POLICY BRIEF

Macro-Economic Effects of COVID-19 on the EAC Economies

Ibrahim Mike Okumu

September 2021

Executive summary

There is no doubt that COVID-19 induced headwinds have rattled the EAC Partner States, the effects of which are: sluggish economic growth; weak private sector credit growth in spite of record low lending rates; weakened external sector and weakened financial sector profitability and return on assets albeit total risk-weighted assets; and Non-Performing Loans and liquidity ratios being above the regulatory requirements, implying a resilient financial sector. Consequently, the EAC Partner States adopted expansionary fiscal and monetary policy in combination with COVID-19 containment measures in an effort to abate the

distortionary effects of the virus. As such, this study sought to undertake an exploratory study of the policy choices across the EAC Partner States in an attempt to identify areas of policy convergence. Evidently, across all the EAC partner states, both fiscal and monetary policy regimes were expansionary. However, a micro examination of the policy paths shows that both fiscal and monetary policy was more intensive and extensive in Kenya, Rwanda, and Uganda in comparison to Tanzania, South Sudan, and Burundi; which was partly accounted for by the less than stringent COVID-19 containment measures adopted in Burundi and Tanzania unlike Uganda, Rwanda, and Kenya. Particularly in Rwanda and Uganda, the nationwide lockdowns implied that both fiscal and monetary policies had to be deep cutting and wide enough to accommodate the COVID-19 induced economy-wide shutdowns.

Background and context

COVID-19 is an unprecedented exogenous shock among the East African Community (EAC) Partner States whose effects have further been perpetuated by domestic choices adopted the each Partner State in an effort to abate the distortionary effect of the virus. The exogenous shock permeated through: global supply chain disruptions; weaker global demand on account of a global recession; travel restrictions; and global financial markets volatility partly because the EAC Partner State economies have trade and financial linkages to the global economy. The domestic effects channel is attributed to COVID-19 induced morbidity and mortality and the measures adopted to abate the spread of the virus in each EAC Partner State. The combined effects of COVID-19 induced external and domestic shocks have partly resulted in subdued GDP growth of 1% in Tanzania in 2020, while GDP growth in Burundi, Kenya, Rwanda, South Sudan, and Uganda was -1.3%, -0.1%, -0.2%, -6.6% and -2.1%, respectively, in 2020. To this extent, the EAC trading block on average contracted by 1.6% in 2020.

The subdued growth among EAC Partner States was partly on account of COVID-19 induced: twin effect of low export demand and disruptions in the supply of inputs which undermined the industrial sector performance; supply chain disruptions adopted within and without the EAC equally compounding the effects of the weak global demand on economic growth outlook among the EAC Partner States; and combined effects of restrictive border controls, inability to restock supplies and economy lockdowns which undermined the service sector performance; and contraction in aggregate demand as reflected by the Purchasing Managers Index (PMI)[1] for once crushing below the 50 threshold in both Uganda and Kenya.

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1 The PMI is a composite index, calculated as a weighted average of five individual sub-components; New Orders (30%), Output (25%), Employment (20%), Suppliers' Delivery Times (15%), and Stocks of Purchases (10%). It gives an indication of business operating conditions in the Ugandan economy. The PMI above 50.0 signals an improvement in business conditions while readings

Furthermore, the EAC Partner States were characterized by weak private sector demand for credit. The effect of which was a reduction in lending rates, the lowest they have been in the region for at least two decades. With regard to the financial sector, it remained largely sound and stable in spite of the COVID-19 induced headwinds. For example, across the EAC Partner States the total capital to total risk-weighted assets, Non-Performing Loans, and liquidity ratios were above the regulatory requirements. Even then, banking sector profitability and return on assets reduced, partly reflecting the COVID-19 induced weak business environment. With regard to the external sector, in both Tanzania and Uganda, the current account deficit as a percentage of GDP narrowed by 2.3% and 1%, respectively, in Financial Year (FY) 2019/20 compared to FY2018/19. While in Kenya and Rwanda, as a percentage of GDP, the current account deficit increased by 0.3% and 1.4%, respectively, in FY2019/20 compared to FY2018/19. Similarly, in South Sudan, current account deficit worsened from US$256.86 million in 2019 to US$ -932.91 million in 2020 on account of weak oil demand and low oil prices. The weakening of current account balance (CAB) in Kenya and Rwanda was on account of disruptions in international travel and tourism which affected export earnings. While the improved CAB in both Uganda and Tanzania was on account of a reduced import bill on one hand, but for particularly the latter gold exports increased by US$846.4 million resulting in a 28.3% increase in export earnings.

Issue

Evidently, the preceding discussion suggests that COVID-19 has had adverse effects on the EAC Partner States economies. Indeed, in an effort to abate the distortionary effect of COVID-19, EAC Partner States adopted various policies and strategies. As such, this policy brief is an exploration of the policy options and strategies adopted by the respective EAC Partner States with the rationale of devising areas of future policy convergence.

Exploration of the policy choices and strategies adopted to abate the distortionary effects of COVID-19 among EAC Partner States

Across the EAC Partner States, fiscal policy was geared towards providing relief and increasing disposable income among households, and protecting jobs and businesses from the distortionary effects of COVID-19. Specifically, to support businesses, Value Added Tax (VAT), Corporation Tax, and Pay as You Earn (PAYE) were deferred in Uganda and Rwanda. In Kenya, the tax relief was characterized by the reduction of Corporation

below 50.0 show deterioration. The PMI is compiled monthly by IHS Markit. The index is computed using recorded reductions during the month of the following components output: new orders; employment; supplier’s delivery times; and stocks of purchases

Tax, PAYE and VAT rates. Also in Uganda, Kenya, and Tanzania governments pledged to settle verified arrears in an effort to increase liquidity among businesses. Furthermore, in Tanzania, VAT and customs duties exemptions were granted on imported medical equipment and medical supplies in an effort to support the health sector. With regard to supporting livelihood, Kenya adopted direct cash transfers to the vulnerable households, Uganda opted for free food distribution among vulnerable inhabitants within and around Kampala city, while in Tanzania social security schemes were expanded to meet the increase in pension withdrawals for retrenched staff due to COVID-19. The effect of the expansionary fiscal policy was partly weak tax revenue performance resulting in debt financing in Uganda, Kenya, and Tanzania.

Table 1: Fiscal policy choices across the EAC Partner States

	Kenya	Tanzania	Uganda	Rwanda	South Sudan	Burundi
Tax exemptions	Yes	Yes	Yes	Yes	Yes	Yes
Social protection	Yes	Yes	Yes	Yes	Yes	Yes
Private sector relief funds	Yes	Yes	Yes	Yes	No	Yes
Increased public debt	Yes	Yes	Yes	No	No	Yes

Similarly, monetary policy was expansionary across the EAC Partner States with the rationale of ensuring financial market stability. Specifically, the policy rates were revised downwards across all EAC Partner States with the rationale of inducing a southward movement of lending rates. Also, to ease financial sector liquidity constraints, the central banks offered a multitude of options, for example, lowering the Reserve Requirement Ratio (CBK[2], NBR[3], and BoU[4]), buying back Bonds (NBR) and increasing the maximum tenor of Repurchase Agreements (BoU, CBK, and NBR). Furthermore, to abate credit risks, central banks (CBK, NBR, BoU, and BSS[5]) advised Supervised Financial Institutions to restructure outstanding loans of borrowers facing COVID-19 induced temporary cash flow challenges on a case by case basis. In addition, CBK temporary suspended the listing of negative credit information for borrowers whose loans were performing previously but have become non-performing due to COVID-19. To ease capital constraints, BSS suspended a nascent regulation of higher minimum paid-up capital for commercial banks. Also in an effort to abate the spread of COVID-19, cashless transactions using the mobile money transactions were supported through reducing transaction charges to zero and increasing transaction limits in Rwanda, Uganda, and Kenya.

2 Central Bank of Kenya.

3 National Bank of Rwanda.

4 Bank of Uganda.

5 Bank of Uganda.

Table 2: Monetary policy choices across the EAC Partner States

	Kenya	Tanzania	Uganda	Rwanda	South Sudan	Burundi
Reducing the policy rate (CBR and Discount Rate)	Yes	Yes	Yes	Yes	Yes	Yes
Reducing the Reserve Requirement Ratio (RRR)	Yes	Yes		Yes	Yes	Yes
Increased the maximum tenor of Repurchase Agreements	Yes	No	No	No	No	Yes
Central bank extending lending to commercial banks at longer maturity periods	Yes	No	No	Yes	No	Yes
Regulatory flexibility to central bank Supervised Financial Institutions (SFIs) that extend loan restructuring operations on a case by case basis	Yes	Yes	Yes	Yes	No	Yes
SFIs directed to defer dividend payments	No	No	Yes	Yes	No	No
Insurers directed to defer dividend payments	No	No	No	Yes	No	No
Suspension of listing of negative credit information for loan defaulters	Yes	No	No	No	No	No
New minimum threshold for negative credit information submitted to credit reference bureaus	Yes	No	No	No	No	No
Purchase of Treasury bonds held by Microfinance Deposit taking Institutions and credit institutions to ease liquidity	No	No	Yes	No	No	No
Encouraged commercial banks to reduce electronic transaction charges	Yes	No	No	No	No	Yes
Daily transaction limit for Mobile Money (MM) operators was increased	Yes	No	Yes	No	No	Yes
Reduction of MM and other digital charges payment charges	Yes	No	Yes	No	No	Yes
Exchange rate and BoP measures	No	No	Yes	No	No	No

In an effort to compliment both monetary and fiscal policy measures across the EAC Partner States, effort was undertaken to contain the spread of the COVID-19 virus. As is evident in Table 3, there is disparity in COVID-19 containment measures. For example, authorities in Kenya, Tanzania, Uganda, Rwanda, and South Sudan: suspended international flights except for essential deliveries; introduced restrictions on domestic travel, for example, limits on number of persons using public or private transports or simply restrictions on non-essential movement within the country; and closed schools and educational institutions. Unlike Tanzania and Burundi, authorities in Kenya, Uganda, Rwanda, and South Sudan instituted restrictions on large gatherings and places of worship. Unlike Kenya, Tanzania, South Sudan, and Burundi, both Uganda and Rwanda adopted more stringent containment measures by closing non-essential businesses. Implying that, overall, the COVID-19 containment measures were more relaxed in Tanzania and Burundi in comparison to Uganda and Rwanda which opted for more a stringent approach akin to economy-wide lockdown.

Table 3: EAC trading block policy mix to abate the impact of COVID-19

	Kenya	Tanzania	Uganda	Rwanda	South Sudan	Burundi
International flight suspensions except for essential/critical deliveries	Yes	Yes	Yes	Yes	Yes	yes
Establishment of isolation centres	Yes	Yes	Yes	Yes	No	Yes
Land border restrictions	Yes	No	Yes	Yes	No	Yes
Evening curfews	Yes	No	Yes	Yes	Yes	Yes
Social distancing	Yes		Yes	Yes	Yes	Yes
14-day mandatory quarantine period for travellers coming from COVID-19 affected countries	Yes	No	Yes	Yes	Yes	Yes
Restrictions on domestic travel	Yes	Yes	Yes	Yes	Yes	No
Working from home was encouraged (teleworking)	Yes	No	Yes	Yes	Yes	No
Closure of schools and educational institutions	Yes	Yes	Yes	Yes	Yes	No
Restrictions on large gatherings	Yes	No	Yes	Yes	Yes	Yes
Restrictions on worship	Yes	No	Yes	Yes	Yes	No
Closure of non-essential business	No	No	Yes	Yes	No	Yes
Mandatory wearing of face masks	Yes	No	Yes	Yes	Yes	No

Conclusion

While there was convergence in the rationale for fiscal and monetary policy choices across the EAC Partner States, evidently both fiscal and monetary policy intensity and extensiveness were more in Kenya, Rwanda, and Uganda in comparison to South Sudan, Burundi, and Tanzania. For Rwanda, Kenya, and Uganda, this could be partly attributed to relatively stringent COVID-19 containment measures which adversely affected businesses and livelihood in comparison to Tanzania and Burundi. Even then, which country's approach was dominant over the other, the genie is still in the bottle. Furthermore, policy debate on the long-term repairs on the EAC Partner State economic systems is either still in the policy board rooms or utterly absent. Yet, such discussions are key to restarting economic activity especially now that COVID-19 inoculation is takings shape. Furthermore, for purposes of optimal policy targeting, it is imperative that EAC Partner States use their respective national identification frameworks and survey data to maintain a database of households by livelihood. Finally, there ought to be optimal signalling as to when the COVID-19 induced tax relief and spending, and financial sector interventions, would to come to an end for purposes of the private sector decision-making.

Mission

To strengthen local capacity for conducting independent, rigorous inquiry into the problems facing the management of economies in sub-Saharan Africa.

The mission rests on two basic premises: that development is more likely to occur where there is sustained sound management of the economy, and that such management is more likely to happen where there is an active, well-informed group of locally based professional economists to conduct policy-relevant research.

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Contact Us
African Economic Research Consortium
Consortium pour la Recherche Economique en Afrique
Middle East Bank Towers,
3rd Floor, Jakaya Kikwete Road
Nairobi 00200, Kenya
Tel: +254 (0) 20 273 4150
communications@aercafrica.org