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Monetary Policy Statement for June 2014

Inflation continued to decline in May 2014 with annual headline and core inflation declining by 1.3 percentage points and 0.1 percentage points to 5.4 percent and 3.3 percent, respectively. The decline in headline inflation was mainly attributed to a drop in food crops inflation which resulted from increased food supply to the market. The continued drop in core inflation is mainly due to the exchange rate appreciation over the last year.

Credit growth for the private sector has picked up a little and is expected to increase over the remaining part of this year and next two years. This will support private sector demand. Therefore growth in economic activity is expected to pick up gradually but it is likely to take some time before the economy returns to the historical growth trajectory of 7 percent.

As in last month's Monetary Policy Statement, real GDP growth for 2014/15 is projected at around 6 percent. Public expenditure on infrastructure and a pickup in private sector investment should support an increase in economic activity together with improved external environment, helped by firmer economic conditions in the advanced countries. Downside risks to growth include the continued weak performance of the agricultural sector and political instability in some of Uganda's major trading partners.

The Bank of Uganda's forecast of core inflation has changed marginally since the previous month. Annual core inflation is projected to be in the range of 5-6 percent in the Financial Year 2014/15 while annual headline inflation is projected to be in the range of 6-7 percent. The outlook for inflation reflects the influence of two opposing forces. A fair degree of spare capacity in the economy will allow stronger growth without exerting pressure on input costs. Working in the other direction is the impetus to prices of tradable goods coming from the possible depreciation of the exchange rate.

The key uncertainties surrounding the outlook relate to the balance of two key forces: the decline in exports and the pick-up in domestic demand. The timing and strength of these and hence their impact on aggregate demand and inflation remain subject to considerable uncertainty.

The balance of risks remains tilted towards lower inflation and sluggish economic growth. Therefore a slight easing of monetary policy is appropriate. Consequently, the Bank of Uganda has decided to reduce the Central Bank Rate (CBR) by 50 basis points to 11 per cent in June 2014. The band on the CBR will be maintained at +/-2 percentage points and the margin on the rediscount rate at 3 percentage points on the CBR. The Rediscount rate and the Bank rate for June 2014 will be 14 percent and 15 percent, respectively.

The accommodative monetary policy stance should provide support to demand, and help growth to strengthen over time. Going forward, the degree of monetary accommodation may need to be adjusted to ensure that the risks arising from both the global and domestic economy do not undermine the outlook for domestic inflation and growth prospects of the Ugandan economy.

Prof. Emmanuel Tumusiime-Mutebile

<u>Governor</u>

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