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Monetary Policy Statement for November 2012

Inflation continued to abate in October 2012. Annual headline and core inflation declined to 4.5 percent and 4.0 percent respectively from 5.5 percent and 4.9 percent in September 2012. These reductions in inflation have re-enforced the BoU's confidence that core inflation will stabilize at around the medium-term target of 5.0 percent through to the middle of next year.

Although real GDP growth is projected to rise to 5.0 percent in 2012/13, from 3.4 percent in the previous fiscal year, it will still be below the economy's potential of 6.5 – 7.0 percent per annum. The main constraints to a faster recovery in the short term are the weak domestic demand and the risks and uncertainties in the global economy.

Uganda's current account of the balance of payments continues to be weak. The BoU will support the gradual adjustment of the real exchange rate which is necessary to reduce the current account deficit to sustainable levels. BoU will, however continue to intervene to curtail disruptive movements in the exchange rate.

Following the reductions in the CBR so far, there are now indications that Commercial Banks' lending to the private sector is beginning to pick-up, although at a slow pace. The lack of a stronger recovery in bank lending is partly explained by the lethargic adjustment of Commercial Banks' lending rates. Whereas interbank rates, wholesale deposit interest rates and securities' yields have all followed the downward trend of the CBR, Commercial Bank's lending rates have been sticky downwards. I note with concern that the interest rate spreads have recently increased. Nonetheless, I want to thank those Commercial Banks that have responded and encourage all Banks to implement bolder reductions in their lending rates.

In the short-term, monetary policy will continue to focus on the objective of stimulating aggregate demand in order to boost real economic activity without jeopardizing the medium term inflation objective. The forecast that core inflation will stabilize at around 5 percent over the next three quarters, provides room for a modest reduction in the CBR of 50 basis points to 12.5 percent in November 2012. I believe that with this reduction, the CBR is now approaching the level which is consistent with the medium-term inflation target of 5.0 percent.

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 will now be set at 16.5 percent and 17.5 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

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