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Monetary Policy Statement for December 2012

Inflationary pressures remained relatively subdued in November 2012. Annual headline inflation rose only marginally to 4.9 percent from 4.5 percent in October, while core inflation declined to 3.8 percent from 4.0 percent in October 2012. This has re-enforced the Bank of Uganda's confidence that core inflation will stabilize around the medium-term policy target of 5.0 percent through to the middle of next year. The increase in headline inflation was driven by food crops and energy, fuel and utilities (EFU) inflation which rose to 7.5 percent and 13.8 percent compared to 4.4 percent and 12.8 percent, respectively during the previous month. Food crops inflation rose because of supply disruptions, while the increase in EFU inflation was driven by increase in pump prices of petroleum products.

Since the last monetary policy statement in November 2012, the prospects for real economic growth in 2012/13 have weakened. The main constraints to economic growth in the short term are the weakness on the demand side of the economy, a lack of growth in private sector borrowing, the need to cut government expenditure in response to donor aid cuts and the difficult global economic outlook. Commercial banks' lending rates which have fallen by just under three percentage points since their peak in March 2012 remain high, averaging just under 25 percent in October 2012. With real GDP growth forecast to remain below potential, the negative output gap is expected to persist through 2012/13.

The BoU's monetary policy will continue to focus on stimulating aggregate demand in order to boost real economic growth without jeopardizing the medium term inflation target of 5 percent for core inflation. The BOU's forecast for core inflation is that it will stabilize at around 5.0 percent over the next 12 months. As I have already noted, inflationary pressures are currently subdued and are likely to remain so in the near term because of the negative output gap. Consequently, in order to support a recovery in real growth, the BoU will reduce the Central Bank Rate (CBR) by 50 basis points to 12.0 percent in December 2012.

The band on the CBR will remain at +/-3 percentage points and the margin on the Rediscount Rate at 4 percentage points on the CBR. The Rediscount Rate and the Bank Rate have thus been set at 16.0 percent and 17.0 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

December 04, 2012