APRIL 2020

FISCAL MEASURES THAT COULD BE UNDERTAKEN BY BANK OF UGANDA DURING AND AFTER THE COVID-19 PANDEMIC.

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Introduction

Today, the novel Coronavirus otherwise scientifically known as COVID-19 is wreaking havoc on economies on a global scale, but nowhere is this more evident than in the already challenged African economies such as Uganda. In a press release dated April 9th 2020, The World Bank predicts and the first economic recession in over 25 years to hit sub-Saharan economies on account of this global pandemic. Uganda's central bank, Bank of Uganda, the establishment mandated to maintain economic stability through its control over the monetary policy, commercial banks and other banking and non-banking institutions in the financial sector is uniquely positioned to rapidly and creatively respond in such a way that the lowest income earner is not left to starve.

The purpose of this research is to determine the fiscal measures that could be taken by Bank of Uganda to stimulate growth during and after COVID-19. This research may be of importance to mainly two groups. The first group consists of policy makers in the financial sector who may find it instrumental in alleviating the effects of the pandemic on the economy of Uganda through coming up with the strategies to be discussed in the findings. The second group consists of businesses and non-profit organizations, who may use this research to fully understand the effect of the pandemic on their organization for purposes of preparedness and to become aware of the fiscal policies and other measures already in place and the emerging ones which can be beneficial to their businesses.

On 26th/03/2020, David Malpass, the World Bank president in his published remarks to G20 Leaders' Virtual Summit made his concern known about the economic repercussions of the pandemic on countries which get support from International Development Association (IDA), an international institution under World Bank Group which offers concessional loans and grants to the world's poorest developing countries, in which Uganda happens to be a member. He recognized that this pandemic will hit the highly indebted poor countries hardest and suggested an equitable debt relief program, to enable such countries to focus their resources on fighting the pandemic and its economic consequences.

Research Methodology

Data for this research was acquired in mainly two phases, firstly from analyzing existing literature as secondary sources and carrying out online interviews of key informants active in the Ugandan financial sector. These informants where asked a total number of five (5) questions in relation to the main topic of the research which was dissected into sub-topics, from which these questions were derived. Listed below are the questions that were posed to the responders:

I. In your opinion, how are the current Bank of Uganda policies affecting urban dwellers light of the COVID-19 outbreak?

II. What policies can Bank of Uganda put in place through commercial banks and other financial institutions to alleviate the urban dweller's suffering in this period?

III. How do you think the economy is going to be affected by COVID-19?

IV. Are there measures that can be put in place by Bank of Uganda to stimulate growth after the recession which is being predicted? If yes, please give details.

V. What sustainable strategies can Bank of Uganda put in place to be prepared to reduce the effect of future disasters on the Ugandan economy?

The answers to the above questions from the responders are covered in detail in the findings section.

Bank of Uganda's response to COVID-19

On April 6, 2020 Prof. Emmanuel Tumusiime Mutebile, Governor of Bank of Uganda released a monetary policy statement, whose major resolution to the COVID-19 pandemic was to cut the Central Bank Rate (CBR) by 1 percentage point to 8%. The Central Bank Rate is the interest rate at which the central bank lends money to commercial bank. It is one of the key monetary tools at its disposal, which in theory should induce commercial banks to borrow funds cheaply and in turn lend the borrowed funds to the its customers at a reduced interest rate, in an attempt to increase the volume of money in circulation. But this is seldom the case. This is because, such regulations like reducing the Central Bank Rate do not directly translate to lowering of lending rates by all commercial banks. Many banks retain their lending rates as in a bid to widen their profit margins.

- All supervised Financial Institutions (SFIs) have been directed to defer payments of all discretionary distributions such as dividends and bonus payments for ninety (90) days effective March 2020.

- Bank of Uganda has undertaken the responsibility of providing exceptional liquidity assistance to commercial banks that are in liquidity distress for a period of up to one year.

- Increase the liquidity of Microfinance Deposit taking Institutions (MDIs) and Credit Institutions (Cis) by Purchasing Treasury Bonds held by such institutions. MDIs and CIs that do not hold Treasury bills or bonds in their asset holdings will be provided with liquidity secured by their holdings of unencumbered Fixed Deposits or Placements with other SFIs.

- Bank of Uganda has granted exceptional permission to SFIs to restructure loans of corporate and individual customers including a moratorium on loan repayment for borrowers that have been affected by the pandemic, on a case by case basis at the discretion of the SFIs for up to 12 months, effective April 1st, 2020.

- Bank of Uganda has also undertaken a bid to provide liquidity to commercial banks for a longer period through issuance of reverse REPOs of up to 60 days at the CBR, with opportunity to roll over. A Repurchase Agreement (REPO) is a form of short-term borrowing for dealers in government securities.

All these measures have been put in place by the Central Bank with the single aim to increase the circulation of money allow commercial banks and other financial institutions to lend more, with all these benefits cascading to the urban dwellers, and eventually jump start the economy which has been put in a trance of sorts by the country wide lockdown.

My findings however, suggest the intentions of the Central Bank are far from yielding the desired outcomes. In an online interview I had by means of E-mail, Mr. Elijah Omagor, the Chief Executive Officer of P-Save SACCO Ltd, his response when queried about the effect of the current Bank of Uganda policies on the urban dweller in light of the COVID-19 outbreak was that such policies are too divorced from the realities of urban dwellers. He explained that despite the lowering of the Central Bank Rate, the benefits do not trickle down to the common Ugandan in terms of reduced costs of borrowing, but instead the benefits are reaped by the formal financial institutions and their elite clients.

David Muinga, a lecturer, PhD fellow and banking analyst in response noted that Bank of Uganda is currently focusing on commercial banks which do not interface on a large extent with the unbanked masses in urban areas and therefore the measures that are being put in place may not necessarily be of impact to the common Ugandan. Dr. Kiiza Hillary, an investor and Makerere University lecturer explained that the Central Bank's directives where unclear in relation to urban dwellers who have outstanding loans with commercial banks, which has created fear and uncertainty.

Measures to be put in place stimulate the economy

In his statement to parliament on Friday 20th/03/2020, the Minister of Finance, Planning and Economic Development, Hon. Matia Kasaija predicted the economic growth of FY2019/20 would decline to between 4.6% and 5.1% and warned that 2.6 million Ugandans were in danger of relapsing into poverty. The end result of such grim outlooks should not to be instill fear into the minds and hearts of Ugandans but to bring more awareness to how imperative it is" for Bank of Uganda as the primary body responsible for economic stability to put in place policies and systems to avert the impending economic fallout. The respondents interviewed echoed five (5) main measures that Bank of Uganda can do to stimulate the economy, as discussed below:

- Expenditure prioritization can be undertaken through a currency injection to increase amount of money in circulation, increase demand among the consumers and breathe life into the businesses currently starved of liquidity.

- Bank of Uganda can liaise with Uganda Revenue Authority to fully waive taxes of businesses and individuals, some of which keep accruing irrespective of the level of activity. As at 30th/03/2020, Uganda Revenue Authority allowed to businesses whose accounting date is in September 2020 to defer filing corporate tax returns to May 2020. The implications are that despite an extension being given, such businesses still have to pay their dues, yet the inactivity in business is still ripe on account of the current lockdown, which on 14th/04/2020 was extended to 5th/05/2020. This waiver can increase the purchasing power for both inputs by businesses and finished products by the average consumer.

- Instruct mobile money service providers to undertake additional waivers on transaction fees like withdrawing fees, including high volume transactions, as an effort towards reduction of the cost associated with flow of funds among businesses and households to encourage funds to easily move in throughout the economy.

- Bank of Uganda can back an emergency low interest fund through Uganda Development Bank, whose mandate is "To operate as Uganda's development finance institution, particularly through interventions in priority sectors and in line with the Government of Uganda's development priorities". This can boost liquidity among Small and Medium enterprises and enable them to meet their working capital and operational requirements.

- Bank of Uganda can extend its intervention to work with lower tier financial institutions. This can be achieved through putting in place a Small and Medium Enterprise (SME) fund to support SMEs with more than ten employees and more than UGX 100M annual output and validated tax compliance in order to support them through this recession. The fund should offer these loans at concessionary rates to boost the economy, with special attention being given to ensure adequate regional balancing so that both SMEs operating in urban and rural areas benefit.

Long term fiscal policies to be put in place by Bank of Uganda for future disaster preparedness.

Bank of Uganda as a regulator of banking financial institutions and all currency related systems among many other roles in a mixed economic system like Uganda, where forces of demand and supply predominantly determine prices and resource allocation, needs to execute a delicate balancing act by putting in place policies and regulations that protect the economy from volatility brought about by such unforeseen circumstances like the COVID-19 pandemic. This should however be done without compromising the sovereignty and free enterprise element of the market. The financial experts, who have deep understanding of the effects of the regulations put in place by Bank of Uganda agreed that the following systems should be put in place even after the passing of the pandemic, as sustainable solutions to volatility Uganda's economy as cog in the broader wheel of global economies.

- The national reserve policies must be amended to enlarge Uganda's capacity to respond to emergencies, without dependence on foreign economies and individual donors which is an unreliable model.

- Bank of Uganda can relax some of its stringent regulations to allow its highly regulated financial institutions grow their capacity to innovate, since the best way to manage disasters emanates from the ability to innovatively respond to them. The stringent banking regulations do not permit such innovativeness and as such most financial institutions are unable to flexibly respond to disasters in time. A case in point goes as far as 2010, a time when financial institutions wanted to introduce the agency banking model in their operations but it was not possible because the enabling regulations were unavailable. They had to wait on Bank of Uganda to approve. This deters financial institutions from experimenting with ideas that could build more resilience into the financial sector.

- The Bank of Uganda can advocate for increased allocation of funds in the national budget to facilitate their efforts to support banking and non-banking financial institutions in the case of any future disasters.

Conclusion

On the basis of the findings, several conclusions have been made concerning the fiscal measures that could be taken by Bank of Uganda to stimulate growth during and after COVID-19. Bank of Uganda should use its large jurisdiction to take a more comprehensive approach as a means to realize economic stability country wide.

From this study it can be concluded that the current measures put in place by Bank of Uganda will to a certain extent make borrowing of funds cheaper as certain institutions like Stanbic Bank have already made use of the reduced Central Bank Rate to reduce their Prime Lending Rate effective on 1st/05/2020 from 17.5% to 16.5% per annum, though the beneficiaries of such initiatives are still limited considering the large numbers of unbanked masses.

Recommendations

New as this pandemic is, the underlying causes and effects of the resulting economic pandemonium being predicted are nowhere near neoteric. From the longest, deepest and widest spread economic depression of the 20th century which unfolded in 1930s to the most recent 2007-2008 global financial crisis, it is safe to say that the global economy has been through its fair share of upheavals. Triggers of global economic crises are wide ranging, from depreciation of subprime mortgage market and subsequent collapse of the investment bank known as Lehman Brothers in the United States of America in 2008 to the major stock market crash on 29th/10/1929 which came to be known as “Black Tuesday” but the bottom line in terms of economic repercussions remain the same. Higher unemployment rates, lower wages and incomes which imply drastic drops in aggregate demand, whose spillover effects create a vicious cycle of low production and may ultimately lead to the worst case scenario of a depression. But lessons have been learnt from previous situations that can be adjusted to creatively respond to this global pandemic and avert suffering of millions.

A deeper look into the 2009 global financial crisis and the response of regulators financial institutions to minimize the economic fallout has enabled me to come up with informed suggestions. In his critically acclaimed book, Andrew Ross Sorkin, author of Too Big to Fail demonstrated how a collaboration of the United States Treasury, New York Federal Reserve and a JP Morgan executive birthed a task force with the sole purpose of reviving the economy. In addition to the COVID-19 National task force team already in place, Uganda’s government can mobilize a taskforce comprising of key Bank of Uganda officials, Ministry of Finance executives and any other relevant member, to provide a unique, detailed analysis of the state of the economy and undertake real time actions to maintain economic stability.

Additional recommendations have been made for Bank of Uganda to stimulate the economy during and after the COVID-19 pandemic; -

- An expansionary fiscal policy can be immediately put in place to increase output, resource utilization and reduce interest rates to produce a positive change in the economy's trajectory. Some of the expansionary monetary policy tools that can be invoked by Bank of Uganda, apart from the recently revised Central Bank Rate and Open Market Operation (OMO) program of purchasing treasury bonds owned by Microfinance Deposit taking Institutions (MDI) and Credit Institutions are explained below:

- Reduction of the legal reserve requirement. This is the minimum amount of funds every commercial is legally required to maintain as a reserve by the central bank. This can be done to increase liquidity in commercial banks and expand their ability to lend the critical funds to individuals and businesses.

- Bank of Uganda can undertake moral suasion to convince the commercial banks to give more credit to businesses to prevent the current situation where many commercial banks are clamping down on all their lending efforts to minimize the amount of risk in their portfolio. Yet it is in this exact period where both corporate and individual clients need the loans most. Bank of Uganda being a regulator and lender of last resort, the commercial banks would have no options than to adhere to such instructions, should they be explicitly given.

- The cash ratio can be reduced. The cash ratio refers to the percentage of total customer deposits in a commercial bank that must by law be kept in cash form. Reducing the cash ratio can be done to increase the loanable funds among commercial banks, which money would be directly injected in the economy.

- The margin requirement can be reduced. This is the difference between the value of collateral security and the value of the loan to be advanced to the borrower by the commercial bank. Reducing that difference would imply that borrowers with limited collateral, which unfortunately encompasses majority of Ugandans, would also be able to acquire loans and re-capitalize their businesses.

- Refund of special deposits can be undertaken by Bank of Uganda. Special deposits include the amount of money that commercial banks deposit in Central Bank upon request on short notice. Refunding those funds would increase the liquidity of commercial banks and in turn translate to more loans for customers.

- Bank of Uganda should consider injecting a direct stimulus package in the economy in the economy. This may include direct bailouts to financial institutions and industries hit hardest by the pandemic in Uganda like the tourism industry which has been brought to a complete standstill or even tax breaks to individuals and businesses. This may not be as extensive as the $2 trillion federal package stimulus package that was signed on Friday 27th/03/2020 president Donald J. Trump in response to COVID-19, but a similar program more practical to Uganda's economic abilities can be put in place.

- Bank of Uganda, which formerly began regulating Mobile Money service providers on 1st/10/2013 can instruct such institutions to effectively waive all charges levied on transactions to stimulate flow of funds throughout the economy.

- As a sustainable disaster preparedness program against future pandemics and similar unforeseen economic disruptors, Bank of Uganda can consider acquiring more gold reserves. Uganda's foreign exchange reserves, a combination of gold and specific foreign currency stood at 3,233.17 USD million as of January 2020.This can be considered because apart from being a fallback position, studies done by the United States Federal Reserve have demonstrated an inverse relationship between the strength of the dollar and the price of gold. This implies that in times of economic slowdown which in turn weakens the dollar according to findings of Goldman Sachs strategist Zach Pandl, the price of gold goes up. These gold reserves could then be liquidated to boost the economy. This inverse relationship between the value of gold and the Trade Weighted Dollar Index is displayed in the figure below.
(source: US Federal Reserve)

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