CIVIL SOCIETY BUDGET ADVOCACY GROUP

CSBAG response to the Bank of Uganda Monetary Policy Statement

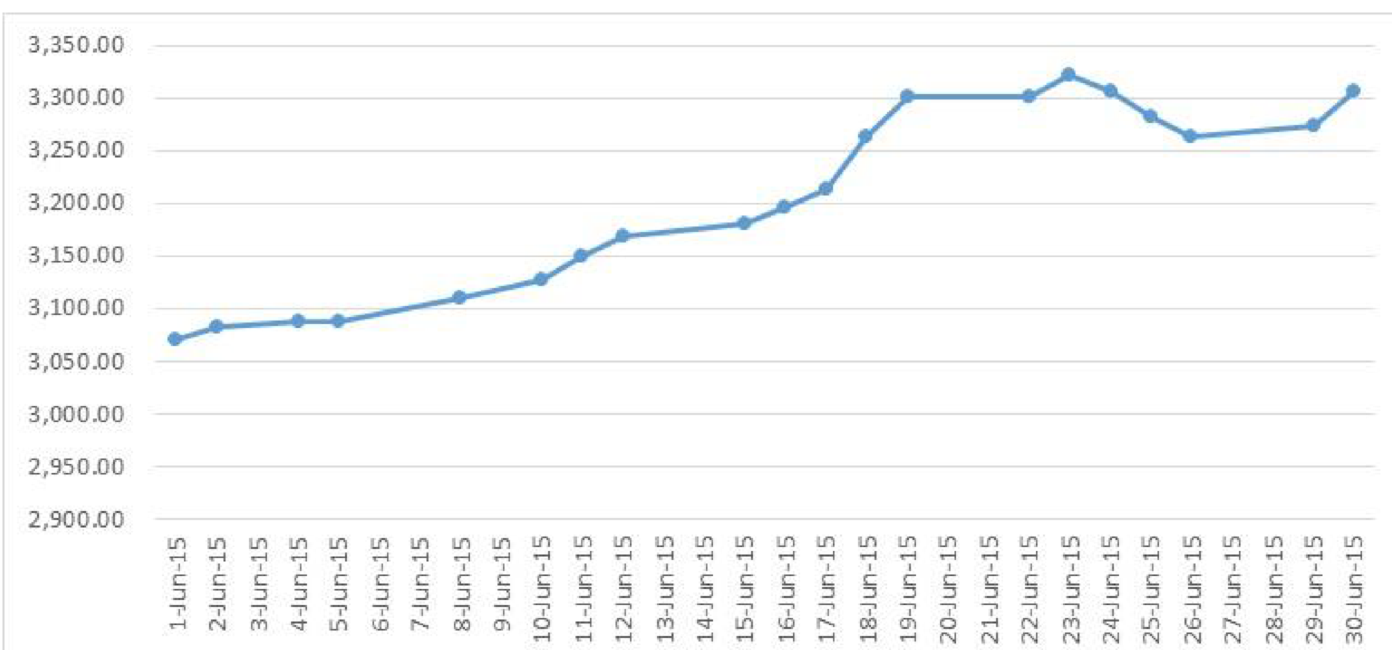
July 2015

THE IMPLICATION OF THE 14.5% CBR AND THE EXPANSIONARY FISCAL POLICY!

INTRODUCTION:

Bank of Uganda issued the much anticipated July 2015 Monetary Policy Statement (MPS) which is a bi-monthly release that guides market sentiments. This was a special one given that the nation is looking on with anticipation to see which steps BoU is taking to tame the rising dollar.

Figure 1: Daily USD selling price for June 2015



Source: Bank Of Uganda

From January to June 2015, the shilling depreciated at an average of 3% per month with end of June having the biggest depreciation rate of 8%. Year on year, the shilling has depreciated by 27% since June 2014. To this, the BoU responded by increasing the Central Bank Rate (CBR) by 1.5% to 14.5%. By increasing the lending rate, BoU is expecting to tame the depreciation of the Shilling. This increment sent signals of tightened liquidity into the market and financial players like Standard Chartered Bank this week signaled a rise in the base lending rate in UGX of up to by 23.5% come mid-August 2015.

The next six months will be a test, as the nation witnesses the play out of the national budget that is at the last bend towards the 2016 presidential elections. The FY 2015/16 budget is what economists interpret to be an expansionary fiscal policy presenting economic growth opportunities. According to the BOU Depository Survey Report, some of the indicators of economic activity that cast a positive growth outlook on Uganda's economy included the faster growth in private sector borrowing from UGX 10,005.73bn in January 2015 to UGX 10,516.93bn and the recovery in the agriculture sector. Whereas these two opportunities are well founded, their risk however lies in the weak links presented in the depreciation of the shilling against the dollar and the limited direct investment by the Government in the Agriculture sector.

Whereas some circles have argued that depreciation of the shilling has had a positive impact on our exports, it should be noted that the international financial conditions are weak which means the real demand for our "cheap" exports has in effect reduced. All in all, the weak shilling only increases the price of imports, of which Uganda is a net importer, but also it's seeking to deplete Uganda's Foreign Exchange reserves looking at both goods and services. Such scenarios disregard the theory of a free market and practice the much needed control in our FOREX market. BoU by now knows that the buying and selling of forex into and out of the market is not sustainable if the private sector is not better regulated

In an economy where anyone can exchange whatever quantity of FOREX especially the USD, it is impossible to manage other related indicators like inflation. What makes it worse is the

To this extent, we recommend the following to curb exchange rate depreciation, improve FOREX earnings and maintain low inflation;

- *Make value addition a major component of GoU projects especially in the agriculture sector. Where the private sector has no capital or lacks expertise in value addition to the various agriculture export products, GoU should intervene by offering incentivized credit and capacity building. This will increase the value fetched by the same volume of exports and consequently, the supply of foreign currency, particularly the USD will be improved.*

- *BoU should increase regulation in Uganda's forex market. Specifically BoU should set limits within which banks can send foreign currency without authorization, among other things.*

- *BoU should rein in on local/international entrepreneurs who strain the shilling against the dollar by charging in dollars with no economic justification apart from profit maximization.*

business community increasingly choosing to transact in foreign currency. To make the CBR more effective, more stringent regulation needs to be coopted into the management of the FOREX in Uganda.

On the other front, Civil Society acknowledges that agriculture sector is exhibiting positive growth at 1.5 % in 2013 according to the 2014 Uganda Statistical Abstract ,but then a decision is made to invest only UGX 479.96bn (2%) in this sector is indication of a disconnect between the Fiscal and Monetary Policy. The potential that food prices have shown in controlling overall inflation cannot be over stated. To continue harnessing this ameliorating effect on inflationary pressures, we need to categorically invest in water for production to guarantee stable agriculture production during droughts/dry seasons, provision of agriculture extension services and also quality control for the agriculture inputs. The question of market for agriculture produce then comes into play with value chain investments being the major drivers of this. The opportunity in the expansionary fiscal policy has been missed in crucial sectors like agriculture and as such we shall struggle to achieve the 5.8% GDP growth in the FY 2015/16.

As a result of not investing heavily in the sector that has potential to increase our FOREX earnings sustainably, the Bank of Uganda notes that the current account deficit will widen to 10.3% in FY 2015/16 from 8.4% in the FY 2014/15 as a percentage of GDP. With the appreciation that the private sector plays a complementary role in service delivery, it's important to set regulations that provide a favorably operating environment. Private sector led equitable growth can only be realised with a strong and robust regulation of the market coupled with good fiscal and monetary policies. The decision by BoU to increase the CBR to 14.5% is cautionary but its impact in the real economy will be negative and profound. The cost of maintaining a low inflation rate is slow economic growth.

To have inflation controlled as well as the real economy and GDP grow, BoU should increase regulation in the financial subsector, however it should ensure the commercial banks do not unnecessarily hike lending rates thus destabilizing the debtors.

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