ABSTRACT

Inflation is one of Tanzania's major macroeconomic problems before and during the whole period of this study, though its magnitude continues to vary overtime ranging from a single digit to double digits. This study examines the significance of exchange rate movements in determining inflation in Tanzania. Eight macroeconomic variables thought to have an impact in explaining inflation taken from Monetarist s,Keynesians and Structuralists proponents of inflation are included and the Error Correction Model (ECM) is applies in the analysis.

The obtained evidence from Angle- Granger cointegration test suggest along run relationship between money supply growth; real exchange rate, import and inflation rate while GDP growth and deficit financing have only short-run effect on inflation rate. The dynamics of inflation are found to be influenced more by money supply growth, real exchange rate and imports.

The general observations of the findings show that some of important monetary and structural factors that can explain inflation are not captured in the model used to this study. Since the test results indicate that inflation is highly responsive to expansion of money supply, real exchange rate and imports; this implies that inflationary pressure in the economy is both domestically originated and imported inflation.

However, it is suggested that, in order to mitigate the problem, monetary expansion through rise in foreign remittance needs to be controlled through more disciplined financial management to counteract potential externally generated liquidity injections. There is a need for the adoption of restrictive monetary policy in which the supply of money must be constrained to grow steadily at a rate of growth in real output.