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Monetary Policy Statement for March 2012

Inflationary pressures have continued to abate for the fourth successive month. Annual headline and core inflation declined to 25.4 percent and 26.3 percent, respectively in February 2012, from 25.7 percent and 28.1 percent in January 2012. Annual non-food inflation also fell to 23.8 percent in February 2012 from 24.2 percent in January 2012. The February inflation was 25.4 percent almost identical to that of January 25.7 percent. The slower decline in inflation is attributable to the big jump in the fresh food crops prices which I believe is temporary. Monthly food crop inflation was 7.3 percent in February compared to the decline of 3 percent in January 2012.

Rising food prices and the recent increase in the power tariffs will keep inflation elevated, especially in the first half of 2012, but these stresses will be partly offset by softer domestic spending and excess production capacity in the economy. The softening of domestic demand together with the deceleration in global inflation is likely to contribute to lower inflation going forward. Overall, the downward trend in inflation observed in the previous four months will pickup again, and I expect headline inflation to move lower again as the current rains reverse fresh produce prices. BOU expects no reversal of the disinflationary trend or a build-up in inflationary pressure in the months ahead and I expect inflation to be in single digit by the end of the year.

The global economic growth for 2012 has been revised downwards and uncertainty on the outlook remains elevated. Europe remains the major source of this global uncertainty. While the likelihood of another global recession seems to have lessened a little recently, if it did occur, it would spill-over into Ugandan economy through trade, financial and confidence linkages. The global slowdown is likely to put more pressure on the Uganda's balance of payments and income from commodity exports. Remittances from migrant workers, trade volumes and

Foreign Direct Investment could decline significantly as a result of the subdued global economic growth. This could put pressure on the exchange rate but equally also on aggregate demand.

The Bank of Uganda believes that while inflation is still high, the disinflation momentum is likely to be much faster than previously expected as reflected in the trend of monetary aggregates. The annual growth rate of M3 decreased to 6 percent in January 2012, from 30 percent at the beginning of the financial year of 2011/12, reflecting a sharp decline in monetary aggregates. The annual growth rates of loans to private sector also decreased in January 2012, and stood at 23.5 percent from 45 percent at the beginning of the financial year of 2011/12. This drastic reduction could result in unwarranted sharp contraction of economic activity in the month ahead. Therefore, a cautious easing of monetary policy is appropriate given that, over the period ahead, inflation is expected to decline much faster and that economic growth is expected to remain subdued.

In line with the above developments, BOU will reduce the CBR by 1 percentage point to 21 percent in March 2012, from 22 percent. The band on the CBR remained at plus/minus 3 percentage points and the margin on the rediscount rate remained at 4 percentage points on the CBR. The rediscount rate and the Bank Rate, therefore, will fall by one percentage point to 25 percent and 26 percent, respectively.

Looking ahead, Bank of Uganda will continue to conduct prudent monetary policy to bring inflation close to 5 percent over the medium term and also ensure a firm anchoring of inflation expectations in line with the BoU's aim of maintaining price stability. Such anchoring is a prerequisite for monetary policy to make its contribution to supporting economic growth.

Prof. Emmanuel Tumusiime-Mutebile
GOVERNOR
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