Abstract

Exchange Rate Regimes and Inflation in Tanzania

The study examines the influence of the major determinants of inflation with a particular focus on the role of exchange rate policy changes. The gradual change in policy orientation from "controls" to "market" in Tanzania is associated with a change from a highly controlled exchange rate (until 1985) to a more liberalized regime from 1986 to the present (2002). The parallel exchange rate dominated price changes from the late 1970s to 1985; the parallel premium tapered off gradually from 1986, almost disappearing by 1992. The problem of inflation cuts across both regimes despite improvements in the past four to five years. The model estimations using quarterly data for 1967–1995 show that the parallel rate had a stronger influence on inflation up until the early 1990s compared with the official rate. Continued macroeconomic (tighter monetary and fiscal), trade and exchange rate reforms, and slow but steady improvements in the growth rates of GDP, may explain the recent (1993–2002) fall in inflation and a more "stable" market for foreign exchange in the inter-bank foreign exchange market (IFEM) arrangement. The charged debates of the 1980s about devaluation are no longer fashionable, but the exchange rate remains potentially sensitive to exogenous shocks and certainly any policy reversal or similar lapse.

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