Emmanuel Tumusiime-Mutebile: Inflation and opportunities in Uganda

Press statement by Mr Emmanuel Tumusiime-Mutebile, Governor of the Bank of Uganda, at the Bank of Uganda, Kampala, 24 September 2008.

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1. Recent inflation developments

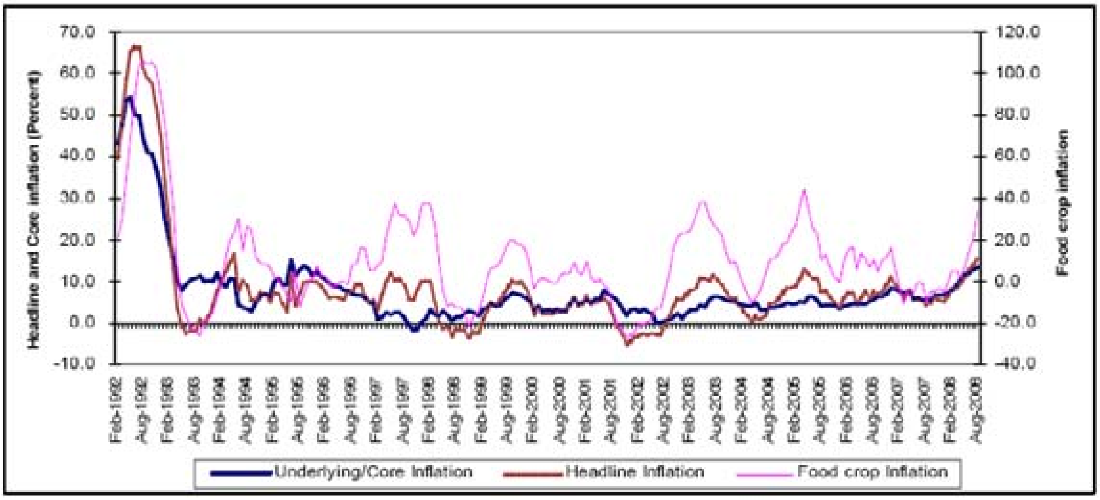
The recent spike in inflation comes after a long period of low and stable single digit inflation that has been entrenched in Uganda since the 1990s. The long term commitment of the BOU remains to maintain price stability at all times. In this regard, it is important to understand the reasons for the recent surge in inflation, and also explain the stance that Bank of Uganda has adopted to deal with the problem.

Two developments need to be explained. First, at the international level, data from the World Economic Outlook indicates headline inflation in advanced economies to have risen to 3.5 percent in May 2008. The rise in inflation in advanced economies has led central banks to express growing concerns in regard to the current price environment. The increase in inflation is more marked and broader in developing economies, particularly Sub Saharan Africa where headline inflation has registered an average of 20.0 percent; the highest rates since the beginning of the current decade. In these economies, food and fuel make up a larger share of consumption baskets and sustained strong growth has tightened capacity constraints. The major part of the spike in inflation reflects sharp increases in global energy and food commodity prices, and other commodities. In part, the rise in prices was driven by the commodity boom that resulted from both accelerated demand and constrained supply. In particular, the increased demand from emerging economies for various commodities; demand for specific food crops and bio fuels; and slow supply responses, amplified the price pressures.

Second, on the domestic front, core inflation had remained in single digits since 1996 but rose above the 10 percent mark after April 2008. In the same vein, headline inflation was recorded at single digit levels for most of the period from August 1993 to May 2008. It was only some episodes in 1997, 2003 and 2005 that inflation rose above the 10 percent level, mainly due to the world oil prices increasing after the genesis of the gulf war, supply constraints after the closure of the sugar factories among others, and periods of elongated drought. Figure 1 maps the inflation profile.

The domestic food crop prices, as reported by the Uganda Bureau of Statistics, rose mainly due to seasonal factors, poor harvest, substitution effect and high domestic and regional demand. The rise I prices of processed foods were brought about by increased costs of raw materials, the impact of supply constraints as a result of the Kenyan crisis, together with increased transportation costs due to the surge in the world oil prices, among others.

Figure 1: Annual Inflation Developments: February 1992-August 2008



Source: Uganda Bureau of Statistics

2. Food prices as a major driver of the recent high inflation rates

In terms of composition, an analysis of the major movers of inflation shows that the contribution of food (comprising of food crop and food-non-food crop) to inflation has been growing steadily since April 2008. The magnitude of the contribution of the above factor, however, equaled that of non-food items on average.

Previously, changes in food crop prices helped neutralize otherwise sharp increases in core inflation resulting in a less accelerated headline inflation rate. However, the annual food crop inflation started rising in February 2008 from levels of 4.8 percent to 15.4 percent in June 2008 and further to 33.7 percent in August 2008; the highest food crop inflation recorded since May 2005. The total effect of the food price changes on headline inflation increased from 0.6 percentage points in January 2008 to 9.1 percentage points in August 2008.

3. Opportunities and challenges before us

While the short run hikes in prices may pose unfortunate and difficult stresses on the general standard of living, it also provides opportunities for the Ugandan producers to increase domestic production to take advantage of the rising world commodity prices. Increased domestic production should help boost supply of food crops, alleviate price pressures and also contribute to prosperity for all. Information from the business confidence survey index conducted by BOU continues to reveal that many firms are positioning themselves to increase investment and boost the supply of domestically produced goods within the near term.

The increased regional demand for our products provides a challenge to firms and households to increase output and take advantage of the high international commodity price developments.

Uganda's future competitiveness and ability to diversify exports depends fundamentally on reducing the costs of production through investment in infrastructure, particularly electricity, telecommunication and the transport system. Indeed, to reap the benefits from expanded access to markets for export products that our people produce requires a solution to the binding supply side constraints, ability to comply with trade standards and rapid improvements in productivity. Undeniably, the cost of doing business can be curtailed further by constituting effective institutions, particularly, the judicial and legal system, the investment, taxation and other regulatory authorities, among others. This institutional development should help maintain and improve Uganda's competitiveness in regional and international markets.

It is anticipated that global inflation will decline in the near future if world economic growth rebounds and the financial market situation in the developed countries normalizes. On its part, the Bank will continue to minimize the adverse impacts of second round price effects that may arise from the external shocks by pursuing appropriate monetary policy.

3. Conclusion

The Central Bank remains committed to the low inflation objectives in the medium term outlook and shall implement an appropriate monetary policy stance aimed at setting money supply to such a level that would keep inflation on track to deliver price stability. Accordingly, while the economy will be allowed to adjust to exogenous shocks, the central bank policy actions will aim at minimizing the second round effects feeding into domestic inflation.

It should be pointed out that continued fiscal discipline; financial markets development, sustained financial stability and deepening have provided a conducive environment for doing business in Uganda. The gains achieved so far will be consolidated by continuing the coordination of monetary and fiscal policies to ensure macroeconomic stability.

There is need for urgent action to tackle supply side constraints to increase production. Going forward, reforms to improve efficiency of institutions will continue to be implemented and significant investment effected in infrastructure to reduce the costs of doing business in the country. Government has already committed itself to address the infrastructure requirement in roads, energy and communication sectors. The private sector is therefore called upon to take advantage of the available opportunities in the global community and neighboring countries to increase the supply of food and other products to maximize the gains from these opportunities.