth in the agricultural sector indicates that agriculture should support any growth momentum, although adverse weather conditions will always risk stalling economic growth. Finally, the business confidence index also provides a confident economic outlook, particularly over the coming months.

6.2.2 Inflation outlook

Inflation forecasts anticipate both headline and core inflation to average about 7-9 per cent in the short-term, slightly exceeding the BoU medium-term target, but to fall in line with the target in the medium-term. Inflation risks include: increased domestic demand, exchange rate depreciation, domestic food price inflation and global commodity price inflation. ***Figures 19a*** and ***19b*** present the 98 per cent confidence bands for annual headline and core inflation, respectively.

Figure 19a: Headline inflation forecasts

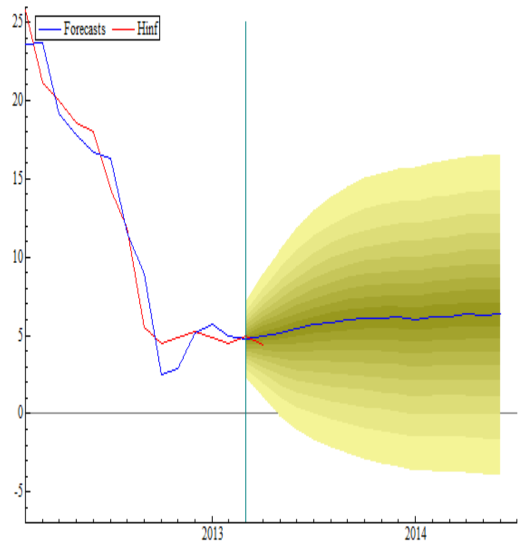
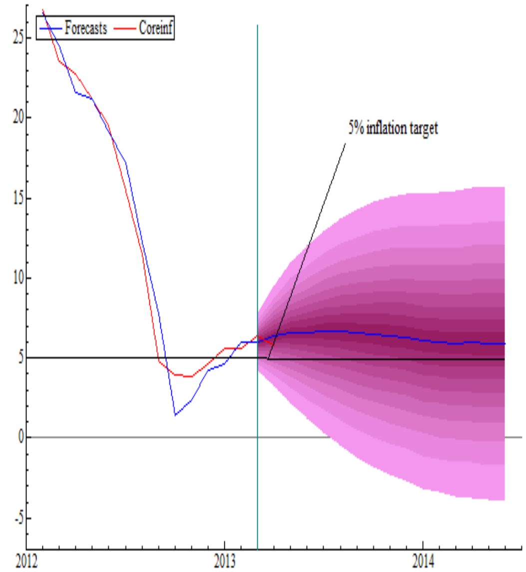


Figure 19b: Core inflation forecasts



Source: BoU

6.2.3 Key risks and uncertainties

Whilst globally low policy rates and declining yields may increase portfolio inflows to Uganda, they will also diminish returns on BoU reserves invested overseas in both deposits and Treasury Securities. In the near-term, the benefits to the interest rate differential definitely outweigh any disadvantages, yet in the long-term there is a heightened risk that the capital inflows will reverse and the BoU may have lesser ability to shield the economy from the effects.

As aforementioned, the risks to inflation have increased over the month: increased Government expenditure, growth in monetary aggregates, potential expansion of private sector credit, persistently sticky interest rates, anticipated tax increases and unfavourable climatic conditions may all threaten the domestic inflation outlook. Similarly, poor global economic growth or commodity price shocks may affect the global inflation outlook, which in turn would create imported inflation to Uganda.

If Government expenditure increases towards the end of the financial year, this may trigger rapid inflation through money growth. Furthermore, if Government expenditure successfully stimulates economic growth then this may have second round inflationary effects, although such effects are less of a concern. Nonetheless, as donors hint at increasing project financing partially in place of budget support, increased infrastructure investment may create a real boost to growth, which would require caution surrounding the inflationary implications.

Monetary aggregates have somewhat increased on account of incomplete sterilisation of forex purchases, which have also created structural liquidity surpluses in the financial system. If private sector credit increases, either as a reaction to the liquidity surplus, or due to the re-opening of the Land Registry Office, which would see a backload of mortgage approvals disbursed, then monetary aggregates may expand further and pose an inflationary risk. Furthermore, the unrelenquishing high interest rates charged would exacerbate any inflation emanating from private sector credit growth.

The prices of food crops are driven by the prevailing weather conditions at harvest; unfavourable weather conditions may cause a poor harvest, which would reduce food supplies and thus trigger inflation. Thus, food crop prices (constituting about 13.5 per cent of the inflation basket) would be directly affected by the climatic conditions, and would indirectly feed through to theoverall food prices, which constitutes 27.2 per cent of the inflation basket. . Given that food prices compromise a high proportion of the inflation basket, food price inflation may have considerable repercussions for the overall domestic inflation figure. However, at the moment, food prices are responsible for exerting considerable disinflationary pressures, and so favourable climatic conditions may similarly maintain low inflation.

Finally, anticipated tax increases for the upcoming financial year as the Government seeks to cover the donor budget cuts, will also exert upwards inflationary pressures.

Global economic developments also pose inflationary implications, the largest being weaker than expected global economic recovery, particularly amongst the advanced economies, and commodity price rises on account of the geo-political tensions in the Middle East; the former would foster disinflationary pressures and the latter inflationary pressures.

7 Monetary policy decision

The Bank of Uganda seeks to foster economic growth through price and output stability. 5 per cent medium-term core inflation is targeted in order to achieve Uganda's potential long-term output growth of 6-7 per cent. Inflation is targeted through the Central Bank Rate, which should steer short-term interbank money market rates, thereby affecting long-term interest rates, which will subsequently determine the monetary policy transmission into prices and output growth. Additionally, the Bank of Uganda may intervene in financial markets to address a liquidity shortage or excess, and thus to improve the channel by which the Central Bank Rate determines the interbank money market rate. This section explains the Bank of Uganda's monthly policy decision given the recent data outturns and projections.

Inflation was expected to trend higher but remain moderate and converge to BoU's target in the medium term. Although upside risks to inflation exist, they remain relatively weak. The output gap has narrowed slightly but remains negative, although the underlying economic momentum is expected to remain positive. Given the significant monetary stimulus already in place and the signs of monetary policy easing evident in output performance and growth in monetary aggregates, the current accommodative stance of monetary policy is currently appropriate. The CBR was maintained at 12.0 per cent in May 2013. The band on the CBR was maintained at +/- 2 percentage points on the CBR, and the margin on the rediscount rate to 3 percentage points on the CBR. The Rediscount Rate and the Bank Rate were set at 15.0 per cent and 16.0 per cent respectively in May 2013.

Appendix

Appendix 1: Key economic indicators

	May 12	Jun 12	Jul 12	Aug 12	Sep 12	Oct 12	Nov 12	Dec 12	Jan 13	Feb 13	Mar 13	Apr 13
Foreign Exchange Market												
Inter-bank purchases (USD millions)	963.0	809.6	895.0	755.0	716.1	837.7	981.3	936.1	919.9	894.1	832.4	1065.4
Inter-bank sales (USD millions)	868.6	747.7	701.6	752.2	675.1	810.0	957.7	802.9	819.4	804.5	833.1	1010.2
Cross currency trading (USD millions)	211.2	158.1	113.9	176.8	181.6	132.4	142.1	123.3	179.6	169.2	150.7	168.1
Inter-bank mid-rate (UGX/USD)	2479.1	2484.4	2474.2	2492.0	2515.9	2579.4	2623.0	2673.5	2683.8	2657.5	2636.9	2578.0
Foreign Exchange Reserves												
Gross foreign reserves (months of imports of goods and services)	3.9	4.1	4.5	4.4	4.5	4.5	4.3	4.4	4.5	4.4	4.3	-
Bank of Uganda foreign exchange reserves (USD millions)	2574.1	2643.8	2827.3	2817.7	2880.3	2902.8	2855.8	2950.5	3018.2	3046.5	2998.7	-
Tax Revenue (UGX billions)												
Tax revenue	499.6	752.8	523.9	516.2	515.4	500.6	557.5	763.0	620.5	576.7	570.3	-
Monetary and credit aggregates (UGX billions)												
Broad money supply (M3)	10623.6	11210.7	10698.6	11286.8	11493.4	11157.3	11926.6	12008.5	11748.0	11977.9	11804.4	-
Foreign exchange accounts deposits	3008.0	3607.7	3176.4	3239.8	3397.6	3266.7	3356.1	3302.5	3261.3	3289.5	3143.1	-
Money supply (M2)	7615.5	7603.0	7522.1	8046.9	8095.8	7890.6	8570.5	8706.0	8486.7	8688.5	8661.3	-
Currency in circulation	1845.4	1952.4	1919.9	2002.0	1988.2	1963.5	2138.4	2262.3	2210.2	2137.4	2164.5	-
Shilling-denominated demand deposits	2663.6	2515.0	2374.1	2687.7	2824.7	2805.1	3240.4	3185.9	3115.9	3266.8	3191.0	-
Shilling-denominated time and saving deposits	3106.6	3135.6	3228.1	3357.2	3282.9	3122.0	3191.7	3257.7	3160.6	3284.3	3305.9	-
Private sector credit	7149.2	7238.5	7219.1	7264.9	7360.5	7486.7	7668.3	7809.0	7798.5	7793.0	7655.9	-
Weighted average interest rates on Shilling transactions (per cent)												
Demand deposit rate	1.4	1.3	1.4	1.6	1.7	1.6	1.7	1.6	1.6	1.5	1.6	-
Savings deposit rate	3.3	3.4	3.4	3.6	3.1	3.1	3.2	3.2	3.3	2.3	3.2	-
Time deposit rate	17.4	17.7	16.7	15.2	11.9	12.7	10.8	12.7	13.4	13.2	11.9	-
Lending rate	26.7	27.0	26.9	26.4	25.7	24.9	23.7	24.8	24.2	24.3	24.0	-
Weighted average interest rates on foreign exchange transactions (per cent)												
Demand deposit rate	1.0	1.0	1.0	1.0	1.0	9.8	9.7	9.6	1.0	1.0	1.0	-
Savings deposit rate	1.5	1.5	1.1	1.5	1.6	1.7	1.8	1.7	1.8	1.7	1.7	-
Time deposit rate	3.4	5.2	3.0	5.0	2.7	4.5	2.6	4.3	6.8	4.8	5.0	-
Lending rate	9.3	8.4	9.0	9.1	8.7	10.7	10.4	8.7	9.8	9.3	9.9	-
Treasury Bills (end period weighted discount rate)												
91 days	16.2	16.7	16.7	12.7	10.7	9.1	9.3	9.4	9.2	9.1	8.8	9.5
182 days	17.5	17.1	16.4	13.5	10.8	11.4	13.5	13.2	13.6	13.3	11.2	10.3
364 days	16.7	16.1	14.9	12.5	10.2	10.9	13.1	13.2	13.4	12.6	10.9	10.4
Treasury Bond secondary market weighted average interest rates (per cent)												
2-year Bond												
Bid	15.3	15.2	14.6	13.6	11.8	11.4	12.3	13.6	14.3	14.1	12.7	12.0
Offer	15.2	15.0	14.5	13.4	11.7	11.3	12.1	13.4	14.1	14.0	12.6	11.9
5-year Bond												
Bid	15.5	15.3	14.9	14.0	12.4	12.1	12.4	13.5	15.1	14.7	13.1	12.6
offer	15.3	15.2	14.7	13.9	12.2	11.9	12.3	13.4	15.0	14.6	13.0	12.4
10-year Bond												
bid	15.8	15.5	15.1	14.7	14.4	14.4	14.6	14.6	14.7	14.5	14.1	14.0
offer	15.6	15.3	14.9	14.6	14.3	14.3	14.5	14.4	14.5	14.4	14.0	13.9
Bank of Uganda interest rates (end month, per cent)												
Central Bank Rate	21.0	20.0	19.0	17.0	15.0	13.0	12.5	12.0	12.0	12.0	12.0	12.0
Rediscount rate	25.0	24.0	23.0	21.0	19.0	17.0	16.5	16.0	16.0	15.0	15.0	15.0
Bank Rate	26.0	25.0	24.0	22.0	20.0	18.0	17.5	17.0	17.0	16.0	16.0	16.0
Weighted average interbank rates (per cent)												
7-day interbank rate	20.7	20.1	18.5	16.4	15.0	13.6	12.6	12.3	12.0	10.9	11.4	11.4
Overnight interbank rate	16.1	17.3	12.5	12.0	10.2	11.3	8.1	7.7	7.2	5.3	7.5	8.2
Consumer Price Index (Base 2005/06, annual percentage changes)												
Composite CPI	18.6	18.0	14.3	11.9	5.5	4.5	4.9	5.3	4.9	3.5	4.0	3.4
Core CPI	21.2	19.6	15.4	11.4	4.9	4.0	3.9	4.6	5.6	5.6	6.8	5.8
Food crops CPI	8.0	11.3	7.5	12.8	6.3	4.4	7.5	7.3	3.0	-6.2	-8.5	-7.5
Electricity, fuel & utilities (EFU) CPI	14.5	12.9	16.7	14.7	12.6	12.8	13.8	9.0	-2.1	-3.3	-2.0	1.8
Monthly average pump prices of petroleum products (UGX/litre)												
Motor Spirit Premium (PMS)	3650.0	3650.0	3650.0	3550.0	3600.0	3650.0	3650.0	3700.0	3800.0	3800.0	3850.0	-
Diesel (AGO)	3250.0	3100.0	3100.0	3200.0	3250.0	3250.0	3250.0	3300.0	3350.0	3350.0	3550.0	-
Kerosene (BIK)	2750.0	2750.0	2750.0	2800.0	2750.0	2750.0	2750.0	2800.0	2850.0	2850.0	2850.0	-

Appendix 2: Trade balance

	Apr 12	May 12	Jun 12	Jul 12	Aug 12	Sep 12	Oct 12	Nov 12	Dec 12	Jan 13	Feb 13	Mar 13	Apr 13
Imports of merchandise (USD millions)													
Total imports (cost, insurance, and freight)	507.4	581.5	623.1	493.9	560.1	511.5	508.5	536.4	447.5	476.4	470.2	451.8	495.7
Imports of merchandise (o/w cost, USD millions)													
Total imports (free on board)	414.8	474.4	507.4	403.8	457.5	419.1	416.1	437.7	365.5	389.2	385.8	370.4	404.6
Government imports	29.7	19.0	55.7	11.9	44.9	14.9	20.8	43.2	32.2	25.8	38.2	16.7	47.3
o/w project	29.4	10.4	50.1	11.6	36.7	12.6	17.8	29.2	29.7	16.8	35.2	15.3	26.7
o/w non-project	0.3	8.7	5.6	0.3	8.2	2.3	3.0	13.9	2.5	9.0	2.9	1.4	20.6
Formal private sector imports	380.0	450.8	448.4	388.8	408.5	400.4	390.7	390.8	329.3	358.5	343.0	348.9	352.5
o/w oil imports	62.1	72.9	64.9	58.4	80.1	76.6	85.7	84.0	84.6	88.5	87.0	95.7	78.8
o/w non-oil imports	318.0	377.8	383.6	330.4	328.4	323.8	305.1	306.8	244.7	270.0	256.0	253.2	273.7
Estimated private sector imports	5.0	4.6	3.3	3.0	4.1	3.8	4.6	3.7	4.0	4.9	4.6	4.8	4.8
Total private sector imports	385.1	455.3	451.7	391.9	412.6	404.2	395.3	394.5	333.3	363.4	347.6	353.7	357.3
Imports of merchandise (o/w freight, USD millions)													
Total imports	88.7	102.6	110.8	86.3	98.3	88.5	88.5	94.5	78.5	83.5	80.9	78.0	87.2
Government imports	7.4	4.7	13.8	3.0	11.2	3.7	5.2	10.7	8.0	6.4	9.5	4.1	11.8
o/w project	7.3	2.6	12.4	2.9	9.1	3.1	4.4	7.3	7.4	4.2	8.8	3.8	6.6
o/w non-project	0.1	2.2	1.4	0.1	2.0	0.6	0.7	3.5	0.6	2.2	0.7	0.4	5.1
Formal private sector imports	81.3	97.8	96.9	83.3	87.1	84.8	83.3	83.8	70.5	77.1	71.4	73.8	75.5
o/w oil imports	15.4	18.1	16.1	14.5	19.9	19.0	21.3	20.9	21.0	22.0	21.6	23.8	19.6
o/w non-oil imports	65.9	79.7	80.8	68.8	67.2	65.8	62.0	62.9	49.5	55.1	49.8	50.0	55.9
Private sector through forex	81.3	97.8	95.7	83.3	87.1	84.8	83.3	83.8	70.5	76.8	71.3	73.8	75.5
Imports of merchandise (o/w insurance, USD millions)													
Total imports	3.9	4.5	4.9	3.8	4.3	3.9	3.9	4.2	3.5	3.7	3.6	3.4	3.9
Government imports	0.3	0.2	0.6	0.1	0.5	0.2	0.2	0.5	0.4	0.3	0.4	0.2	0.5
o/w project	0.3	0.1	0.5	0.1	0.4	0.1	0.2	0.3	0.3	0.2	0.4	0.2	0.3
o/w non-project	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.2	0.0	0.1	0.0	0.0	0.2
Formal private sector imports	3.6	4.3	4.3	3.7	3.8	3.7	3.7	3.7	3.1	3.4	3.2	3.3	3.3
o/w oil imports	0.7	0.8	0.7	0.6	0.9	0.8	0.9	0.9	0.9	1.0	1.0	1.1	0.9
o/w non-oil imports	2.9	3.5	3.6	3.0	3.0	2.9	2.7	2.8	2.2	2.4	2.2	2.2	2.5
Private sector through forex	3.6	4.3	4.2	3.7	3.8	3.7	3.7	3.7	3.1	3.4	3.1	3.3	3.3
Exports of merchandise (USD millions)													
Total Exports	216.3	245.1	247.6	245.2	242.4	231.8	227.6	242.9	227.8	250.7	266.0	248.1	245.9
Total Formal Exports	181.7	209.8	214.0	215.3	202.1	189.0	182.2	197.5	174.7	206.9	218.5	200.0	199.4
Exports of merchandise (o/w coffee)													
Coffee value (USD millions)	21.9	35.8	36.6	40.5	31.5	23.5	23.7	28.8	30.1	42.6	42.3	38.0	30.5
Coffee volume (thousands 60kg bags)	0.1	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.2
Average unit value	2.6	2.4	2.2	2.2	2.3	2.2	2.2	2.1	2.1	2.1	2.0	2.0	2.0
Exports of merchandise (o/w non-coffee, USD millions)													
Total non-coffee formal exports	159.8	174.0	177.4	174.8	170.6	165.5	158.5	168.7	144.6	164.2	176.2	162.0	168.9
Electricity	1.7	1.5	1.4	1.3	1.2	1.2	1.1	1.2	1.1	1.4	1.3	1.5	1.3
Gold	1.2	1.1	0.9	0.5	0.6	0.5	0.0	0.2	0.1	0.1	0.4	1.3	0.7
Cotton	12.6	9.3	9.2	1.5	1.6	1.3	2.3	0.8	0.3	2.9	5.9	6.1	6.5
Tea	3.7	8.3	6.4	7.1	6.5	5.8	6.7	8.0	6.8	8.8	6.9	5.3	7.9
Tobacco	2.7	4.3	7.2	7.9	5.2	2.2	2.9	6.3	4.3	7.3	8.4	6.0	15.0
Fish & fish produce (excluding regional)	10.6	12.0	10.4	9.4	8.1	8.3	9.4	8.8	7.6	8.8	7.9	8.8	5.7
Hides & skins	3.6	4.9	4.3	3.2	3.2	3.9	4.0	3.2	1.0	0.6	1.2	0.9	0.9
Simsim	2.2	1.3	0.6	0.3	0.0	0.3	0.4	0.1	1.1	4.0	4.5	3.4	3.5
Maize	4.1	5.3	5.3	2.9	5.0	8.0	5.0	5.7	2.9	6.2	4.8	3.4	3.1
Beans	0.7	0.3	0.7	3.0	0.7	0.6	1.5	2.3	1.3	1.3	1.4	0.8	0.4
Flowers	3.7	6.1	5.6	4.8	5.0	3.7	3.6	3.3	2.9	4.6	5.2	4.4	1.6
Oil re-exports	9.5	10.8	10.6	12.0	12.6	12.0	12.1	10.9	11.5	11.2	10.0	10.7	11.0
Cobalt	0.5	1.1	0.5	1.6	2.1	1.1	2.6	1.1	1.1	1.6	1.1	1.1	1.1
Others	103.0	107.6	114.2	119.1	118.8	116.7	106.7	117.0	102.6	105.6	117.4	108.4	110.3

Source: Bank of Uganda