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Monetary Policy Statement for September 2012

The momentum of disinflation strengthened in August 2012. Annual headline and core inflation fell sharply to 11.9 percent and 11.5 percent respectively in August from 14.3 percent and 15.4 percent in July. There was also a sharp fall in annual non-food inflation from 19.1 percent in July to 16.0 percent in August, which in previous months had been relatively sticky. Since the beginning of the year, monthly inflation rates have been very subdued, with the headline and core inflation rates averaging 0.4 percent and 0.3 percent respectively, which is an indication that the disinflation process has remained solid.

There are three main reasons for the decline in inflation. First, the food price shocks which afflicted the economy in 2011 have abated somewhat. Second, domestic demand pressures are weak, with the economy operating below potential output levels. Third, the stability in the e nominal exchange rate since the start of the second quarter of 2011/12 has been translated into stable prices of traded goods.

In the short term, inflationary pressures are very likely to remain subdued. The BOU now expects that annual core inflation will fall to single e digits by the end of September 2012 and then gradually flatten out at around 5 percent in the first h an lf of 2013. However, all forecasts are subject to risks. As we move into 2013, there are potential risks of stronger inflationary pressures emanating from food price shocks. Global food prices have already begun current account deficit.

Monetary policy will continue to focus on stimulating a recovery in aggregate demand in order to boost real growth while at the same time guarding against any resurgence in inflation. Accordingly, the Bank of Uganda will reduce its policy interest rate - the Central Bank Rate (CBR) - by two percentage points to 15.0 percent for September 2012. This reduction in the CBR is intended to bring about a further fall in the marginal cost of funds for the Commercial Banks and hence a fall in bank lending rates to stimulate a recovery in bank lending to the private sector. Unfortunately, despite the CBR having already been reduced by 6 percentage points since February 2012 prior to today's reduction, Commercial Banks' lending rates have not yet fallen in line with the CBR. With the trend towards lower interest rates now firmly established, I expect Commercial Banks to respond more positively and reduce their lending rates to stimulate demand for credit.

The band on the CBR will remain at +/-3 percentage points and the margin on the Rediscount Rate will remain at 4 percentage points on the CBR. The Rediscount Rate and the Bank rate will now be set at 19.0 percent and 20.0 percent respectively in September 2012.

Prof. Emmanuel Tumusiime-Mutebile
GOVERNOR
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