



REPORT OF PROCEEDINGS

7TH AUGUST, 2015 AT PROTEA HOTEL KAMPALA

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Abstract

Over the course of 2014/15 fiscal year, the Ugandan shilling depreciated against the US dollar by over 20%. Uganda, like many other economies, was struggling with the falling value of its' currency against the dollar which was attributed to the fall in export commodity prices, heavily impacted by export markets. This depreciation made mobilizing capital from international markets difficult. Given the circumstances and the depreciation of the Ugandan shilling, long-term ramifications for the economy were likely. It was against this background that the Advocates Coalition for Development and Environment (ACODE) held the 59th

State of the Nation (STON) Platform to bring together key stakeholders for discussions on the likely impact of the falling value of the Ugandan shilling. Titled the *"Depreciation of the Ugandan Shilling: Implications for the National Economy"*, three main recommendations emerged; chief among them was the need to prioritise investment in the agricultural sector. Second was the need to pursue import substitution and export promotion, and thirdly the Government of Uganda (GoU) was advised to prioritise the adoption of an updated national monetary policy that reflected current economic needs.

Introduction

The 59th STON Platform focused on understanding the implications of the depreciating value of the Ugandan shilling for the economy. The dialogue brought together officials from the Ministry of Finance, Planning, and Economic Development (MoFPED), Members of the Committee on National Economy and other Members of Parliament, civil society, academia, and the private sector to engage in honest discussions about the depreciating value of the Ugandan shilling. The principal speakers for the session were Mr Keith Muhakanizi - Permanent Secretary and Secretary to the Treasury from MoFPED, Mr Ben Mungyereza - Executive Director of Uganda Bureau of Statistics (UBOS), Mr Issa Sekitto - Spokesperson for Kampala City Traders Association (KACITA); and Dr Stephen Isabalija - Board Member of Uganda Development Bank. The session was chaired by Mr Edmond Kizito, renowned journalist and moderator. The objectives of the 59th STON Platform were as follows:

- To promote a deeper understanding of the implications of the depreciating value of the Ugandan shilling for the economy.
- To ascertain the level of sustainability of the strategies being undertaken by the Central Bank of Uganda (BoU) to address the depreciation.
- To learn lessons from Uganda and develop measures for managing the volatility of the Ugandan currency against the dollar and other currencies.

Background

The 59th STON Platform was called at a time when the value of the Ugandan shilling had reached a record low of 3,500 Ugandan shillings per US dollar in July 2015¹. Between March and July 2015, the shilling depreciated by over 20 percentage points². The BoU attributed the falling value of the Ugandan shilling to two factors. First, the dollar had strengthened dramatically on global markets, evidence being the 13 percent strengthening of the US dollar against the Euro since the start of 2015. Second, there was a large increase in demand for dollars by Uganda, mainly from the corporate sector, to fund imports and dividend payments to foreign shareholders following improved corporate profits in 2015. Despite this increase in demand for foreign currency there was a decline in export earnings due to problems in regional markets which widened the current account deficit.

On several occasions, the BoU intervened in a bid to address the depreciating Ugandan shilling by injecting more foreign currency into the economy to absorb excess shillings and halt the decline³. However this strategy was recognised as ‘unsustainable’⁴ by the BoU. The implication of the position taken by the BoU was that alternative measures, aimed at enhancing the supply of foreign exchange, should be adopted to address the depreciating shilling.

¹ See ‘BoU Trend Statistics’ showing exchange rates over time, available online at www.bou.or.ug

² For more information, Enock Nyorekwa Twinoburyo, PhD (2015), explains how the depreciating shilling affected the Ugandan Economy, available online at www.utamu.ac.ug

³ ‘Shilling loses grip despite Central Bank interventions’, available online at www.monitor.co.ug

⁴ ‘Here is why the Uganda Shilling is weakening’, available online at www.monitor.co.ug

“It is not sustainable for the Bank of Uganda to try and prop up the exchange rate, at levels which are not consistent with supply and demand in the foreign exchange market, by intervening and selling foreign currency. The Bank of Uganda would simply deplete its foreign exchange reserves if it attempted to do this”.

Mr Emmanuel Tumusiime Mutebile, Governor - Central Bank

The 59th STON Platform therefore sought to explore and discuss the effects of the falling value of the Ugandan shilling on the Ugandan economy to restore confidence among the citizens and trigger production in all sectors of the economy.

Presentations

Mr Keith Muhakanizi, Permanent Secretary and Secretary to the Treasury of the Ministry of Finance, Planning and Economic Development

Mr Muhakanizi presented the position of MoFPED and discussed the depreciation of the Ugandan shilling



Image 1: Mr Keith Muhakanizi presenting at the 59th State of Nation Platform

and its implications for the national economy. He framed his presentation in terms of economics noting that Africans were “*losing out*” if debates continued to focus on democracy and politics which, unlike economics, never “*put food on the table*”.

Although the Ugandan shilling had depreciated by 24% against the dollar, Mr Muhakanizi noted that Uganda was not alone as the strength of the dollar had also weakened other regional and international currencies⁵. He attributed the wide-spread currency depreciation to the flow of capital back to the United States of America following the financial crisis in Europe and increased trade in emerging markets which served to strengthen the dollar. For Uganda, Mr Muhakanizi noted that four shocks had impacted the strength of the shilling.

First, global commodity prices had weakened and the drop in coffee, tea, oil, mineral, and gold prices had impacted on Africa, generally. Second, South Sudan (a key trading partner with Uganda) had collapsed, resulting in lost business and economic opportunities. Third, low oil prices had impacted potential revenue from investors, resulting in slowed commitments to invest. Finally, the GoU (previously a foreign exchange earner) was and remained a net foreign exchange user, thanks to foreign investments in infrastructure and a subsequent commitment to trading in dollars.

⁵ Mr Muhakanizi cited Kenya, Tanzania, Canada and Japan, amongst others



Image 2: A cross section of the speakers at the session, from L-R Mr Issa Sekitto - KACITA, Mr Ben Mungyereza - UBOS, Mr Edmond Kizito (Chair), and Mr Keith Muhakanizi - Ministry of Finance, Planning, and Economic Development

The impacts of the depreciation of the shilling included higher inflation, which Mr Muhakanizi speculated was likely to be greater than originally anticipated, as Central Bank had to tighten regulations on the market. Contrary to speculators who predicted that the GoU would overspend as a result of elections, Mr Muhakanizi explained that GoU expenditure was on track with a net saving, although GoU Reserves were slightly lower.

The increase in interest rates was anticipated to absorb the shock to the private sector and result in lower Gross Domestic Product (GDP) growth than anticipated as imports became expensive due to the depreciation of the shilling. As a result, Ugandans should expect a decrease in the total number of imports, despite their necessity for economic activity. Mr Muhakanizi predicted that foreign-exchange users (particularly net import foreign-exchange users) were likely to suffer the biggest losses as a result of the depreciation of the Ugandan shilling while net foreign-exchange earners stood to benefit.

In his closing remarks, Mr Muhakanizi explained that the depreciation of the Ugandan shilling was not wholly negative because the current depreciation meant that net foreign currency earnings had become competitive, leading to the completion of some key projects in, for example, South Western Uganda. Moreover, investments in coffee growing were increasing as a result of the depreciation of the shilling. His final advice was for Africa to redirect efforts towards exports and foreign exchange earnings and avoid “*lamenting about deprecation*”.

Mr Ben Mungyereza, Executive Director, Uganda Bureau of Statistics

Mr Mungyereza discussed the effect of the exchange rate on core inflation⁶. UBOS statistics demonstrated a clear relationship between the exchange rate and core inflation elements;

⁶ Core inflation elements are those which do not include all volatile elements of inflation such as food crops, electricity, fuel, and utilities

using a simple test of correlation, Mr Mungyereza explained that when the official mid-term rates of exchange and core inflation elements were plotted, they moved together in the same direction.

The perceived connection between the exchange rate and inflation, according to Mr Mungyereza, was however “*spurious*” given that the exchange rate went up in May/June whilst core inflation only showed a small increase from 4.6% in April to 4.8% in May to 4.9% in June. The increase in core inflation, according to his analysis, was likely due to food crop inflation which jumped from negative 0.1% in April to about 6% in May.

In his concluding remarks, he noted that the exchange rate impacts the economy in multiple ways, including through core inflation and food crop prices. Although averse to predictions, Mr Mungyereza concluded that the effects of exchange rate were being felt with a lag and may yet cause higher inflation.

**Mr Issa Sekitto, Spokesperson,
Kampala City Traders Association**

Mr Sekitto provided an overview of the challenges faced by the trading community which he described as “*suffocated with low economic activity*” as a result of the shilling depreciation. Agreeing with comments made by previous speakers on the need to increase Uganda’s exports, Mr Sekitto highlighted the trade imbalance where imports accounted for three times the exports which resulted in a permanent trade deficit.

The imports of raw materials and finished goods (with 60% of goods for the manufacturing sectors also being imported) meant that traders and manufacturers use the dollar “*more than people think*”. He explained that

an economy that is three times more import-led than export-led cannot be sustained, as evidenced by the impact of the shocks.

One key area that Mr Sekitto identified as “*neglected*” was agriculture; yet to receive anything in excess of 4% of the national budget for the past 10 years. Despite exporters having a comparative advantage, deliberate planning of the agriculture sector in infrastructure and electricity has been lacking.

In order to compete in global markets and enhance comparative advantage, Mr Sekitto recommended that a year be devoted to the agriculture sector, with a focus on increasing budgetary allocation and pursuing actionable ideas in developing the sector.

Mr Sekitto explained that trading sector activity had declined partly due to an increase in Central Bank rates, which forced commercial banks to increase rates on existing loans. This negatively impacted borrowing which would otherwise have been used to partake in economic activities that would have boosted the economy. The increase in rates by Central Bank as a response to the shilling depreciation thus reduced economic activity among traders. The



Image 3: Issa Sekitto of Kampala City Traders Association making his remarks at the session.

local economy in Uganda was also impacted by violence in South Sudan as trade and business opportunities shut down as a result of the conflict. Ugandan traders did acknowledge, however, that the Ministry of Finance had tried to support Ugandan traders amidst difficult times. For example, business compensation was being organised with the Government of Kenya pledging to compensate the property of Ugandan traders destroyed in 2007.

The depreciation of the Ugandan shilling had further been impacted by the policy of permitting multinational companies to own 100% of their shares. This, to Mr Sekitto, was a risky policy because dividends were not paid in Ugandan shillings and earnings would likely be spent beyond Uganda, particularly during election time⁷. Mr Sekitto recommended that the GoU ensure that adequate economic interventions were adopted with locally appointed directorship able to take a 30% share of dividends for re-investment into the Ugandan economy. The ease with which foreign investors could operate was also highlighted by Mr Sekitto who argued that Uganda was “importing importers” rather than attracting businessmen who added value. He stressed that transparency in liberal markets does not mean “nakedness” but that the GoU needed to contain and regulate direct foreign investment which would require restrictions on how much foreigners were investing and what they were investing in.

In his concluding remarks, Mr. Sekitto noted the difficulty of retrieving US dollars.

In particular, he highlighted the issue of “hiding” dollars to insulate them around election time and recommended it was necessary to look at domestic mechanisms for “injecting” dollars into the local economy.

Dr. Stephen Isabalija, Board Member, Uganda Development Bank

Dr Isabalija discussed ways to improve the Ugandan economy with a “blunt look at the fundamentals”. The “dollarization” of the economy, he said, had revealed that Uganda did not control the US Dollar despite the national economy being measured against it and despite moves by the BoU to “control” the dollar by injecting cash into the economy. Dr Isabalija agreed with previous speakers that increasing exports would address economic shortfalls to balance payments and “fight” the dollar, but that this required a concerted effort. He noted that for the last fifteen years, the shilling had not been strong enough to do this effectively.

Furthermore, the cost of borrowing in Uganda was so high that local investors, farmers, and traders were



Image 4: Dr Stephen Isabalija discussing the presentations at the session

⁷ Presidential elections in Uganda are scheduled for February, 2016

unable to borrow money due to high rates of interest on loans. Despite global competition with the dollar, interest rates in Uganda were much higher than in the United States of America (0.05%) and Europe. Dr Isabalija attributed this to a failure by the GoU and BoU to invest in access to money, necessary to stimulate the economy during hard times.

In his closing remarks, Dr Isabalija stressed that stimulating the economy did not mean increasing interest rates. Instead, it meant spending in priority areas such as agriculture and energy which required that the GoU prioritise spending and adopt an effective monetary policy to build the economy of Uganda.

Hon. Evelyn Kabuule, Vice-Chairperson, Committee on National Economy, Parliament of Uganda

Hon. Kabuule focused her discussion on addressing rumours surrounding the “*expected, potential election monetary expansion*” involving large amounts of money moving around in response to the 2016 Presidential Elections, scheduled for February. She noted that all expenditure is tallied against a budget, although expenditure could be “*squeezed*” to make savings. Given that Mr Muhakanizi would not permit the printing of money, she articulated her uncertainty as to where this money would come from and proposed that, if the shilling was to collapse, a realistic monetary tool would be best suited to address the situation.

Echoing the sentiments of previous speakers, Hon. Kabuule reiterated the need to invest effectively in agriculture, adding that a focus on value addition would be necessary. Without electricity and good roads, the ability of Ugandan farmers to add value to agricultural produce for export was restricted.

Public investment in infrastructure for agriculture would require a tactical review of the resource envelope that targets direct investment and prioritises infrastructure to ensure value-addition in the sector.

Conclusion

The plenary discussions provided deep insights into possible mitigation measures to address the depreciation of the Ugandan shilling. A number of proposals were made on how to strengthen the economy against future shocks and discussions focused on investing in the agricultural sector, increasing exports, and restoring confidence in the economy. Participants also noted that traders were affected by the policy of the Uganda Revenue Authority (URA) wherein taxes were calculated in US Dollars although traders were required to pay in shillings, thereby losing out due to the depreciation of the Ugandan shilling and unfavourable foreign exchange rates. Discussions also addressed the need for regional conflict resolution in South Sudan to improve the Ugandan economy and allow leaders to redirect their focus to regional integration and engaging the youth in promoting economic security.

Policy Recommendations

- **Invest in the Agriculture Sector:** A recommendation that a year of investment in agriculture to develop the agricultural sector was made. The focus of such a year would be on value addition in order to meet global standards for export to the international market with investment in infrastructure to support production.

- **Promote Exports:** Participants reached consensus on the general need to promote exports. The pursuit of import substitution and export promotion was recommended; particularly for strengthening agricultural exports and to address barriers to exports on the international market, currently hampered by the poor quality of goods.
- **Review Out - Dated Policy:** It was recommended that GoU needed to prioritise its spending by adopting an effective monetary policy to build the economy. The following recommendations on monetary policy were made:
 - *Reviewing Economic Stabilisation Policies:* The current economic stabilisation policies have been in place since the 1990's and were designed to address prior macro-economic instability and high inflation. These policies needed to be reviewed to refocus policy towards economic growth.
 - *Protect and Invest in Ugandan Workers:* Securing access to low-interest loans for Ugandan traders and buffering local economies from the volatile exchange rate by offering protection to tenants who are forced to pay rent in dollars was recommended. Adopting youth livelihood schemes to support productive youth to start businesses was also recommended.
 - *Increase Spending in Priority Areas:* It was agreed that the GoU needed to increase spending in priority areas to stimulate the economy instead of increasing interest rates to the detriment of the national economy and Ugandan traders, investors, and businessmen. Investment in the agriculture sector and supporting infrastructure was recommended in order to add value to products for export.
 - *Ensure that Multinational Companies Contribute to the Ugandan Economy:* It was proposed that GoU needed to review the policy on liberalized foreign exchange and ensure that multinational companies contribute to the Ugandan economy either through local directorship, shareholder dividends, or similar arrangements.
 - *Increase Market Transparency:* Consensus was that the GoU needs to contain and regulate direct foreign investment for the sake of developing Uganda. For example, it was noted that most taxes come from imports and it was unclear how much of that tax was being used to promote import substitution and export promotion.
 - *Account for Non-Tradable Investments:* Public investments need to be calculated according to 'cost and return' balances for non-tradable investments, such as roads and shopping malls.
- **Address Project Delays:** Participants noted that delays in big projects had postponed investment dividends and it was recommended that projects need to be fast tracked to stimulate the economy with attention paid to securing local content and financial retention in the local economy.

The full report on these findings can be accessed on ACODE's online information center at:

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