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Monetary Policy Statement for June 2013

Inflation remained stable in May 2013. Annual Headline inflation rose only marginally to 3.6 percent from 3.4 percent in April 2013, while core inflation declined to 5.6 percent from 5.8 percent over the same period. The monthly headline and core inflation rates also decelerated to 0.1 percent and 0.0 percent from 1.4 percent and 0.2 percent, respectively in May 2013, an indication that inflationary pressures have remained muted.

The forecast of the Bank of Uganda (BoU) for core inflation over the next 12 months has improved in two respects. We are now forecasting slightly lower inflation rates in the short-term. In addition, there has been a reduction in the upside risks that average inflation will be higher than the medium term target of 5 percent over the course of the next 12 months. The change in the inflation forecast is mainly for two reasons. First, household consumption demand is weaker than previously estimated, which is likely to dampen demand side pressures on consumer prices. Secondly, the exchange rate has appreciated more than previously forecasted, which dampens pressures on the prices of imported consumer goods. The BoU forecasts that core inflation will stabilise around its medium-term target of 5 percent over the next 12 months, with the balance of risks being roughly neutral.

Economic growth in 2012/13 is now projected to be higher than in the previous fiscal year. Nonetheless, the recovery in output in this fiscal year is driven by net export demand and, to a lesser extent, investment demand. In 2013/14, it is unlikely that net export demand will continue to provide the primary source of growth for the economy and consequently, domestic demand will have to make a larger contribution to the growth of output. Although we expect that there will be further growth in investment, from both public and private sectors, a rebound in household consumption spending will be necessary to boost aggregate demand and real economic growth in the next fiscal year.

Although growth in monetary aggregates continues to pick-up, private sector credit growth remains constrained by both the high bank lending rates and structural factors. Strong credit growth will be important in boosting domestic demand next year.

Given the improvement in the inflation forecast and the need to further stimulate domestic demand to support the economy in 2013/14, the BOU will reduce the Central Bank Rate (CBR) by 1 percentage point to 11 percent. This should also be a signal for commercial banks to reduce their lending rates further in order to boost demand for bank credit. The band on the CBR will be maintained at +/-2 percentage points on the CBR and the margin on the rediscount rate at 3 percentage points on the CBR. Consequently, the rediscount rate and Bank rate have been set at 14.0 percent and 15.0 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

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