Towards Sustainable Development

The Uganda Business Climate Index

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Business environment improved amid continued depreciation of the Kenya Shilling.

Executive Summary

The Business Climate Index (BCI) improved from 78 index points in the previous quarter to 109 in the quarter under review (October to December 2023). The improvement in the business environment sentiments is mainly explained by the enhancement in the business environment, the increase in labour availability, and the improvement in capacity utilization over the quarter.. The agriculture sector registered a decline of 12 index points, from 89 in the previous quarter to 77 in the quarter under review. The manufacturing and services sectors registered improvements of 16 and 6 index points, from 80 and 77 to 96 and 83 respectively. Over the quarter ended December 2023, unfavourable tax policy, worsening macroeconomic factors, insufficient demand, limited electricity availability, limited access to finance, and corruption and bribery were highlighted as the major constraints to business operations. The same challenges prevailed in the previous quarter ended September 2023, indicating that business challenges in Uganda are persistent. The near-term business sentiments indicate that conditions for doing business are expected to decline, from 105 to 103. The indices for the agriculture, service, and manufacturing sectors are expected to increase from 77, 96 and 83 to 82, 100 and 100, respectively. Of the businesses surveyed, 36.4 percent of them were affected by the depreciation

Source: The Star

Data and methods

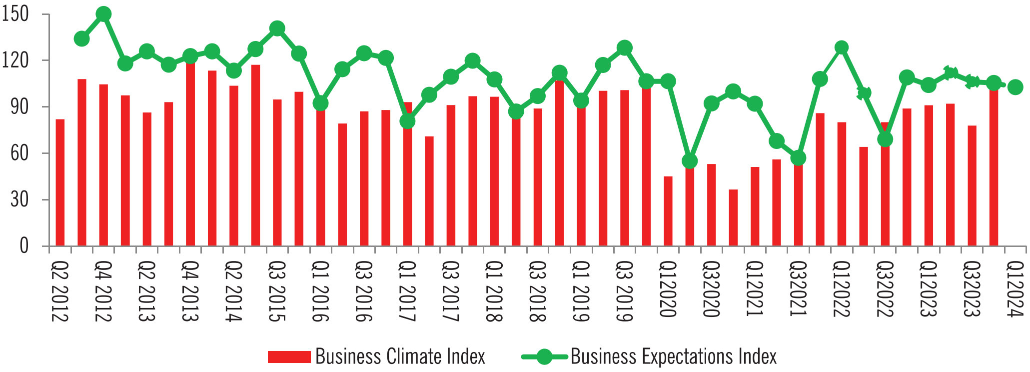
The data used in computing the Business Climate Index (BCI) is a panel of businesses based on the Uganda Bureau of Statistics Census of Business Establishment 2011, first tracked in 2012. This current quarterly bulletin covered 160 business establishments. The panel element has enabled us to track the business environment in Uganda over time.

The BCI is computed based on the following business evaluation indicators: level of business activity, turnover, profitability, incoming new business, capacity utilisation, average costs of inputs, price of produced goods, business optimism, number of employees, and average monthly salary. For each of the evaluation indicators, respondents are asked to express their perceptions on a Likert scale: "improved", "did not change", "declined", or "above normal for the quarter", "normal for the quarter", "below average for the quarter" or "more favourable", "unchanged", "less favourable". We code these responses as 0, 1, and 2, respectively. In this case, if a respondent perceives that the business environment deteriorated, we code such a response as 0.

The index does not consider the magnitude of change in the data, but considers the general direction of movement in the key indicators. As such, the index is sensitive to the direction as opposed to the magnitude of the change in business conditions. During the data collection process, we ask business managers to assess the general economic environment for the current quarter relative to the previous quarter and their expectations for the next quarter. Based on the business evaluation indicators explained earlier, we compute the business climate index as the weighted arithmetic mean of individual business evaluation indicator indices. The indices range from 0 to 200. The interpretation of the BCI is such that scores above 100 point to an improving business climate. Scores below 100 imply that the general business conditions are getting worse. And a score of 100 points to unchanged business conditions.

Also, the index analyses the evolution of challenges facing businesses during October-December 2023 by identifying which business constraints became more of a problem and less of a problem. We also ask business managers to indicate how each identified business constraint has evolved during the quarter. For each of the business constraints, we asked if it was "more of a problem", "unchanged", or "less of a problem". The resultant weighted indices range from -100 to 100, with positive scores indicating that a particular constraint is perceived to be more of a problem in the current quarter.

Figure 1 **The Business Climate Assessment**



Results

Conditions for doing business improve, but the future outlook remains pessimistic.

During the quarter under review (October-December, 2023), the conditions for doing business improved by 31 index points, from 78 to 109 (Figure 1). The improvement in the business environment sentiments occurred due to the enhancement in the business environment, the increase in labour availability, and the improvement in capacity utilization.

The improvement in the business environment can be partially attributed to the reduction in the general price level of goods and services. This decline in prices has had a noticeable impact, with headline inflation experiencing a notable drop, from 3.3 percent in the quarter ending September 2023 to 2.5 percent in the quarter ending December 2023. This decrease in inflation has positively influenced business operations, making it more conducive for enterprises to thrive and expand. Lower inflation rates translated to decreased costs for businesses, allowing for more competitive pricing and increased consumer purchasing power. Consequently, this creates a more favourable landscape for investment and businesses' operation.

Moreover, during the same period, the Ugandan Shilling (UGX) experienced a depreciation against the United States Dollar. Specifically, the UGX depreciated by 0.7 percent against the USD; for the quarter ended September 2023, the rate stood at 3,757, while for quarter ended December, 2023, it was at 3,782. This depreciation of the local currency against the USD, alongside the declining inflation trend, suggests a favourable scenario for the export sector. A cheaper domestic currency makes exported goods relatively cheaper for foreign buyers, potentially boosting demand for Ugandan products abroad. Consequently, this could lead to an increase in exports.[1]

Additionally, the downward trajector of the business expectations index could be linked to various global economic uncertainties. Factors such as the ongoing Russia-Ukraine conflict, Israel-Hamas war, the choking supply chains and the persistently high inflation rates in several advanced economies, coupled with aggressive monetary policy tightening, have cast a shadow of uncertainty over the global economic landscape. These external factors have inevitably spilled over into the performance and future outlook of the Ugandan economy.

The Business Climate Index by sector

Figure 2 shows that during the current quarter, the manufacturing and services sectors experienced an improvement in the conditions for doing business, while the agriculture sector registered a decline.

The current quarter saw a remarkable improvement in the manufacturing sector, with a 16 index point increase from 80 to 96 compared to the previous quarter. The service sector experienced a 6 index point increase, rising from 77 to 83. There was a 12 index point decline in the agriculture sector, dropping from 89 to 77. A fall in input costs and an increase in capacity utilisation were the main factors that drove the improvement in the conditions for doing business in the manufacturing sector. The services sector witnessed an improvement as a result of lower input costs and more favorable sales prices. The decline in the agriculture sector was driven by increased product costs and less business activity.

Challenges in doing business.

The top five most pressing constraints to doing business for the quarter under review include unfavourable tax policy, macroeconomic factors, insufficient demand, electricity unavailability, and access to finance (Figure 3). Some of these factors have persisted from the

Figure 2 **Business Climate Index by sector**

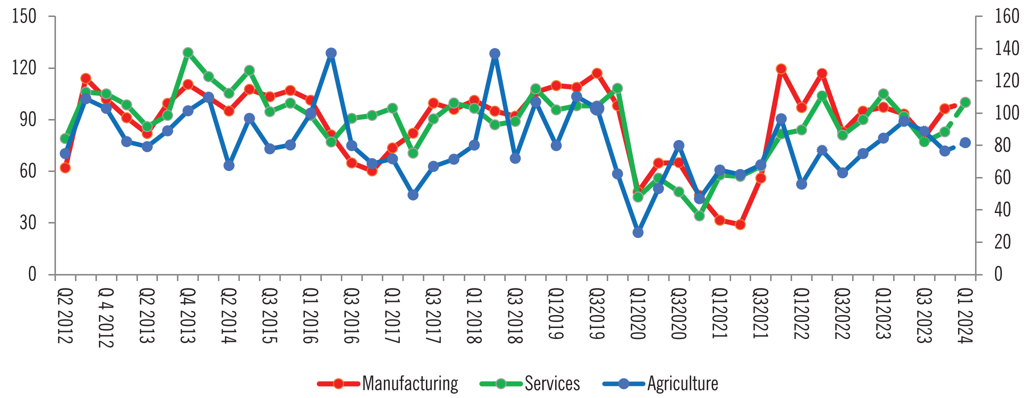
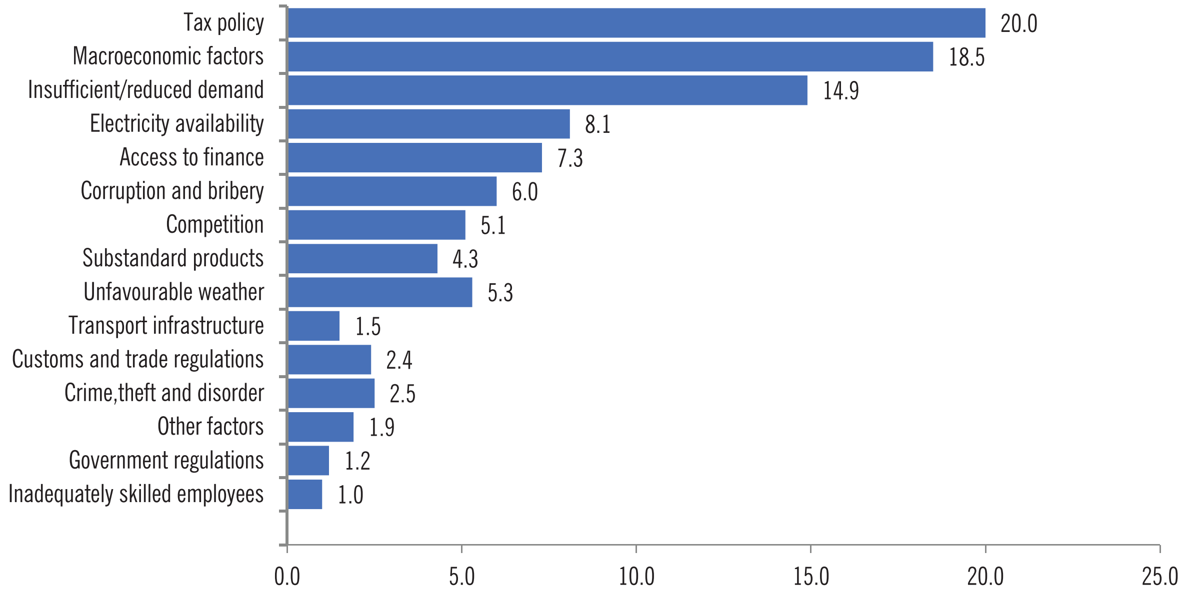


Figure 3 Business Constraints (%)



previous quarter (July-September, 2023), implying that some business constraints are rather persistent.

The evolution of business constraints

In addition to tax policy and unfavourable macroeconmic factors being the top business constraints, the severity of these two increased during the quarter under review (Figure 4). conversely, there was a notable decline in the severity of other business constraints such as inadequate skilled workers, transport infrastructure, weather, access to finance, government, crime, theft and disorder, competition and trade regulations.

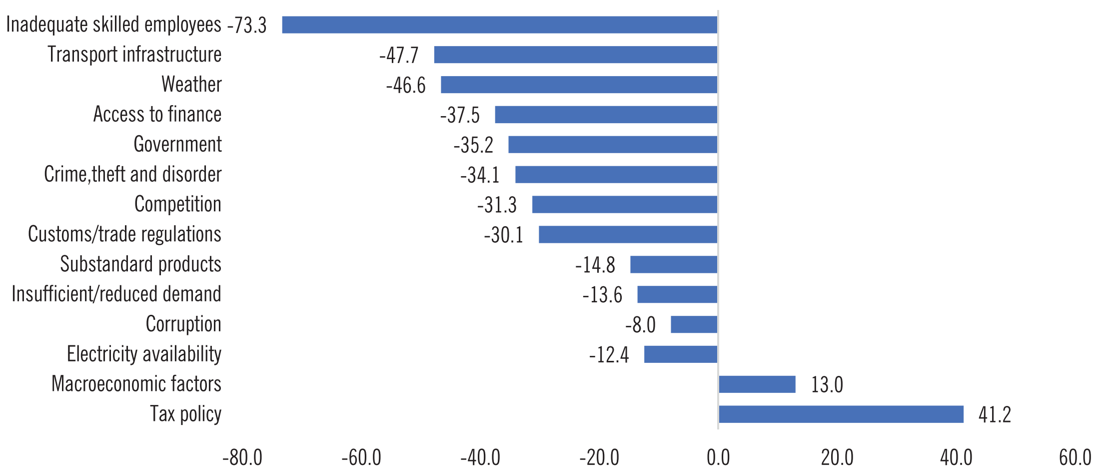
Unfavourable tax policy has consistently been reported as a key issue for a number of businesses. Indeed, the President recently accented a number of Tax-related Bills, making them laws of the land. The State House Presidential Press Unit press statement dated August 21, 2023 revealed this. The Bills accented include the Income Tax (Amendment) Bill, Value Added Tax (Amendment) Bill, Excise Duty (Amendment) Bill, and Tax Procedures Code (Amendment) Bill.[2] These may improve the country's tax environment and business perceptions and sentiments.

Future business outlook: January-March, 2024

Businesses are pessimistic about near-term developments. Figure 1 indicates that businesses anticipate a decline in sentiments by 2 index points, from 105 in the quarter under review to 103 in the next quarter (January-March, 2024). This expected drop to 103 is mostly driven by high input costs, high product costs, low optimism about the economy's performance, low-capacity utilisation, low labour supply and low salaries. According to our projections, the manufacturing and service sectors are expected to operate at full potential, with an index of 100 for each sector, while the agricultural sector is projected to operate below full its potential, with an index of 82 (Figure 2).

The sector-specific future outlook suggests that the manufacturing sector will witness a 4 index point improvement in business perceptions for the quarter of October-December 2023. This will cause an increase from 96 in the current quarter to 100 in the quarter of January-March 2024. This increase is driven by the expected increase in product prices, increase in labour supply and improved optimism. Similarly, the

Figure 4 The evolution of business constraints (% of businesses)



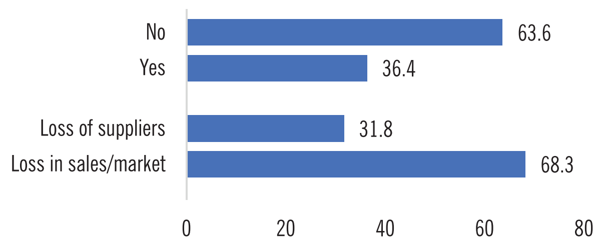
conditions for doing business in the services sector are expected to improve by 17 index points, increasing from 83 in the current quarter to 100 in the next quarter. The main factors expected to contribute to the increase are increased sales turnover, improved profitability, increased capacity utilization, and an improvement in the business environment.

The agriculture sector expects a slight improvement in the condition for doing business of 5 index points, increasing from 77 in the current quarter to 82 in the next quarter. However, the business sentiments in the sector shall remain below potential. This improvement is driven by the expected increase in capacity utilisation, improved salaries and labour availability.

Question of the quarter

In this quarter, we sought to understand the extent to which the depreciation of the Kenyan Shilling affected businesses in Uganda. The Kenya Shilling has continuously depreciated against the US Dollar and other major global currencies. Specifically, during January-December 2023, the Kenyan shilling depreciated by 27% from KES 122 to KES 156 to the dollar. As such, some Ugandan businesses found it difficult to import from Kenya. On the other hand, several traders were observed to be crossing the border to buy Kenyan products because of the Kenya Shilling deprecation and Uganda Shilling appreciation.

Figure 5 The extent to which the depreciation of the Kenya Shilling has had an effect on businesses



Particularly, we asked (i) "Has the depreciation of the Kenya Shilling over the past year had an effect on your business?" (ii) "If Yes, why?"

According to Figure 5, the depreciation of the Kenya Shilling affected on 36.4 percent of businesses surveyed. Of those affected, 68.3 percent reported that their businesses experienced a loss in sales/market, while 31.8 reported a loss of suppliers. The loss in sales/market could be due to the fact that the Kenya Shilling could no longer purchase as many goods as it could before the depreciation started, thus discouraging Kenyan importers. The loss in suppliers could be because many suppliers along the Kenya export value chain found it hard to purchase inputs to feed into their production processes, thus halting supply chains. Figure 5 further shows that 63.6 percent of the businesses were not affected in any way by the depreciation of the Kenya Shilling.

Conclusion

Conditions for doing business in Uganda in the quarter under review (October-December, 2023) improved by 31 index points, from 78 to 109 (Figure 1). The improvement in the business environment sentiments occurred due to the enhancement in the business environment, the increase in labour availability, and the improvement in capacity utilization

Perceptions about doing business in the agriculture sector declined by 12 index points. This was mainly driven by increased product costs and less business activity.

The manufacturing and services sectors registered improvements of 16 and 6 index points, from 80 and 77 to 96 and 83 respectively. The increase in capacity utilization and a decrease in input costs were the primary drivers of the improvement in business conditions in the manufacturing sector... The improvement in the services sector was because of lower input costs and more favourable sales prices.

Like in the previous quarter (July- September, 2023), some business constraints persisted. In this regard, the persistent challenges to doing business in the current quarter are, unfavourable tax policy, worsening macroeconomic factors, insufficient demand, limited electricity availability, limited access to finance, and corruption and bribery were the major constraints to business operations.

The projection for the next quarter (January-March, 2023) shows an expected decline in conditions of doing business from 105 to 103. This expected drop to 103 is mostly driven by high input costs, high product costs, low optimism about the performance of the economy, low capacity utilisation, low labour supply and low salaries.

The depreciation of the Kenya Shilling affected 36.4 percent of the businesses during the quarter. Of those affected, 68.3 percent reported that this depreciation resulted in a loss in sales/market, 31.8 reported that the depreciation resulted in a loss of suppliers. This points to the fact that since Kenya is a major trading partner to Uganda, any economic downturn in Kenya, to a greater extent, will spill-over into the Ugandan economy. There is a need for Uganda to try to diversify the portfolio of its trading partners in order to cushion against the spill-over effects of such economic occurrences.

Endnotes

1 https://www.bou.or.ug/bouwebsite/Statistics/

2 https://observer.ug/businessnews/78953-is-there-hope-for-taxpayers-after-president-s-assent-to-taxation-bills

The Economic Policy Research Centre (EPRC) has been producing the Business Climate Index (BCI) for Uganda since June 2012. The BCI reflects the perceptions of Ugandan business managers on the current and near-future (expected three months ahead) business conditions. The BCI is a perceptions indicator of economic activity and the general business environment in which businesses operate. The purpose of BCI is to forecast turning points in economic activity and thus provide critical information for policy makers both in Government and the Private Sector.

About EPRC
The Economic Policy Research Centre (EPRC) is an autonomous not-for-profit organization established in 1993 with a mission to foster sustainable growth and development in Uganda through advancement of research – based knowledge and policy analysis.

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