Emmanuel Tumusiime-Mutebile: The international financial crisis and its impact on Uganda

Speech by Mr Emmanuel Tumusiime-Mutebile, Governor of the Bank of Uganda, at the Bank of Uganda, Kampala, 24 September 2008.

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I. Introduction

The current global financial turmoil is rooted to the sub prime mortgage crisis. It is a recent economic problem that is characterized by contraction in liquidity in the global credit markets and banking system. An undervaluation of the real risk in the subprime market is cascading, rippling and ultimately severely affecting the world economy.

The crisis began with the bursting of the United States' housing bubble and high default rates on "subprime" and adjustable rate mortgages (ARM). Loan incentives, such as easy initial terms, in conjunction with an acceleration in rising housing prices encouraged borrowers to assume difficult mortgages on the belief that these would be easy to refinance at more favorable terms. However, once housing prices started to drop moderately in 2006–2007 in many parts of the U.S., refinancing became more difficult. Defaults and foreclosure activity increased dramatically, as easy initial terms expired. Home prices failed to go up as originally anticipated, and ARM interest rates reset higher. Foreclosures accelerated in the United States in late 2006 and triggered a global financial crisis through 2007 and 2008.

II. Effects of the crisis on Uganda

Uganda's macroeconomic conditions and the entire financial system are generally robust, healthy, and better able to weather the ongoing financial storm in the global economy. First, Uganda's financial institutions had not invested in derivatives that had exposure to these investment bankers. Better supervisory oversight and risk management practices have strengthened bank balance sheets while Bank asset quality, profitability, and capital adequacy have also improved remarkably over recent years.

Second, our real estate sector is also unlikely to be negatively affected since our relatively young real estate companies are not linked to the international organizations that have failed. Our company valuations are therefore unlikely to be adversely affected.

Uganda's economy resilience also stems from improved economic policies and institutional frameworks built over the last two decades. The banking and the entire financial system are stronger after years of restructuring. These have not only favored price stability and a firm base for sustained economic growth, but have also increased the country's resilience to shocks generated by adjustments in international financial markets.

For example, since late 2007, as the subprime-generated financial turmoil gained momentum, Uganda's continued economic expansion has not been adversely affected. In fact, according to Uganda Bureau of Statistics (UBOS), real economic growth was registered at 9.8 percent in 2007/08 and is projected at 8.1 percent in 2008/09.

Although direct exposure to crisis-related debt is very limited, vulnerabilities in sub-Saharan financial markets may become more exposed. As a result, perceived risks of a protracted US downturn, or even recession, and what that would mean for Africa's and in particular Uganda's growth momentum may be intensified.

The economic slowdown in the US and Europe could naturally affect demand for Uganda's exports. Coupled with the pass-through effects of ongoing price hikes in oil and foodcommodities, the harsher external environment today may inevitably place downward pressure on our growth prospects in the immediate period.

There may be also an impact from reduced private transfers to Uganda especially as industrialized economies take a hit in terms of reduced GDP growth and market liquidity. There is also the possibility of reduced aid flows from developed countries to low income countries.

A prolonged poor performance in the industrial economies may also be reflected in reduced interest from offshore players in the Ugandan market. However, given our strong and favourable macroeconomic fundamentals, it is expected that foreign direct investment to the Ugandan economy will maintain a sustained upward trend.

III. Conclusion

Bank of Uganda will continue to closely monitor and assess the possible effects of the ongoing turmoil in the international financial market on Uganda's economy and will effect necessary policy actions to ensure overall macroeconomic stability. However, as the country continues to experience robust economic growth, the Bank of Uganda is always wary of the vagaries of our linkage to the global financial system. In addition, the economic cooperation and integration being pursued both regionally and globally will aid in addressing any effects of the exogenous shocks on the domestic economy.