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Monetary Policy Statement for October 2016

Inflation has continued to slow down. Annual headline and core inflation declined to 4.2 percent and 4.1 percent in September 2016 from the respective 4.8 percent and 5 percent in August 2016. The main factors behind the inflation slowdown include weak consumer demand, decreasing inflation expectations, and relatively stable exchange rate dynamics on the back of moderately tight monetary policy twelve months prior. However, because of the drought in many parts of the country food crop prices are rising with annual food crop inflation increasing from *minus* 1.9 percent to 5.1 percent in the last three months.

The revised Gross Domestic Product (GDP) data indicates that the economy grew by 4.8 percent in Financial Year (FY) 2015/16, up from an earlier estimate of 4.6 percent. High frequency indicators point to a significant pick-up in economic activity during the fourth quarter of FY 2015/16, which has continued in the first quarter of FY 2016/17. The economy is projected to grow in FY 2016/17 at about the same rate as in the last financial year. Domestic demand will be a key driver of growth in the current fiscal year.

The overall economic outlook remains largely unchanged from that in the August 2016 Monetary Policy report. Economic growth is projected at 5.0 percent in FY 2016/17 and between 5.0 percent - 5.5 percent in FY 2017/18.

A gradual recovery in private sector credit will support private sector spending and economic growth. Nevertheless, there are risks to the balance of payments arising from weaknesses in the economies of some of Uganda's trading partners and the potential volatility of capital flows.

Inflation in 2016 and 2017 is forecast to remain unchanged from the August 2016 forecasts. Increased demand pressures from the economic recovery are offset by a decline in costs because of lower imported inflation resulting from weaker global demand. Nevertheless, the forecast for headline inflation is slightly higher in line with an upward revision in the food crop price forecast. While the Bank of Uganda (BoU) expects core inflation to remain around 5 percent within this financial year; this will primarily, depend on the exchange rate movements as well as the impact of less than normal rains for the current season.

Given that core inflation is forecast to remain around the medium term target of 5 percent over the next 12 months, there is room to support the domestic economic growth momentum especially against the ongoing global economic slowdown. Therefore, the BoU believes that there is scope to ease monetary policy.

Accordingly, the BoU will reduce the CBR by 1 percentage point to 13 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. Consequently, the rediscount rate and the bank rate have been reduced to 17 percent and 18 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

October 18, 2016