# MACRO ECONOMIC DETERMINANTS OF BALANCE OF TRADE: THE CASE OF UGANDA

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## Abstract

Uganda continues to experience persistent trade balance deficits. This is because its exports are majorly primary products while it imports expensive manufactured goods. Majority of studies done indicate that trade balance is mainly influenced by exchange rate, domestic income and foreign income. This study adopted the two country imperfect substitute model of international trade to investigate the effect of these macroeconomic factors on Uganda's trade balance.

Secondary data spanning the period 1990-2015 were obtained from online statistical databases of the World Bank and Bank of Uganda. The data entailed annual time series observations on total exports, total imports, real exchange rate and real GDP for Uganda as well as real foreign income from Uganda's major trading partner (Kenya). Trade balance was estimated as the ratio of total exports to total imports. Descriptive statistics were used to explore the status of Uganda's trade balance and other macroeconomic attributes over time. The time-series properties of the data were investigated after which the variables were transformed by taking their natural logarithms. At multivariate level, a multiple linear regression model was fitted on the log-transformed series using ordinary least squares technique to determine the predictors of balance of trade.

The results reveal that over the study period, Uganda averaged a trade balance ratio of 0.28, an exchange rate of 1,525 shillings per US dollar, foreign income worth 31.6 billion US dollars from its major trading partner and domestic income of 13.5 billion US dollars, all in real terms. The results indicate that real exchange rate was the only significant predictor of Uganda's trade balance and that the relationship was positive. Holding other macroeconomic factors constant, a 1% increase in real exchange rate resulted in a0.33% improvement in real trade balance.

The study concludes that real exchange rate is the standout macroeconomic predictor that influences Uganda's balance of trade behavior. In particular, devaluation of the local currency improves trade balance position. The study therefore recommends that economic policies in Uganda should target devaluing the Ugandan shilling under the right economic conditions as this can help bridge the trade deficit gap by increasing exports and reducing imports.