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Monetary Policy Statement for January 2012

Inflationary pressures continued to abate in December 2011, with headline and core inflation declining to 27 percent and 29 percent from 29 percent and 31 percent, respectively in November 2011. Annual food inflation also declined to 34.7 percent from 40.3 percent in November 2011. Monthly headline inflation declined to *minus* 0.14 percent from 0.13 percent in November 2011. Monthly headline and core inflation over the last 3 months averaged 0.5 percent and 0.8 percent, respectively, indicating lower annualized inflation. Annual non-food inflation has however remained relatively sticky, at about 22.8 percent for the last three consecutive months.

There are clear signs that inflation has peaked and I expect inflation to continue declining in most of 2012. But of course, prices for goods and services are sticky, and therefore the decline in inflation is expected to be gradual, especially for non-food commodities. The continuous decline in food inflation since October 2011 is an indication that the impact of supply-side-shocks to food prices is abating. The stickiness of non-food inflation on the other hand is a combination of the lagged impact of exchange rate depreciation on prices of imported goods and the temporal impact of seasonal factors on the elasticity of demand for non-food items during the festive season.

Global inflation is also forecast to fall during 2012 because of the possibility of a sharp economic deterioration in developed countries that will result in the decline in commodity prices, which will support our anti-inflationary monetary policy stance. Nonetheless, the weak Balance of Payments and the associated exchange rate depreciation pressures remains a major upside risk to inflation. Furthermore, the continued turbulence and vulnerability of global financial markets could also lead to depreciation pressures, as offshore investors in

Government securities exit the market. Therefore, although inflation has reduced, the challenge of bringing down inflation to an acceptable level on a sustainable basis remains significant.

The peaking of inflation and the recent strengthening of the shilling shows that monetary policy is quite effective and that Bank of Uganda must maintain a tight stance in order to bring down inflation and stabilise it around its medium-term target of 5 per cent. As expected, this stance has resulted in an increase in the lending rates from weighted average of 21.7 per cent in July 2011 to 25.4 per cent in November 2011. However, there are sectoral differences reflecting differences in risks. Also, lending rates on personal loans increased from 21.7 per cent in July 2011 to 25.7 per cent in November 2011 contrary to what has been reported that personal loans are above 30 per cent.

Bank of Uganda will therefore maintain the Central Bank Rate (CBR) at 23 percent in January 2012. However, due to the sharp decline in the monetary aggregates and weakening of economic activity as reflected in 2011/12 Q1 GDP growth rate and the sharp decline in the Index of Manufacturing output, the band on the CBR is reduced by one percentage point to plus/minus 3 percentage points. The margin on the rediscount rate will therefore be 4 percentage points on the CBR, and the rediscount rate and the Bank rate will be 27 percent and 28 percent, respectively. I acknowledge the fact that the long-term solution to controlling inflation rests on addressing the structural constraints and improving productivity, but controlling inflation in the short to medium term is extremely crucial in stimulating this long-term economic growth.

Prof. Emmanuel Tumusiime-Mutebile
GOVERNOR
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