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Monetary Policy Statement for September 2013

Inflation accelerated in August 2013; annual headline inflation rose markedly from 5.1 percent in July 2013 to 7.3 percent in August 2013. The rise in headline inflation was driven by higher food crop prices because of drought. Food crop prices rose by 16 percent in August 2013 alone. Despite the sharp rise in food crop inflation, annual core inflation was relatively stable, rising by 0.2 percentage points to 6.6 percent in August 2013.

Uganda is currently facing a supply side shock to agriculture which has raised food prices and may also impede real growth in 2013/14. The risks to the outlook for core inflation over the next 12 months, which is the target for monetary policy, have clearly increased. Core inflation is likely to be pushed up directly because the higher food prices affect items within the core basket, such as maize flour, and indirectly to the extent that higher food prices feed through to the general price level through cost push effects and through their impact on inflation expectations.

Although the outlook for inflation has worsened, the Bank of Uganda (BoU) does not expect a repeat of the inflationary surge which occurred in 2011, mainly because some of the causal factors which contributed to the rise in inflation in that year, such as rapid bank credit growth and a large exchange rate depreciation, do not pose the same threats in the current economic situation. Nevertheless, it is prudent to ensure that any second round effects from the food supply shock on non food prices are contained, thereby limiting the upward pressure on core inflation, through a timely adjustment of monetary policy. A modest tightening of monetary policy should act to discourage economic agents from raising non food prices in response to the food price shock and should counter any rise in inflation expectations. I am fully aware of the potential impact of this on real sector activity. However, it is my strong view that this is a necessary action to anchor inflation expectations and to support economic growth over the medium to long term.

For the reasons outlined above, I believe that it is warranted to raise the Central Bank Rate (CBR) by one percentage point to 12 percent in September 2013. Although annual core inflation will probably remain above 6 percent for the next few months, by tightening monetary policy now, I am confident that it will fall back towards our policy target of 5 percent by the third quarter of 2014.

The band on the CBR will remain at +/-2 percentage points and the margin on the Rediscount Rate will be 3 percentage points on the CBR. The Rediscount Rate and the Bank Rate will now be set at 15 percent and 16 percent respectively in September 2013.

Prof. Emmanuel Tumusiime-Mutebile

<u>Governor</u>

September 3, 2013