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Monetary Policy Statement for June 2016

After peaking in December 2015 at 8.5 percent and 7.6 percent, annual headline and core inflation declined gradually to 5.1 percent and 6.4 percent, respectively in April 2016. However, both annual headline and core inflation edged up in May 2016, rising to 5.4 percent and 7.0 percent, respectively. The Consumer Price Index (CPI) data for May 2016 indicates that there have been broad-based increases in domestic cost pressures, in part reflecting the lagged impact of exchange rate depreciation. All sub-components of inflation increased, except "food crops and related items", which declined further to ***minus*** 5.0 percent from ***minus*** 4.2 percent in April 2016.

The economy continues to grow at a moderate pace, and is projected to expand by 4.6 percent in Financial Year (FY) 2015/16, down from an earlier projection of 5.0 percent. The downward revision reflects the adverse impact of the weak external economic environment, soft commodity prices, tight financial conditions, and subdued domestic demand. Going forward, economic activity is expected to improve with domestic demand being the key contributor to economic growth amidst continued weakness in the external sector. However, the recovery is expected to be slow with downside risks.

The outlook for domestic and external cost pressures is a key source of uncertainty. Despite below-trend growth in economic activity over the current financial year, it is possible that domestic cost pressures may increase further, and so inflation may edge up in the coming few months. In particular, the persistent "Non-food" and "Services" inflation which have remained above 5 percent for the first five months of 2016; projected worsening of food crops inflation in the second half of 2016; combined with effects of rising international oil prices and fuel tax increases, make the near term inflation trajectory somewhat more uncertain. Further ahead, the outlook for inflation remains largely unchanged since the last Monetary Policy Committee meeting held in April 2016. Both annual headline and core inflation are forecast to stabilize around the medium term target of 5 percent by early 2017.

Bank of Uganda (BoU) is cognisant of the fact that demand pressures on inflation remain subdued, and indications are that domestic demand is likely to remain constrained at least in the remaining part of 2016. Given that inflation is forecast to fall back to the policy target of 5 percent over the next 12 months, BoU believes that there is scope to continue easing monetary policy. Accordingly, the BoU will reduce the CBR by 1 percentage point to 15 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 19 percent and 20 percent, respectively.

Prof. Emmanuel Tumusiime-Mutebile

Governor

June 13, 2016