



The Economic Policy Research Centre (EPRC)

SPEAKS ON ECONOMIC TURBULENCE IN UGANDA - INFLATION, STRIKES, AND DEMONSTRATIONS

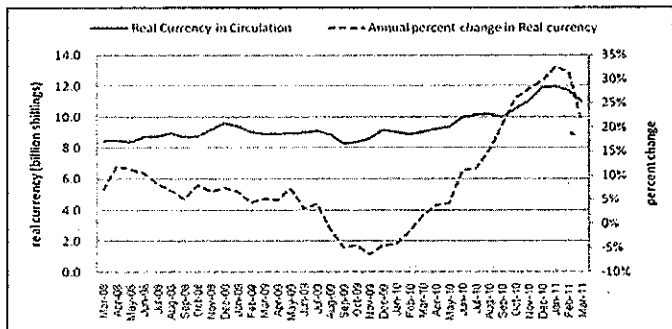
The Uganda economy is experiencing turbulence. Rising inflation and a depreciating shilling are major concerns that have seen sections of some Ugandans demonstrate on the streets and others go on strike. The exchange rate depreciated from US\$1,900 per dollar in November 2010 to US\$2,600 per dollar in July 2011. Monthly inflation rose from 5 percent in January 2011 to 15.8 percent in June 2011.

We should be mindful that being a small open economy, Uganda could not have been spared the adverse effects of the global financial crisis that started in 2008. The crisis led to slackened growth of exports, capital inflows, remittances, and foreign direct investment. Lower growth of these inflows against rising demand for foreign currency partly explains the steady depreciation of the shilling witnessed in Uganda since November 2009. For example, the increase in Uganda's export earnings notwithstanding, imports grew faster leading to a widening balance of trade from negative US\$200 million in August 2010 to negative US\$420 million in March 2011, which partly contributed to the depreciation of the shilling.

Increasing prices of crude oil on the international market seem to have also contributed to the increasing fuel pump prices in Uganda. The price of crude oil on the international market rose from US\$90.7 per barrel in December 2010 to US\$116.32 per barrel in April 2011 before falling to US\$105.85 per barrel in June 2011.

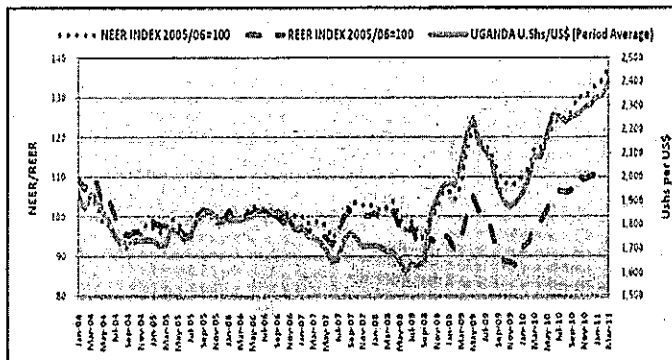
On the domestic scene, Uganda witnessed increasing growth of currency in circulation from below 2 percent per annum in November 2009 to about 32 percent per annum in March 2011 (see figure 1). The growth of currency in circulation moved in tandem with the exchange rate, which increased from about US\$1,900 in November 2009 to about US\$2,500 in March 2011 (see figure 2). As currency in circulation grew fast, the exchange rate depreciated from US\$1,900 per dollar in November 2010 to slightly over US\$2,400 per dollar in March 2011.

Figure 1: Currency in Circulation (Ushs billion)



Source: Bank of Uganda

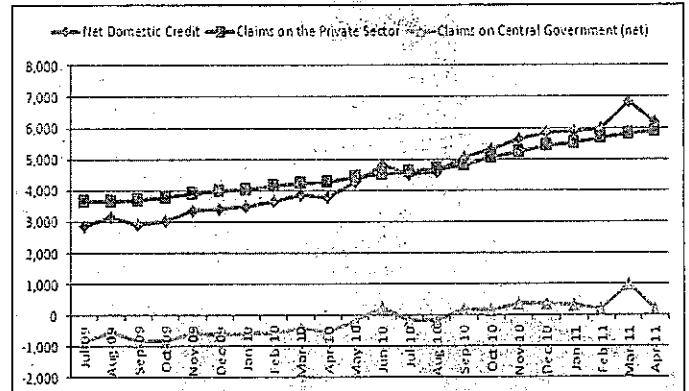
Figure 2: Nominal and Effective Exchange Rate Movements



Source: Bank of Uganda

The source of growth of currency in circulation was the significant increase in net domestic credit, which increased from Shs2,916 billion in September 2010 to Shs6,859 billion in March 2011 before declining slightly to Shs6,169 billion in April 2011 (see figure 3). Net domestic credit moved in tandem with Bank of Uganda claims on the Central Government, which turned from savings from around June 2010 to borrowing for the period thereafter (see figure 3). From July 2009, the central government began drawing down on its savings with Bank of Uganda.

Figure 3: Movements in Domestic Credit (US\$ billion)



Source: Bank of Uganda

Net issuance of government securities not only remained in the negatives but widened from negative (-) Shs35 billion in January 2010 to negative (-) US\$141 billion in December 2010 (see table 1). The Government securities market partly contributed to the increase in growth of currency in circulation until March 2011. Bank of Uganda monetary policy from November 2009 to March 2011 was expansionary i.e. Bank of Uganda allowed the central government to i) draw down her savings from July 2009 to May 2010; ii) increasingly borrow from Bank of Uganda from June 2010 to March 2011; and issue less Government securities compared to maturities from January 2010 to March 2011. The exchange rate depreciated when monetary policy was expansionary.

However, from April 2011, net issuance of Government securities turned positive, signaling a beginning of Bank of Uganda tightening of monetary policy. Also beginning April 2011, Central Government borrowing from Bank of Uganda reduced tremendously as can be seen from figure 3.

Table 1: Net Issuance of Government Securities (US\$ Billion)

	Jan 2010	Feb 2010	Dec 2010	Jan 2011	Feb 2011	Mar 2011	Apr 2011
Net issuance of Government Securities	-35	-53	-141	-78	-67	-87	26

Source: Bank of Uganda

Although high food inflation (44.2 percent in May 2011) also contributed to the high headline inflation (16 percent in May 2011) the extent was mainly on account of coincidence with increasing growth in currency in circulation. For example, in September 2009 Uganda witnessed even higher food inflation (48.3 percent) with less effect on headline inflation (14.5 percent), because at that time, the growth of currency in circulation was low and falling (see figure 1). In September 2009, growth of currency in circulation was only about 2 percent per annum compared to above 20 percent in May 2011 (see figure 1). Therefore, in addition to global developments, increasing growth of currency in circulation seems to explain the inflation and exchange rate depreciation Uganda has witnessed from late 2009.

SUGGESTED WAY FORWARD

The way forward lies in stabilization of prices and the exchange rate. This would entail tightening monetary policy in the short run and focusing on the supply side in the medium and long run. Bank of Uganda is already beginning to tighten monetary policy with the growth of currency in circulation beginning to fall. This is a development in the right direction. However, Government would have to prioritize the supply side to boost growth of exports. In agriculture, focus should be more on enhancement of productivity through especially application of fertilizer to improve soil health. In manufacturing, focus should be more on manufacturing for exports and public sector interventions in this regard should be more in terms of addressing the production constraints manufacturers face, especially poor and transport infrastructure.

In the situation obtaining in Uganda, exchange rate depreciation may neither encourage exports nor check growth of imports. This is because the export side faces a plethora of constraints and Uganda is largely an import dependent economy. As a country we need to deliberately influence formation of expectations that are supportive of increasing growth of capital inflows – foreign aid, foreign direct investment, and remittances. With fast growth of exports, depreciation of the shilling is likely to be checked. Strikes and demonstrations lead to worsening inflation expectations and discourage foreign direct investment, thus worsening the economic turbulence. Therefore, both the state and non-State actors need to work together in order to address the current economic turbulence.