Business Daily

MONEY MARKET

Middle East conflict puts pressure on the shilling

Middle East tensions ripple through as investors retreat to safer assets, triggering fresh pressure on the previously stable shilling.

Currency market. |

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After months of relative stability, the shilling is beginning to feel pressure from the conflict in the Middle East.

Investors are shifting funds toward safer global assets, while exports worth $5.27b, or 41.77 percent of Uganda's total export earnings, remain under threat.

For much of the past year, the shilling has remained stable against the dollar, supported by inflows from exports, remittances, and foreign portfolio investments, in a region where several currencies have experienced sharper volatility amid global economic uncertainty.

However, the outbreak of hostilities between Iran and Israel, with the involvement of the United States, has unsettled global financial markets.

This repositioning has started to weigh on emerging market currencies, including Uganda's.

The shilling closed last Friday at Shs3,674.91, which was relatively weaker than the under Shs3,500 level posted about two weeks ago.

The shilling weakens as Middle East conflict drives investors to safe-haven assets, raising dollar demand and pressure on the local unit. PHOTO / EDGAR R BATTE

Dr Adam Mugume, the Bank of Uganda executive director for research, said last week that the shilling had begun responding to geopolitical shock, "depreciating by about Shs100 against the dollar in the last two days [between Monday and Wednesday] since the start of the conflict". He noted that foreign exchange markets reacted almost immediately after the conflict began, reflecting the sensitivity of markets to geopolitical developments.

Uganda's fully liberalized foreign exchange market also means capital can move freely in and out of the country.

This has allowed foreign investors to quickly reposition their investments.

Mr Richard Nsubuga, the Absa acting head of trading, said at the weekend that offshore investors had been selling their holdings in government bonds "in search of safe-haven assets, adding significant pressure on the shilling", with additional demand from energy, manufacturing, and telecoms, which rely on imported inputs, further weighing on the local unit.

The conflict has also disrupted global energy markets, pushing oil prices sharply higher after shipments through key global supply routes were affected.

Mr Stephen Kaboyo, managing partner at Alpha Capital, said the global rush for safe-haven assets has overlapped with domestic market movements that encouraged investors to exit local bonds.

"The Middle East crisis coincided with events in the domestic markets where bond yields dropped, prompting offshore investors to take profits and convert proceeds from sales into dollars," he said, warning that the surge in global crude oil prices could also increase inflationary pressure.

Experts also warn that remittances from Ugandans working in the Middle East, which bring in about $1.6b annually, could be affected if the conflict disrupts economic activity in the region.

Key data

Shs3,674

The shilling closed last Friday at Shs3,674, which is weaker than the under Shs3,500 posted about two weeks ago.