CONFIDENTIAL

INTERNATIONAL MONETARY FUND

UGANDA

Real Effective Exchange Rate - Information Notice

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

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February 18, 1986

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 November 1985 the value of the Uganda shilling had depreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Uganda's exchange rate policy--the 1984 Article IV consultation in February 1985. The depreciation is estimated to have amounted to 20.6 percent.

Following a devaluation by 89 percent of the shilling relative to the U.S. dollar in June 1981, several smaller changes were introduced, resulting in a further cumulative depreciation relative to the U.S. dollar of 22.5 percent by August 1982; thereafter, a dual exchange rate system was formally established. Under this system, the less depreciated rate in the first market (Window One) applicable to traditional exports, official loans, and essential imports was to be set periodically by the Central Bank, while the more-depreciated rate in the second market (Window Two) applicable to all other transactions would be determined at an auction held by the Central Bank at weekly intervals. Transactions at Window One would gradually be transferred to Window Two to facilitate eventual rate unification. Window One and Window Two rates were initially set at U Sh 99.3 = US$1 and U Sh 300 = US$1, respectively, and were to be progressively narrowed. As a result, between August 1982 and June 1984 the monthly average Window One rate depreciated rapidly from U Sh 99.3 = US$1 to U Sh 292.1 = US$1, or by 66 percent, while the corresponding Window Two rate depreciated more slowly from U Sh 300 = US$1 to U Sh 325 = US$1, or by 7.7 percent. Reflecting these developments, the shilling depreciated by 90 percent in real effective terms from mid-1981 to mid-1984. In June 1984, these rates were formally unified at U Sh 320 = US$1.

Provisional data indicate that the central government budget deficit widened in FY 1984/85 from 4 to 7 percent of GDP, leading to a marked increase in domestic credit and bringing about an acceleration in the rates of increase of broad money and prices to 139 percent and 115 percent, respectively. The external current account deficit also appears to have widened from SDR 45 million to SDR 61 million (6 percent of GDP). This larger current account deficit was almost wholly offset by a sizable net recourse to short-term borrowing by the public sector and debt cancellation, resulting in a small overall balance of payments deficit of SDR 4 million. However, as Uganda discharged its substantial net repurchase obligations to the Fund amounting to SDR 58 million, gross international reserves fell from SDR 93 million at end-June 1984 to SDR 34 million by end-June 1985 (four weeks of cash imports).

In the context of these developments, the Uganda shilling depreciated rapidly to nearly U Sh 500 = US$1 by end-October 1984. The Ugandan authorities, in order to contain the growing pressures on the current account and to discourage what they considered to be excessively high bids for foreign exchange, intensified restrictions on the bidding process by introducing in November 1984 new regulations requiring importers to prepay customs duties and sales taxes on imported goods before the actual release of foreign exchange. In addition, the import licensing system was tightened. As a result, the rate of depreciation of the shilling decelerated and its value reached U Sh 550 = US$1 by end-November 1984, and remained at U Sh 600 = US$1 through September 1985; however, in real terms, it appreciated by 43 percent during this period.

At the conclusion of the 1984 Article IV consultation on February 8, 1985, Executive Directors expressed considerable concern about the deterioration in Uganda's economic and financial situation in 1984/85 after the considerable gains that had been made in the previous three years. They emphasized the urgency of securing a much-improved fiscal performance supported by adequately restrictive credit and monetary policies, which they considered as pivotal for any credible adjustment program; of liberalizing the exchange and payments systems, which would contribute to the establishment of a realistic official exchange rate and would eliminate the distortions that had emerged in domestic prices and resource allocation; and of achieving a more broadly based recovery of production.

Preliminary information for the first half of FY 1985/86 suggests that the economic and financial situation has continued to deteriorate as the authorities have been unable to take corrective measures because of the political conditions that resulted in the changes of government in late July 1985 and again in late January 1986. In particular, weak budgetary expenditure policies have led to a further acceleration in the annual rate of inflation to 160 percent and to a reduction in the level of gross external reserves at end-1985 to SDR 22 million (2.6 weeks of cash imports). Despite continuing pressures in the exchange market, the authorities managed to hold the exchange rate in the official market to U Sh 600 = US$1 through September 1985. As a result, the reported premium in the parallel market rose sharply to some 250 percent compared with that of 20 percent at the time of rate unification in June 1984. However, in October 1985 the authorities changed their stance and permitted the exchange auction system to operate more freely. Consequently, by end-December 1985, the official rate had depreciated markedly to U Sh 1,400 = US$1 and the tendency toward real appreciation of the currency was reversed.

At the conclusion of the 1984 Article IV consultation, it had been envisaged that the next consultation should be concluded in 12 months. In the event, the security situation has necessitated a postponement of the discussions scheduled for November/December 1985. However, it is hoped that with the return to more normal political and security conditions, the consultation can be rescheduled shortly.

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						
1981						
I	122.2	101.5	120.4	95.7	128.6	128.6
II	107.3	72.7	156.0	64.6	171.3	178.6
III	20.4	11.2	182.0	9.2	205.0	206.0
IV	20.0	10.9	183.7	9.2	212.0	203.2
1982						
I	20.5	10.6	193.3	8.6	227.4	226.4
II	20.9	10.5	198.5	8.3	238.2	246.9
III	19.0	9.2	207.3	7.0	253.5	254.2
IV	19.5	8.7	224.8	6.4	278.8	270.2
1983						
I	18.6	8.1	230.3	5.9	289.2	287.5
II	16.5	7.1	233.0	5.0	297.4	306.7
III	14.3	5.9	243.7	4.0	316.4	316.5
IV	12.6	5.0	251.8	3.4	333.3	325.8
1984						
I	10.5	4.3	246.5	2.8	331.6	329.6
II	9.9	3.8	263.1	2.5	358.2	367.9
III	9.7	3.2	299.6	2.0	413.9	412.7
IV	9.1	2.5	374.0	1.5	525.4	515.8
1985						
I	10.6	2.3	453.5	1.3	647.2	644.0
II	10.4	2.1	491.7	1.2	714.2	732.0
III	11.3	2.0	567.5	1.2	832.3	828.2
Monthly						
1985						
Feb. 3/	10.9	2.4	454.8	1.3	648.7	639.4
Mar.	10.4	2.3	460.2	1.3	661.2	657.6
Apr.	10.2	2.1	478.1	1.3	691.4	714.4
May	10.3	2.1	489.9	1.2	711.6	730.3
June	10.6	2.1	507.3	1.2	739.6	751.2
July	10.5	2.0	523.0	1.2	764.6	765.4
Aug.	11.6	2.0	588.9	1.2	863.7	854.1
Sept.	11.8	2.0	590.5	1.2	868.6	865.1
Oct.	10.5	1.7	622.5	1.1	920.6	916.8
Nov.	8.6	1.3	649.9	0.9	965.6 4/	
Percentage change						
Feb. 1985–Nov. 1985	-20.6	-44.4	42.9	-34.9	48.9	

Source: Information Notice System.

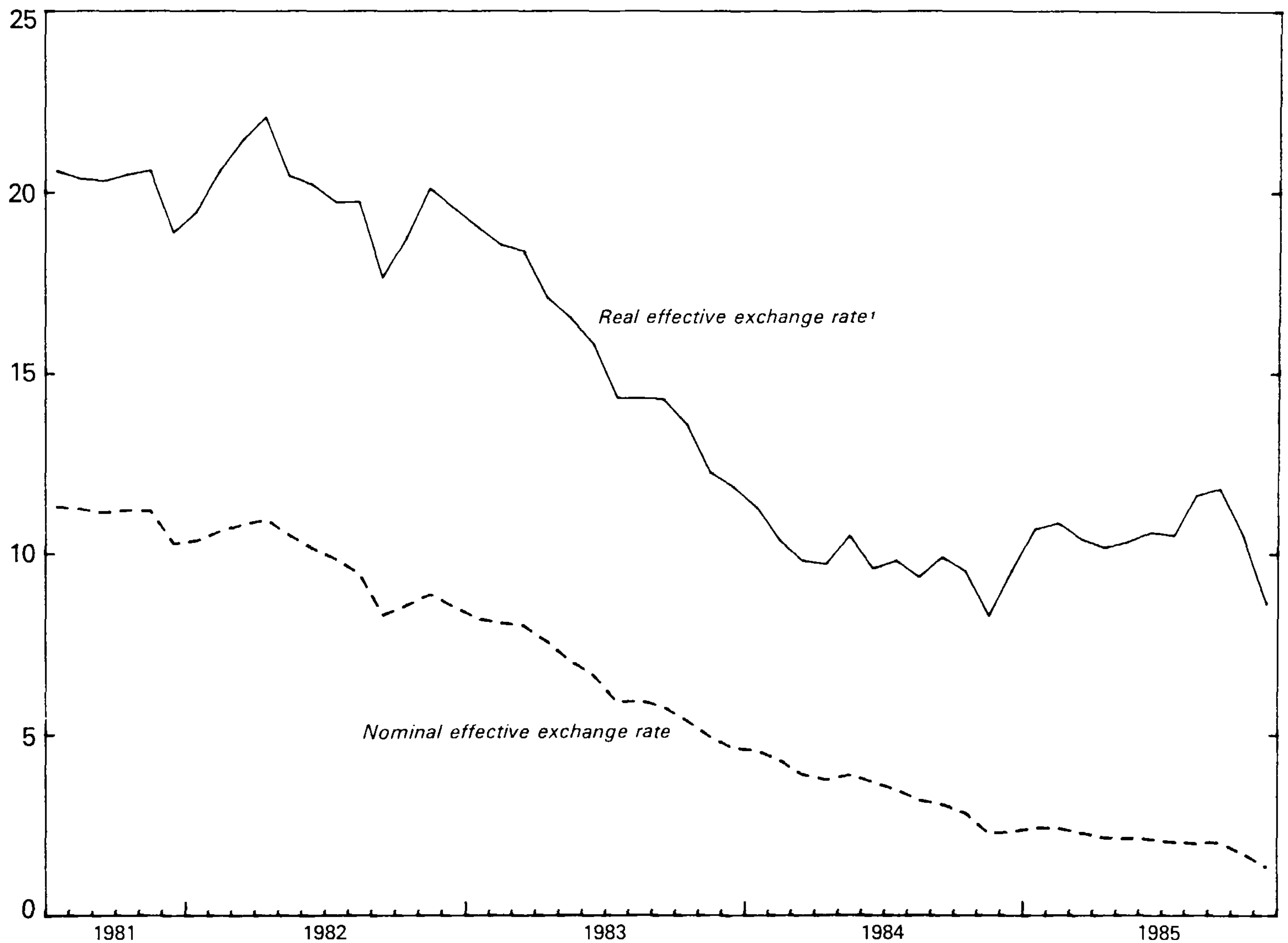
1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.
4/ November's CPI is an extrapolation.

CHART

UGANDA

REAL AND NOMINAL EFFECTIVE EXCHANGE RATES

(1980=100)



Source: Information Notice System.

[1] Trade weighted index of nominal effective exchange rate deflated by seasonally adjusted consumer prices; increase means appreciation.