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Monetary Policy Statement for February 2016

The Uganda Bureau of Statistics in line with international best practice to reflect changes in household consumption patterns and technological progress rebased the Consumer Price Index (CPI) to Financial Year (FY) 2009/10. This has resulted in slight changes in the recent inflation developments, in part reflecting an expanded consumption basket. The share of food crops in the CPI basket dropped to 10.2 percent from 13.5 percent, while the share of core inflation increased to 82.4 percent from 81.6 percent. Comparing the rebased CPI to the previous series, headline inflation in December 2015 declined to 8.4 percent from 9.3 percent, while core inflation rose to 7.6 percent from 7.4 percent.

Annual headline and core inflation declined to 7.6 percent and 7.1 percent, respectively in January 2016. Food crop inflation declined from 16 percent to 12.3 percent. A fall in food crop prices, by 4.7 percentage points in January 2016 contributed to the reduction in headline inflation. Although the annual core inflation declined in January, monthly core inflation rates have increased in the last three months, reflecting persistence of underlying inflationary pressures.

The high frequency indicators of economic activity suggest that economic growth was higher during the final quarter of 2015 than in the previous quarter. These indicators for the first half of the financial year are consistent with the real economic growth forecast of 5 percent in FY2015/16. While the key drivers shaping the outlook largely remain the same as in the December 2015 monetary policy report, the forecast for GDP growth has been revised marginally to 5.5 percent in FY 2016/17 from 5.8 percent. The marginal reduction reflects the current global economic weakness and volatility in the international financial markets.

Since the previous meeting of the Monetary Policy Committee, the inflation outlook has improved slightly, mainly due to the exchange rate and food price developments. The shilling regained stability while the impact of the *El Nino* weather on food prices has been mild so far. We now forecast that core inflation will peak at 6-8 percent in the second quarter of 2016, before flattening out in the second half of 2016, and then gradually falling back to the 5 percent target during the course of 2017. Nonetheless, there are significant upside risks to this outlook, including the future path of the exchange rate, which will be influenced by domestic and external factors, and the possibility of adverse weather conditions following the *El Nino* weather phenomenon.

Given the inflation forecast and accompanying risks, the Bank of Uganda (BoU) believes that it is prudent to maintain the current monetary policy stance and will therefore, hold the Central Bank Rate (CBR) unchanged at 17 percent. The band on the CBR will be maintained at +/-3 percentage points and the margin on the rediscount rate at 4 percentage points on the CBR. The rediscount rate and the bank rate will thus remain unchanged at 21 percent and 22 percent, respectively. The BoU believes that this monetary policy stance will curb the rise in core inflation over the next two to three quarters and then gradually bring it back to the target of 5 percent over the medium term.

Prof. Emmanuel Tumusiime-Mutebile

Governor

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