

**DETERMINANTS OF SHORT RUN EXCHANGE RATE MOVEMENTS IN UGANDA:
CASE OF THE INTERBANK FOREIGN EXCHANGE MARKET**

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ABSTRACT

The purpose of this study was to examine the determinants of short run exchange rate movement in Uganda which seem not to be in sync with market fundamentals. This has impacted the international trade and investment in foreign exchange related services negatively. Although this random short run movement has largely been attributed to factors like market fundamentals, central bank intervention and speculation; such claims are merely and largely anecdotal in nature, completely lacking any empirical basis. There is need for conducting an empirical study using a micro-structural approach to find out whether such claims hold truth.

The study was conducted using a cross-sectional survey approach that involved collecting primary data from 48 randomly chosen authorized foreign exchange dealers on the Uganda interbank market. Quantitative data was scrutinized, cleaned, coded, entered into a Microsoft Office Excel computer program and consequently analyzed. In addition, descriptive statistics such as frequencies, percentages and means were used in describing dealers' responses to the various items contained in the questionnaire.

This study had three objectives: to establish how interbank foreign exchange market in Uganda operates in terms of mode of transaction, major currency of trade, and market concentration of players; determine the bid-ask spread in the interbank foreign exchange market and the factors determining the spread; and establish dealers' perceptions about the factors influencing movements in Uganda's exchange rate over the short-run.

In terms of how the market operates, electronic transfers is the most popular mode of forex trading on the interbank with settlement after two days, the USD/UGX is the most preferred underlining the US Dollars importance to the economy, and forex trading is largely dominated by the a few big banks whose decisions are largely followed by others. The average bid-ask spread varies across the different currencies traded and is largely determined by market convention which is dominated by the peer banks. The empirical survey results suggest that speculation is perceived by Bank dealers as the major factor explaining the currency volatility in the Ugandan market.

In order to minimize the potential effects of speculative forces on the interbank foreign exchange market, the study recommends that the market, including the central bank, the banking sector and the corporate sector, ought to encourage use of derivative instruments to minimize speculative

tendencies , narrow further the spreads through increased price discovery, and cap true risk premiums embedded therein. It also recognized need for more technologically accessible platforms to improve competitiveness in the foreign exchange market.