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Monetary Policy Statement for June 2015

Inflation continued to rise in May 2015 with annual core inflation edging up to 4.8 percent from 4.6 percent in April 2015. The rise in core inflation was in part driven by the pass-through effects of the exchange rate depreciation. Annual headline inflation also rose in May 2015 to 4.9 percent from 3.6 percent in April 2015. The main contributions to the May headline inflation came from the categories of: services, which accounted for 2.4 percentage points; other goods, which accounted for 1.7 percentage points; and food crops, which accounted for 0.9 percentage points.

Aggregate demand has improved though exports of goods and services remain depressed, which is a key drag on aggregate demand. Indicators of economic activity point to a relatively strong real Gross Domestic Product (GDP) growth in the fourth quarter of 2014/15, supported by faster growth in private sector borrowing and a recovery in the agricultural sector. Real GDP growth is projected at 5.3 percent for 2014/15 and 5.8 percent for 2015/16, driven by higher public investment announced in the budget and a rebound in private sector demand. The domestic borrowing requirement in 2015/16 is no larger than that of 2014/15. Bank of Uganda (BOU) believes that the more expansionary fiscal stance of the 2015/16 budget will support economic growth and will not threaten macroeconomic stability.

Pressures on the exchange rate have persisted since the beginning of 2014, reflecting global financial conditions as well as a weak balance of payments position. The current account deficit is projected to widen to 10.3 percent of GDP in 2015/16 from 8.4 percent in 2014/15 on account of: higher non-oil private sector imports and public infrastructure related imports; lower personal transfers; and weak exports, owing to subdued global commodity prices and lower aggregate demand in key export markets.

The BOU's conditional inflation forecast has changed since the previous meeting of the Monetary Policy Committee. The exchange rate pass-through and strengthening of economic activity both at home and abroad will exert further upward pressure on consumer prices over the medium term in the absence of further tightening. Annual core inflation is now projected to rise to 8-10 percent by the end of 2015/16; an increase of 1 percentage point compared to the April 2015 forecast. Much of the increase in core inflation is attributed to currency depreciation and inflation expectations.

In such circumstances, an increase in the Central Bank Rate (CBR) is appropriate given high inflationary pressures and the expected strengthening in demand, and to ensure that medium term inflation converges towards the BOU's policy target of 5 percent during the course of 2016/17. Therefore, the BOU will raise the CBR by 1 percentage point to 13 percent. 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 will therefore be increased to 16 percent and 17 percent, respectively. BOU will tighten monetary policy further should there be deterioration in the inflation outlook.

Prof. Emmanuel Tumusiime-Mutebile

Governor

June 16, 2015