EBS/87/269

CONFIDENTIAL

December 17, 1987

To: Members of the Executive Board

From: The Acting Secretary

Subject: Uganda - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Uganda shilling.

Mr. Bélanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

UGANDA

# Real Effective Exchange Rate - Information Notice

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Legal Department and the Research Department)

Approved by A.D. Ouattara and Eduard Brau

December 16, 1987

The recent evolution of Uganda's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of September 1987, the Uganda shilling had appreciated in real effective terms by 43 percent since the last occasion on which the Executive Board had an opportunity to discuss Uganda's exchange rate policy--the 1987 Article IV consultation and request for arrangements under the Structural Adjustment Facility (SAF) in June 1987. 1/

On May 15, 1987 the Ugandan government inaugurated a major economic adjustment and rehabilitation program supported by a first-year SAF arrangement covering the period July 1987-June 1988. 2/ The program included the introduction of a new Uganda shilling equivalent to 100 old shillings and the requirement that all old currency and deposits be converted to new shillings after payment of a 30 percent conversion tax. In addition, the Uganda shilling, which is pegged to the U.S. dollar, was devalued from the equivalent of U Sh 14 per U.S. dollar to a new rate of U Sh 60 per U.S. dollar. Shortly after announcing these measures, the Government also increased agricultural producer prices, with the coffee price rising by nearly 200 percent to U Sh 24 per kg, thus restoring a substantial part of the loss in farmers' real incomes since the last increase in producer prices at end-May 1986. Retail prices for petroleum products were also increased. Donors responded to these measures with substantial new commitments of assistance at a Consultative Group meeting held in early June 1987. In addition, the Paris Club agreed to debt rescheduling for Uganda on exceptional terms.

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1/ The Chairman's Summing Up was circulated as SUR/87/54.

2/ Uganda - Staff Report for the 1987 Article IV Consultation and Request for Arrangements under the Structural Adjustment Facility, EBS/87/110 (5/22/87).

There are preliminary indications of an increase in domestic production during 1987, following several years of declining real GDP. Reports have indicated a substantial increase in agricultural output, reflected partly in a large rise in marketed coffee production. In addition, a number of industrial establishments have significantly increased their production levels, with some now operating at close to capacity.

After falling by 16 percent in June 1987, the principal consumer price index rose by 39 percent between June and September. Much of the recent increase has reflected the impact of the May devaluation on the prices of imported goods and the adjustment of administered prices, a factor anticipated in setting the magnitude of the exchange rate adjustment. It is therefore too early to gauge the strength of underlying inflationary tendencies. Despite the recent appreciation in real effective terms, the real effective exchange rate remains about 60 percent below its level prior to the May currency reform, and broadly in line with its level during 1984, when the auction system for foreign exchange was in effect.

After some delay, the authorities announced a budget with domestic financing in line with the program benchmark under the SAF. The budget, however, envisaged both substantially higher tax revenues and recurrent expenditures than envisaged in the program supported by the SAF arrangement, and the staff is concerned that the budgeted level of tax revenues may not be realized. During the first quarter of 1987/88, 1/ however, recurrent expenditure was held substantially below the budgeted level, while the government was credited for the bulk of the proceeds from the currency conversion tax. Net bank credit to government accordingly decreased by about U Sh 750 million during the quarter, somewhat more than the U Sh 500 million decline targeted in the program.

The broad money stock has begun to grow rapidly in recent months, after an initial decline between April and June 1987 attributable to the currency conversion exercise. Broad money increased by 24 percent between end-June and end-August, reflecting both an increase in net foreign assets and growth in domestic credit. Credit to the nongovernment sector grew by about one third during this period, largely because of a rapid increase in crop finance. Although the increase in total domestic credit is believed to have exceeded the program target for the July-September 1987 quarter, the end-September level is estimated to have been lower than in the program. This reflected a better than anticipated revenue performance in late 1986/87, which lowered net credit to government and total domestic credit at the end of June significantly below the level assumed in formulating the program.

Continued weakness in world coffee prices and less optimistic projections for noncoffee exports have led to a downward revision of export projections for 1987/88. As updated information has also revealed more debt due to multilateral organizations than was assumed at

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1/ Fiscal year starting in July.

the time of negotiation of the program supported by the SAF, a US$38 million external financing gap is now estimated for 1987/88. Reflecting this financing gap and also delays in receipts of external assistance during the early period of the program, Uganda has continued to have difficulty in meeting its debt service obligations to external creditors, including the Fund. Despite payments exceeding SDR 20 million since the approval of the first-year SAF arrangement on June 15, 1987, Uganda has been continuously in arrears to the Fund since mid-July. Uganda's overdue obligations to the Fund totaled SDR 13.9 million as of December 7, 1987.

The exchange rate on the parallel market, which had appreciated from the equivalent of U Sh 200 per U.S. dollar before the policy initiatives to U Sh 70 per U.S. dollar in early June, has since returned to the U Sh 200 per U.S. dollar level. The size of the recent depreciation of the parallel market rate may in part reflect a number of temporary factors, such as the delay in receiving external assistance, that have constrained Uganda's foreign exchange resources in recent months. As the influence of these temporary factors ebbs, developments in the parallel market exchange rate will deserve close scrutiny.

## Staff Appraisal

The appreciation of the real effective exchange rate for Uganda between June and September 1987 resulted from a large increase in domestic prices that mostly reflects the impact of the May 1987 exchange rate adjustment and adjustments in administered prices. This impact had been anticipated in determining the size of the May devaluation. Thus, the recent appreciation of the real effective exchange rate is not considered a source of concern. Nevertheless, the Ugandan authorities must be vigilant and maintain a restrictive stance of fiscal and monetary policies. Also, the appropriateness of the current exchange rate needs to be monitored carefully, in light of the emergence of an external financing gap and developments in domestic inflation and in the parallel market exchange rate.

Table 1. Uganda: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

| | Real Effective Exchange Rate 1/ 2/ | Nominal Effective Exchange Rate 1/ | Relative Consumer Prices (Local Currencies) | Exchange Rate in Terms of U.S. Dollars 1/ | Consumer Price Index (Seasonally Adjusted) | Consumer Price Index (Not Seasonally Adjusted) |
|---|---|---|---|---|---|---|
| Quarterly | | | | | | |
| 1982 | | | | | | |
| I | 20.1 | 11.5 | 175.7 | 8.6 | 225.9 | 226.4 |
| II | 20.7 | 11.6 | 179.0 | 8.3 | 238.7 | 246.9 |
| III | 18.8 | 10.2 | 184.6 | 7.0 | 255.4 | 254.2 |
| IV | 19.0 | 9.7 | 195.2 | 6.4 | 278.5 | 270.2 |
| 1983 | | | | | | |
| I | 18.2 | 9.4 | 193.7 | 5.9 | 285.3 | 287.5 |
| II | 16.5 | 8.5 | 195.0 | 5.0 | 298.4 | 306.7 |
| III | 14.5 | 7.2 | 200.6 | 4.0 | 322.1 | 316.5 |
| IV | 12.5 | 6.3 | 198.4 | 3.4 | 332.6 | 325.8 |
| 1984 | | | | | | |
| I | 10.3 | 5.5 | 186.0 | 2.8 | 323.3 | 329.6 |
| II | 10.1 | 5.0 | 199.6 | 2.5 | 359.8 | 367.9 |
| III | 10.0 | 4.4 | 227.6 | 2.0 | 427.1 | 412.7 |
| IV | 9.1 | 3.4 | 266.5 | 1.5 | 522.2 | 515.8 |
| 1985 | | | | | | |
| I | 10.3 | 3.4 | 304.6 | 1.3 | 623.0 | 644.0 |
| II | 10.7 | 3.2 | 336.9 | 1.2 | 718.8 | 732.0 |
| III | 12.3 | 3.1 | 392.3 | 1.2 | 870.4 | 828.2 |
| IV | 9.1 | 2.1 | 433.3 | 0.8 | 1,003.1 | 995.1 |
| 1986 | | | | | | |
| I | 7.4 | 1.3 | 564.2 | 0.5 | 1,363.1 | 1,424.6 |
| II | 8.9 | 1.3 | 683.3 | 0.5 | 1,674.8 | 1,699.2 |
| III | 11.2 | 1.3 | 869.7 | 0.5 | 2,164.8 | 2,038.8 |
| IV | 18.9 | 1.3 | 1,457.5 | 0.5 | 3,718.6 | 3,708.7 |
| 1987 | | | | | | |
| I | 23.2 | 1.3 | 1,826.9 | 0.5 | 4,828.6 | 5,073.7 |
| II | 14.4 | 0.6 | 2,372.9 | 0.3 | 6,655.6 | 6,758.4 |
| III | 9.0 | 0.3 | 2,777.7 | 0.1 | 8,195.6 | 7,673.6 |
| Monthly | | | | | | |
| 1987 | | | | | | |
| June 3/ | 7.2 | 0.3 | 2,272.5 | 0.1 | 6,534.0 | 6,420.0 |
| July | 8.3 | 0.3 | 2,572.3 | 0.1 | 7,495.8 | 6,927.1 |
| August | 8.4 | 0.3 | 2,587.9 | 0.1 | 7,623.7 | 7,167.4 |
| Sep. | 10.2 | 0.3 | 3,166.7 | 0.1 | 9,449.3 | 8,909.4 |
| Percentage change | | | | | | |
| June-Sep. 1987 | 42.7 | 2.4 | 39.3 | — | 44.6 | |

Source: Information Notice System.

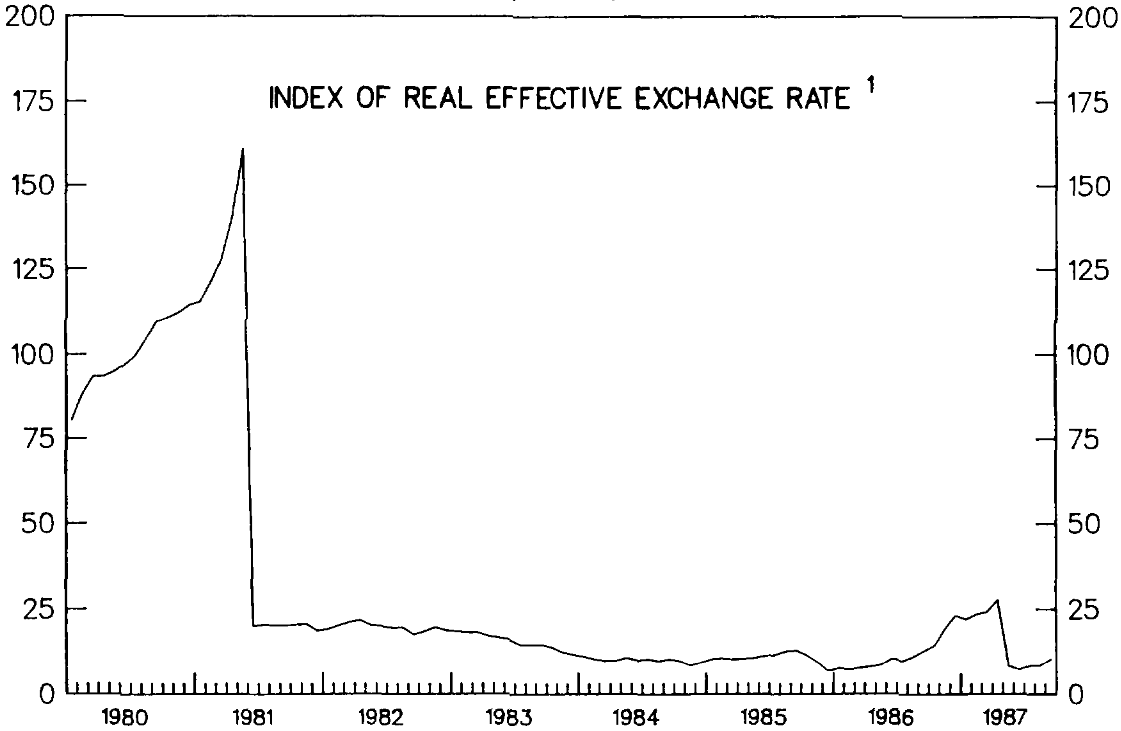
1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

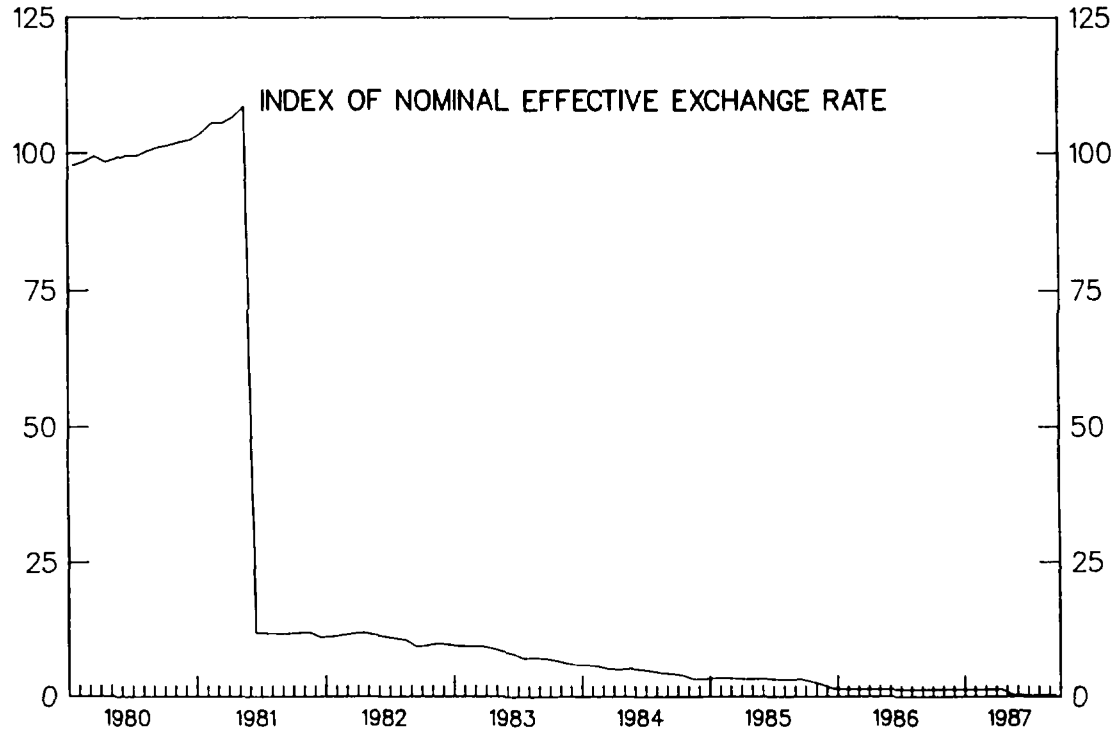
CHART 1

UGANDA

## INFORMATION NOTICE SYSTEM INDEX OF EFFECTIVE EXCHANGE RATE

(1980=100)




Source: Information Notice System.

[1] Trade weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation.

[2] Seasonally adjusted.