

**UGANDA COFFEE TRADE FEDERATION BREAKFAST MEETING ON THE GLOBAL FINANCIAL CRISIS AND ITS IMPLICATIONS ON THE COFFEE INDUSTRY IN UGANDA, REMARKS BY MR. LAMIN K. MANJANG – CEO, STANDARD CHARTERED BANK.**

- Mr. Chairman, distinguished ladies and gentlemen, a good morning to you all.
- Thank you for giving me the opportunity to share my thoughts on the current Global Financial Crisis and its impact on Uganda and the implications for the coffee industry in particular.
- The Global Financial Crisis started with the bursting of the housing bubble in the US and high default rate on sub – prime mortgages. US sub prime mortgages were estimated at \$ 1.3 trillion in March 2007.
- Financial innovation led to securitization. The securities are called Mortgage Backed Securities (MBS) and Collateralized Debt Obligations (CDOs).
- Mortgage Backed Securities enabled financial institutions worldwide to invest in the U.S. housing market and thus exposure to the financial crisis.
- Investors in Mortgage Backed Securities and Collateralized Debt Obligation can insure against credit risk by buying Credit Default Swaps (CDS).
- As mortgage defaults increased in the USA, there was uncertainty whether Credit Default Swaps issuers (like AIG) would honour their obligations.

**Some of the causes of the Global Financial Crisis included the following:**

- There was an explosion in house prices in the US, with prices increasing by 124% between 1997 and 2006. Low Interest rates and large inflows of foreign funds fuelled this explosion. Speculative purchase of houses also grew, estimated at 40% growth in 2006.
- Banks engaged in risky lending practices. The median down payment for loans was 2%, with 43% of buyers making no down payment. By contrast, in China, the median down payment for a mortgage is 20% and about 30% in Uganda.
- Running out of who to lend to, Banks turned to the poor. Risky loans like “No Income, No Job, No Asset” (NINJA) Loans were being made. Rising house prices led lenders to think that it was not too risky, bad loans meant repossessing high value property.
- Banks borrowed heavily to finance the boom in mortgages and financial leverage involved Banks borrowing at a lower interest rate and investing the proceeds at a higher interest rate. This strategy proved profitable in the housing boom, but resulted in large losses when house prices declined and mortgages began to default.
- The US trade deficit increased from 1.5% of GDP in 1996 to 5.75% by 2004, over \$650 billion .The US had to borrow from the emerging economies of Asia and the oil producing nations to finance this level of import consumption. A flood of funds entered into the US financial markets and the U.S consumers used the borrowed funds for consumption and to bid up the housing prices. Banks directed their funds towards Mortgage Backed Securities.
- Credit Default Swaps are a form of insurance against credit default. As the net worth of Banks and other financial institutions deteriorated because of losses related to sub – prime mortgages, the likelihood increased that those providing the insurance would have to pay the counter parties. That is why AIG had to seek government bailout because it had Credit Default Swap exposure of around \$ 440 billion.

- The U.S Federal Reserve lowered the federal funds rate target from 2000 to 2003 from 6.5% to 1.0% in response to the collapse of the dot.com bubble and the September 11 terrorist attack. The lowering of interest rates contributed to the rise in house prices by lowering the cost of borrowing and increasing access to credit.
- The practice of securitization led to the Originate to Distribute model, where debt was sold down. Since issuers no longer carried any default risk, they had an incentive to lower their underwriting standards to increase their loan volumes and earn more profit.
- Finally, Rating Agencies like Moodys and Standard and Poor's gave investment grade ratings to MBS /CDOs based on sub-prime mortgages. This encouraged investors to buy securities backed by sub-prime mortgages, helping finance the housing boom. There was conflict of interest because the rating agencies were being paid by investment banks and other firms that were selling securities to investors.

#### **From Financial Crisis to Economic Crisis...**

- Shrinking banks suck money out of the economy as they try to build up their capital and are nervous about lending. As a result businesses and individuals that rely on credit find it difficult to access credit and a spiral of problems occur.
- The combination of lower asset prices, highly indebted households, restricted access to credit, lead to lower demand and consumption, which lead to lay offs and higher unemployment.
- This is why drastic steps were taken in the U.S and Europe to pass stimulus packages to support demand and consumption and increase infrastructural spending. Measures were taken to remove the toxic assets from Bank's Balance Sheets to allow them to resume lending.

## Impact of the Economic Crisis on Uganda

- The Ugandan Banking system was not exposed to sub – prime mortgages and Banks are generally highly liquid and well capitalized.
  
- However, the Global recession emanating from the financial crisis has impacted Uganda in several ways:
  - o Commodity prices have declined due to a fall in demand. The price of coffee, tea and flowers has seen marked declines.
  
  - o Portfolio investment into Uganda (for both bond and equity market) has slowed down. In fact the flight of investors in October 2008, led to a sharp depreciation of the shilling.
  
  - o Decline in Foreign Direct Investment due to stringent lending conditions and increased risk aversion in developed countries.
  
  - o Decline in remittances as a result of the increased unemployment and uncertainty in the markets where Ugandans work. The decline is estimated to be between 30% to 40%.
  
  - o Decline in regional trade especially with Southern Sudan, due to the impact of reduced oil prices and reduction in South Sudan’s budget allocation.
  
  - o Reduction in URA tax collections due to slower economic activity.
  
  - o Cost cutting measures by the private sector and NGOs, including staff redundancies.
  
  - o A sharp depreciation of the Uganda shilling between October 2008 and now, due to reduced inflows in relation to demand.

## **Impact of the Recession on the Ugandan Coffee Sector**

- Demand for coffee has been very dynamic in recent years growing at an average rate of 2% – 2.5% per a year, equivalent to an extra 2 million bags (each weighing 60 kgs) being consumed per a year. Domestic consumption in producing countries has also increased.
- The first analysis carried out by the International Coffee Organization came to the conclusion that coffee consumption should not suffer much except for the area of specialty coffee, sold at trendy coffee shops. Consumption of basic foodstuffs, coffee included, is not so much affected by the Crisis.
- Coffee prices peaked between 1994 and 2000, and then fell sharply, discouraging production and new investment. As a result, output in African countries fell by about 20%, particularly in Ivory Coast, DRC, Uganda and Angola.
- From 2000 to 2005, the coffee sector went through a critical situation where the level of prices was half the cost of production. This prompted more than 400,000 workers to emigrate from coffee growing areas in Central America and Mexico to the USA, or to urban areas in their own countries. As a result production in Central America was reduced by 20% to 25%.
- From 2005, the trend was reversed and coffee prices recovered until late 2008, when the prices of other commodities were falling, because of the Global Financial Crisis. The recession affected coffee prices from September 2008, and they have fallen by about 20%.
- However demand for coffee is rising. Coffee is currently selling at \$ 1.15 to \$ 1.20 per a pound. A price of \$ 1.20 is manageable, but not high enough to prompt new developments or new plantations.

- The depreciation of the Uganda shilling by nearly 30% from October to date has benefited exporters, including coffee exporters. However, there is a risk of higher inflation due to higher prices of imported commodities.
- Banks have continued to support the coffee industry. We have taken steps to revalue stock positions when prices fluctuate, and have made margin calls when prices fell significantly between October 2008 and December 2008. However, prices seem to have stabilized in the last few months, and we should continue to support the growth of the coffee industry.

### **Can Uganda Cope with the Crisis?**

- Government spending on infrastructure is a form of stimulus spending which could support domestic consumption.
- At Government, Business and Individual level there is a need to assess expenditure patterns and cut down on unnecessary and wasteful spending.
- Uganda should take advantage of its strength in food production to come up with incentives to increase food production for both domestic and export markets.
- The Government should engage development partners like IMF, World Bank and ADB, that all announced plans to increase lending and facilities to vulnerable developing countries to cushion the impact of the Global Financial Crisis and engage the Private Sector on how to partner with Government to support these initiatives.
- There is a need for dialogue and coordination of policies at a regional level to ensure that the region as a whole is able to withstand the strains from this Global Economic Crisis.
- Commercial Banks must continue to stress test their portfolios to anticipate signs of credit defaults and proactive measures to mitigate this risk.

- A Crisis contains within it some opportunities. Uganda should look at the opportunities that may arise from this Crisis and seize them in order to emerge from it with a stronger and more resilient economy.
- Thank you for your attention.