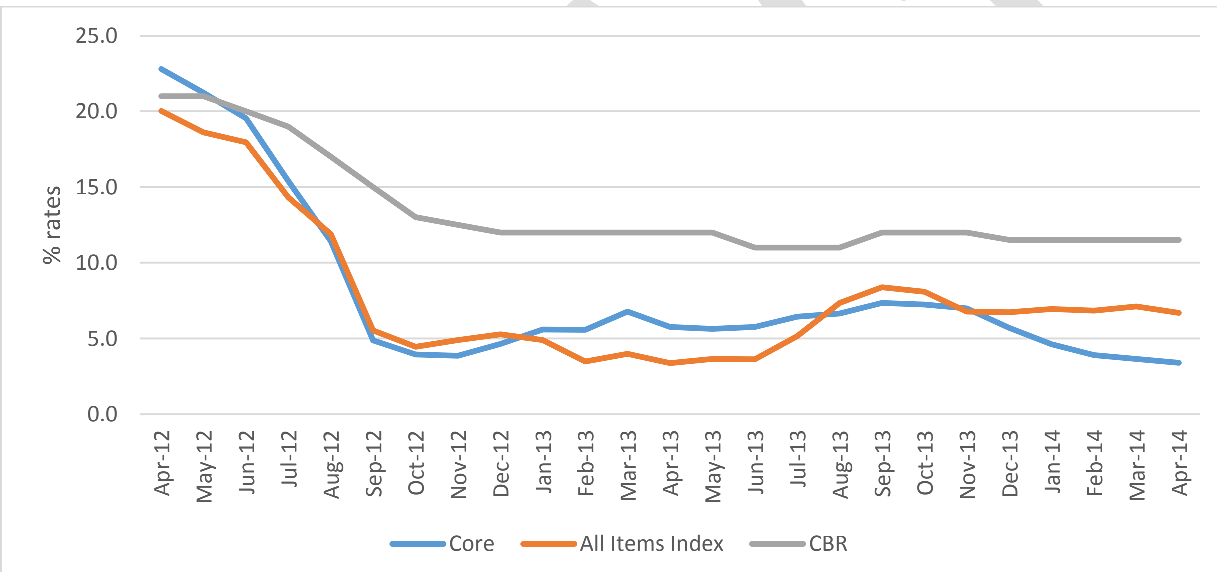
Monetary policy response for the month of May 2014

In the month of April 2014, both the core and headline inflation reduced from 3.7% and 7.1% to 3.4% and 6.7% respectively. For the bank of Uganda, this means that for the fourth month in a row since January 2014, the policy target of core inflation below 5% has been achieved. This has been achieved in part due to the neutral Central bank Rate that has been held at 11.5% since December 2013.

Figure 1: Inflation and CBR trends from April 2012 to April 2014



Source: Bank of Uganda

The period of July 2013 to March 2014 registered an average annual headline inflation rate of 7.02%, which was higher than the targeted average rate of 6.2%. Inflation has a negative effect on aggregate demand which affects enterprise growth and production of goods and services. This partly explains the negative performance of VAT on goods and services and corporation income tax mainly due to reduction in production activities.

Over the months, CSBAG have pointed out that the use of CBR as a policy target to achieve low inflation in the economy will hurt the real economy and the players there with in.

Point in case;

- The FY 2013/14, GDP was projected to grow at 6.0%, however it grew at 5.74% as at March 2014. This directly affected taxes like VAT and Excise duty.
- Also, in the FY 2013/14, demand for credit was projected to grow at 14.5 %, however it grew at 6.8%. This was partly due to high interest rates charged by commercial banks, though the central bank lending rates (Central Bank Rate-CBR) reduced to 11.5% for the last three months from January to April, 2014. We also noted that the refusal of the commercial banks to reduce the lending rates will also come back to haunt them and this this too has been witnessed in their reports for the FY 2013/14 with either reduced profits or actual losses.
- According to the URA report for July 2013 to March 2014, 347 major companies that posted profits in FY 2012/13 registered losses in FY 2013/14.

The attainment of low inflation is a desirable but in this case the methods used and the other desirable conditions that are not sorted have made the Ugandan economy and the Ugandans at large pay the price. All this was the basis for the policy recommendation to the Central Bank to exercise more of its mandate and regulate the financial sector. We recommended and still recommend the use of fines and charges for commercial banks that do not follow suit with the guidance of the CBR.

Appreciating the tough times in the financial sector caused by high default rates on loans, high government borrowing from the sector, a large informal sector most of which is unbanked, a reduction in the CBR to 11% would be warranted to ease the tough credit situation in the economy and boost businesses that are in dire need. In an economy were over 60% of the youth are and employed and 347 businesses are registering losses, and many more closing down, we need a multi-pronged approach to dealing with inflation in Uganda.

We therefore urge the Bank of Uganda to join us in requesting government to spend more on dealing with the structural rigidities in the agriculture sector. And this can be achieved better if the beneficiaries are consulted. This will guard against high infrastructure expenditure that does not solve the issues in the agriculture sector.

Bank of Uganda should regulate the commercial banks beyond the moral persuasions. The commercial banks can afford to flaunt the commercial protection guidelines, like not notifying customers when their ATMs are off but when it comes to responding to CBR, the BoU should come out stronger since the impact is profound on the whole economy.