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Monetary Policy Statement for February 2017

The consumer price index (CPI) data for January 2017 indicates a mixed picture of inflation outturn. Higher inflation for food crops as well as electricity, fuel and utilities pushed up the annual headline inflation to 5.9 percent from 5.7 percent in December 2016. In contrast, annual core inflation declined to 5.3 percent in January from 5.9 percent in December 2016, reflecting declining inflation in most of the services sector.

Economic growth estimates for the first half of FY 2016/17 indicated that Gross Domestic Product (GDP) growth was weaker than expected, largely reflecting temporary adverse weather related factors. The Bank of Uganda's (BoU) Composite Index of Economic activity for December 2016, indicates a slowdown in economic activity in the quarter to December 2016. While the slowdown is due to temporary factors, economic growth could remain weak in the remaining part of FY 2016/17, reflecting a combination of domestic and external factors. Consequently, GDP growth projection for FY 2016/17 has been revised downwards to 4.5 percent from the 5.0 percent that we had at the previous Monetary Policy Committee meeting.

The economic prospects are more optimistic for FY 2017/18, with GDP expected to grow at 5.5 percent, driven by improved public infrastructure investment, a recovery in private sector investment and improvements in agricultural production and consumption. Global conditions remain uncertain though tentatively improving. Bank of Uganda, therefore expects the impact of negative external shocks on the economy to be softened going forward.

Since the previous meeting of the Monetary Policy Committee (MPC), the near-term inflation outlook has deteriorated, but the medium-term outlook is unchanged. The BoU's short term forecasts indicate that inflation will temporarily increase but remain within the target band of 5 percent plus/minus 3 percentage points. Inflation is expected to return to the target of 5 percent in 12 months as potential growth is achieved. The near term increase in inflation is attributed to the increasing international oil and food prices though it may be constrained by weak aggregate demand. The more favourable shilling exchange rate has been an important factor in offsetting some of the upward pressures on inflation. Nevertheless, the exchange rate remains vulnerable to both domestic and external shocks.

Bank of Uganda judges that a further cautious easing of monetary policy is warranted to support economic activity. The easing will also be consistent with achieving the annual core inflation target of 5 percent over the medium term. Therefore, the BoU will reduce the CBR by 0.5 percentage points to 11.5 percent. The band on the CBR will be maintained at +/-3 percentage points and the margin on the rediscount rate at 4 percentage points on the CBR. Consequently, the rediscount rate and the bank rate have been reduced to 15.5 percent and 16.5 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

February 15, 2017