EVALUATING EFFICIENCY OF A SPOT MARKET; A CASE STUDY OF UGANDA FOREIGN EXCHANGE MARKET

BY

KAZIGO ALEX

2011/HD06/3201U

SUPERVISOR: DR. GODFREY AKILENG

A RESEARCH REPORT SUBMITTED TO THE SCHOOL OF BUSINESS IN PARTIAL FULFILMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINSTRATION OF MAKERERE UNIVERSITY

SEPTEMBER 2013

ABSTRACT

This study seeks to evaluate the efficiency of a spot market and come up with strategies that can be used to overcome the constraints that limit the efficiency of a spot market. Extensive evidence of anomalies in Uganda's currency market, suggests either that the market systematically misprices or that the theoretical or empirical limitations are binding, or both. Foreign exchange rates do fluctuate minute by minute or even day by day. Data was gathered from the different financial institutions and foreign exchange bureaus in Kampala through the use of self-administered questionnaires. This created anonymity leading to more valid responses and convenience during the study. One important factor to determine how market operates is information about the way agents determine their transactions. A large number of both banks and bureaus describe their spot transactions as being driven by customer orders. But also technical trading is indicated as another important determinant of their transactions. Findings show that cost of trading and cost of information or profit motive by the actors are major factors that hinder market efficiency. So far, currency forward has been the most common hedge tool compared with other edging strategies to control the foreign currency exposure risk. In this regard, several hedging strategies are evaluated and compared with one another. Bank of Uganda intervention reduces volatility of the exchange rate but also moves the exchange rate away from its fundamentals and hence leading to failure of the Efficiency Market Hypothesis (EMH).