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Monetary Policy Statement for August 2011

The primary objective of the Bank of Uganda's monetary policy is to maintain low and stable inflation, with a target for annual core inflation of 5 percent. Headline inflation and core inflation increased to 18.7 per cent and 15.6 per cent respectively in July 2011, from 15.7 percent and 12.2 percent respectively in the previous month. The priority for monetary policy is to bring down the current high rates of inflation to the target over a realistic time frame, which is 12-24 months.

Headline inflation rose due to a sharp increase in food prices, in particular prices for maize flour, sugar, and sweet potatoes. Annual food price inflation rose to 40.6 percent in July 2011. In contrast, non food price inflation remains relatively low, although it rose to 9.1 percent in July 2011. The high food price inflation has been caused by supply side shocks, both within Uganda and in the neighbouring countries, which have reduced the availability of food on the markets. However, the prices of some food crops, notably matooke, have started to fall. Over the next few months, food prices in general should begin to decline as more food becomes available, although the rate at which food prices will fall is uncertain because of the very difficult regional food situation.

Whereas food prices in the short term are driven primarily by supply side factors, inflation for most non-food items is affected by the strength of aggregate demand in the economy, which can be influenced by monetary policy. The Bank of Uganda's main monetary policy instrument is the Central Bank Rate (CBR), which is set every month and provides a guide for short term interbank interest rates. The BOU has raised the CBR from 13 percent in July 2011 to 14 percent in August 2011. The increase in the CBR is

intended to curb the growth of bank credit in the economy, which expanded very rapidly in the 2010/11 fiscal year, and to provide some support for the nominal exchange rate, which affects the domestic prices of imported goods. In tightening monetary policy further, the Bank of Uganda intends to prevent the current high rates of food price inflation from feeding through into higher inflation for non food items, by curbing the growth of aggregate demand and hence spending on goods and services. As spending growth subsides, inflationary pressures will ease.

Looking ahead, the Bank of Uganda expects that headline inflation will fall back to between 8 and 10 percent by July 2012 and to around 5 percent by the middle of 2013. However, if the upside risks to inflation increase in the coming months, monetary policy will be tightened further.

Prof. Emmanuel Tumusiime-Mutebile

GOVERNOR

August 02, 2011