Njuguna Ndung'u: Taming of inflation and food security

Opening remarks by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya and Chairman of the Monetary Policy Committee, during the Monetary Policy Committee Seminar on "Taming inflation and food security", The Kenya School of Monetary Studies, Nairobi, 14 August 2009.

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Permanent Secretaries: Ministry of Finance; Ministry of Planning, National Development and Vision 2030; Ministry of Agriculture; Ministry of Trade; Ministry of Special Programmes;
Representatives of our Development Partners;
Chairmen and Heads of Government Parastatals;
Representatives of the Private Sector;
Distinguished Guests;
Ladies and Gentlemen;

It gives me great pleasure to be with you today during this important seminar on **"Taming Inflation and Food Security"**. Let me take this opportunity from the onset to warmly welcome you all to the Kenya School of Monetary Studies (KSMS).

As you may all be aware, the Bank's principal objective is to formulate and implement monetary policy directed at achieving and maintaining stability in the general level of prices, as well as supporting the economic policy of the Government including its objectives of growth and employment. Price stability is an important signal to the economy and provides a stable planning horizon to predict future prices and perhaps returns. Most coordination failures occur due to the inability to forecast future prices or calculate, for example, return on investment.

This seminar comes at a time when the country is just recovering from the effects of high inflation arising from supply side factors caused by several shocks. These shocks have an international as well as domestic dimension. They include volatile oil prices, commodity prices and drought conditions which continue to pose a challenge to the achievement of the Bank's core mandate of price stability.

Given these outcomes – that shocks tend to affect domestic prices upwards and domestic output downwards, simultaneously – we have to rethink the appropriate measure of inflation and how to target or contain it.

But also, appropriately computing and reporting inflation becomes very critical – the information processed from the reported numbers on inflation leads directly to cost of living adjustment (COLA) requests even at CBK!

Usually, the CBK must have some inflation target. But also this has to be consistent with inflation experience or profile for the general public as well as create the required consistency of the monetary framework and economic growth profile.

This workshop should help in defining the appropriate inflation indicator.

The emphasis that seems to converge is to come up with a single measure of inflation that can be easily explained, analyzed and related to economic outcomes. But of course different economic constituencies will understand this in terms of how it affects them.

Alternatively we may want to focus on measures that will say exactly what they mean. These include:

a) Food inflation.

b) "Core" inflation – (define what is core).

c) Inflation (takes care of all the above) – National inflation indicator.

d) For CBK, we would prefer a non-tradable goods price index to compute our inflation index that responds or is affected by monetary policy directly and also links to the exchange rate and the issues of competitiveness. For your information, Ladies and Gentleman, many countries are currently publishing statistics on tradable and non-tradable inflation as part of their dissemination of inflation data. This allows central banks to easily compute the profile of real exchange rate.

e) Finally, we want an inflation index that comes close to measuring or reflecting the cost of living. The question is, how can this be done and at least cost by KNBS and how other players in this process can partner.

But why do we want several indicators of inflation to be developed? At the outset, money or the demand side is just one factor or driving force on inflation. The other one is on the supply side. Monetary policy becomes passive when supply side factors drive the domestic prices and so inflation. This means that several indicators can also bring in a wealth of information to be processed.

The experience; the achievement of the inflation target has been constrained by increased volatility in food prices and other exogenous shocks. In particular, the overall month-on-month inflation increased from 9.67 percent in January 2007 to 11.1 percent in June 2007, and to 31.5 percent in May 2008 before declining gradually to 17.79 percent in July 2009. On the other hand, CBK underlying inflation declined from 5.15 percent in January 2007 to 4.90 percent in June 2007 before rising to 7.90 percent in July 2009. The issues and questions raised by such volatility in one measure of inflation thus attract policy debate and action.

It is important to note that the rising overall inflation rate during the period was attributed mainly to food prices which account for 50.5 percent of the overall consumer price index basket. The rising food prices have been attributed mainly to drought, supply constraints and lack of cultivation by farmers in Kenya's grain basket in the Rift Valley who were displaced following the post poll crisis in January 2008.

Food inflation has been quite volatile and erratic since January 2007, increasing from 11.8 percent to 15.9 percent in December 2007, 44.2 percent in May 2008 and declining to 24.4 percent in July 2009. The volatility of food inflation was the highest during the period and using a measure of volatility stood at 10.72 percent compared with 8.98 percent and 6.19 percent for fuel and transport & communication inflation rates, respectively.

The Monetary Policy Committee of the Bank is concerned that the prevailing famine and drought in the country will result in a spike in inflation and so an appropriate policy response is required.

The solution; most studies have advocated for improved agricultural productivity as the most effective way of addressing food crises associated with higher international prices and food security concerns. But this has to be supported by an appropriate infrastructure for processing, storage and transportation of food.

In this regard, it is our hope that this seminar will seek to achieve the following objectives:

a) Agree on how best to report inflation.

b) Review the sources, magnitude and structure of inflation in Kenya, to gain a better understanding of its dynamics.

c) Come up with feasible solutions to the food supply problem.

d) Deliberate on possible action plans among key stakeholders to keep inflation low and stable.

This seminar is therefore expected to come up with resolutions that would form a basis for a long term policy on domestic prices and food security in Kenya. We still have to contend ourselves with a three-dimensional solution: food production; food processing; food storage and transportation.

Let me underscore the important role of partnership between the stakeholder-institutions represented here today in addressing the challenges of inflation. It is my hope that such partnerships will involve regular consultations, sharing information and strategies geared towards seeking solutions to supply constraints or challenges to food production and distribution with the overall objective of achieving price stability. This workshop should re-define and strengthen future partnership and the responsibility for each institution.

On behalf of the Central Bank of Kenya and the Monetary Policy Committee, let me express my sincere gratitude to the presenters, discussants and all participants who responded to our invitation and have graced us with their presence at this seminar. I am sure they will provide a good platform to share information and discuss feasible solutions.

Ladies and Gentlemen, I now take this opportunity to declare this seminar officially open.

I wish you all fruitful deliberations.

Thank you.