ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

The Uganda Business Climate Index

Issue No. 44, July-September, 2023.

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Business environment significantly deteriorated as unrests erupted in Kenya

Executive Summary

Protests regarding high cost of living in Nairobi, Kenya. (Source: Aljazeera)

The Business Climate Index (BCI) declined significantly from 92 basis points in the previous quarter to 78 in the current quarter (July to September 2023). In the quarter under review, the agriculture sector witnessed a decline of 6 percentage points, dropping from 95 in the previous quarter to 89. The manufacturing and service sectors experienced declines of 13 and 14.8 percentage points, falling from 93.4 and 91.8 to 80.4 and 77 respectively. The decline in the sentiments of the business environment is attributed to insufficient demand, less favourable product prices, unfavourable macroeconomic factors, slowing regional markets, inadequate electricity supply, and unfavourable tax policy. The same challenges prevailed in the previous quarters, January-March and April-June 2023, indicating that business challenges in Uganda are persistent. The projections indicate that conditions for doing business in the next quarter are expected to marginally decline from 106 to 105. Current rising fuel prices, the depreciation of the exchange rate consequently increasing the costs of imported inputs, pessimistic global economic outlook and the monetary policy tightening in most developed countries account for the expected drop in the index to 105. 34.7 percent of the businesses surveyed were affected by the high cost of living induced protests in Kenya.

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". The" These responses are coded as 0, 1, and 2, respectively. In this case, if a respondent's perception of the business environment worsened, we would 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. Interpreting the BCI is such that when scores are above 100, this points to an improving business climate. Scores below 100 imply that the general business conditions are getting worse. A score of 100 points indicates an unchanged business conditions.

Also, the index analyses the evolution of challenges facing businesses during July-September 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 developed 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, and positive scores suggest that a particular constraint is perceived to be more of a problem in the current quarter.

Figure 1 The Business Climate Assessment

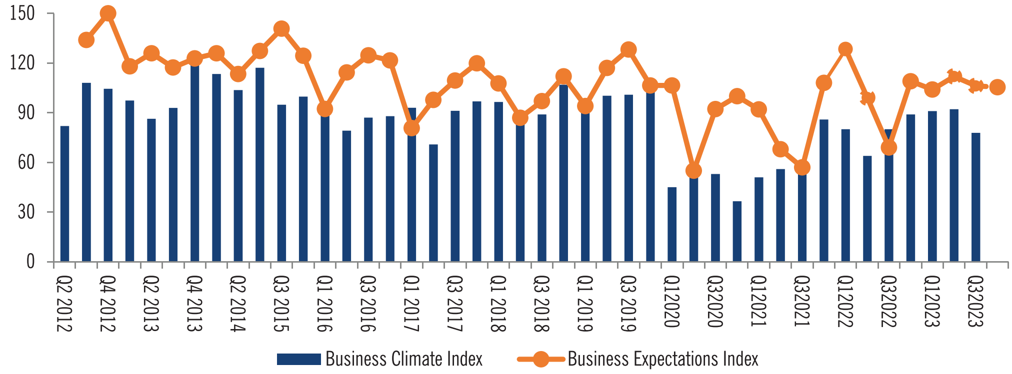
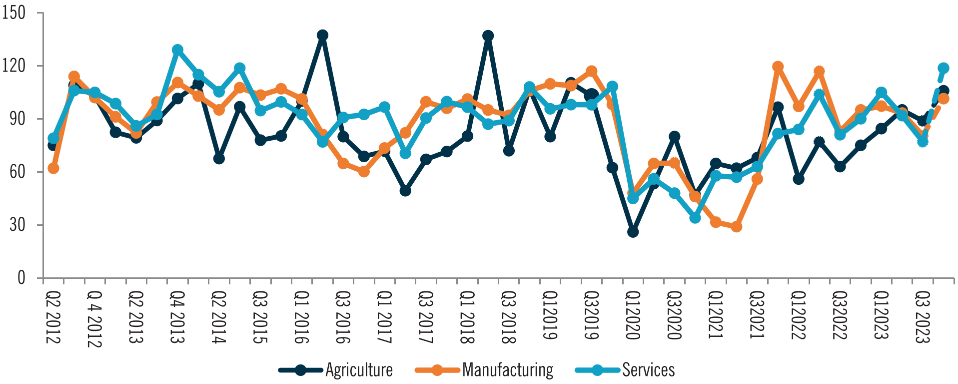


Figure 2 Business Climate Index by sector



Results

Conditions for doing business deteriorated, and the future outlook remains pessimistic.

During the quarter under review (July-September, 2023), the conditions for doing business declined significantly by 14 percentage points from 92 in the previous quarter to 78 in the current quarter (Figure 1). Insufficient demand, less favorable product prices, unfavorable macroeconomic factors, slowing regional markets, inadequate electricity supply, and unfavorable tax policy, are the reasons for the decline in the business environment sentiments.

The decline in the conditions for doing business is indeed evidenced by the decline in the GDP growth rate. The country's quarter-on-quarter GDP in the quarter under review grew by only 1.4 percent, compared to 5.2 percent in the previous quarter (Uganda Bureau of Statistics 2023).[1] Specifically, over the current quarter, the service sector GDP declined by 2.2 percent compared to a 6.5 percent growth in the previous quarter. In contrast, industry grew by 4 percent in the current quarter compared to 7.6 percent growth during the last quarter.

Additionally, the prevailing pessimistic global economic forecasts, projecting sluggish growth rates[2] of 2.7 percent and 2.5 percent in 2023 and 2024, respectively, coupled with the pronounced tightening of monetary policy in most developed countries, introduce heightened uncertainties into the business landscape.

The Business Climate Index by sector

In the quarter under review, the conditions for doing business deteriorated in all the three sectors under consideration, namely, the agriculture, service and manufacturing sectors as shown in Figure 2. The agriculture sector registered a decline of 6 percentage points, from 95 in the previous quarter to 89 in the current quarter. The manufacturing and service sectors registered further declines of 13 and 14.8 percentage points , from 93.4 and 91.8 to 80.4 and 77 respectively

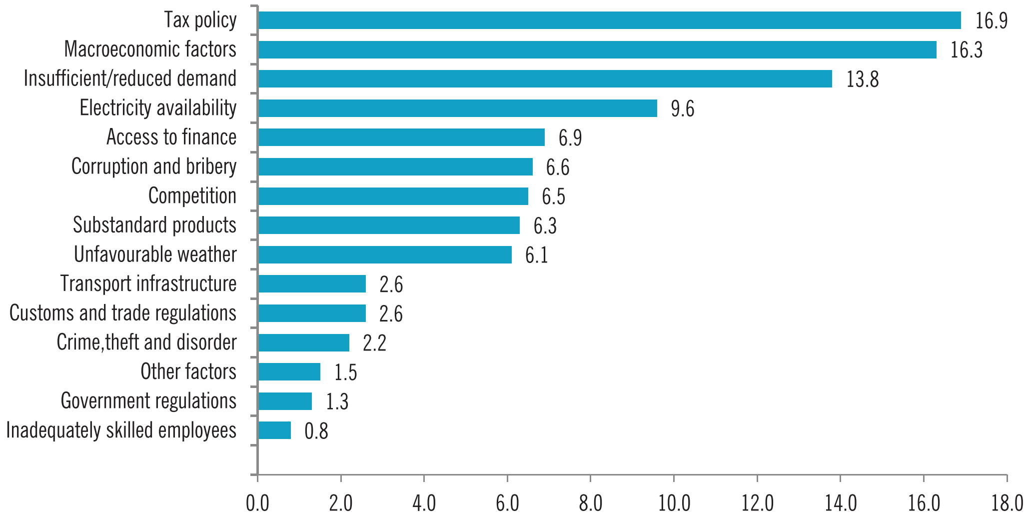
The decline in the conditions for doing business in the agriculture sector was mainly driven by high input costs and high product costs, resulting in lower profits. The onset of the mid-year dry season (June-September) also contributed to the decline in the agriculture sector. For instance, hot and dry conditions, especially in Southwestern and Central Uganda, affected livestock production due to diminished water and pastures for livestock. Insecurity and limited access to inputs for crop production exacerbated the effect of the mid-year dry season in the Karamoja region.

The deterioration in the manufacturing and service sectors could be attributed to the rise in the input costs (especially for imported inputs) emanating from the depreciation of the Ugandan shilling as well as the hike in the prices in early August 2023.[3] According to the July-September 2023 Key Economic Indicators Issue No 131 by UBOS, the decline in the manufacturing and services sectors over the quarter stemmed mainly from the decline in the growth rates of the construction activities, real estate and trade and repairs subsectors.

Challenges in doing business.

The top five most pressing constraints to doing business for the current quarter include unfavourable tax policy, macroeconomic factors, insufficient demand, electricity unavailability, and access to finance (Figure 3). These factors have persisted from the previous two quarters of January-March 2023 and April-June 2023. This implies that these business constraints are rather persistent. Other key constraints to doing business include corruption and bribery, competition, substandard products and unfavourable weather.

Figure 3 **Business Constraints (%)**



The unfavourable macroeconomic factors include the depreciation of the exchange rate, which increases the cost of imported inputs. For instance, the Uganda Shilling depreciated by around 1.3 percent against the US Dollar (from Shs 3689 per US Dollar in August to Shs 3738 per US Dollar in September).[4]

The evolution of business constraints

The major challenges to business operations for the current quarter under review are tax policy, macroeconomic factors, insufficient demand, and corruption (Figure 4). Most of these challenges remain unchanged compared to those reported in the previous quarters (January-March 2023, and April-June, 2023). Therefore, one can conclude that the challenges to doing business in Uganda are more or less consistent.

Future business outlook: October-December, 2023

In general, businesses are pessimistic about near-term developments. Figure 1 shows that sentiments are expected to drop by 1 percentage point, from 106 in the current quarter to 105 in the next quarter (October-December, 2023). The expected drop of the index to 105 is most likely driven by rising fuel prices and the exchange rate depreciation, consequently increasing the costs of imported inputs.

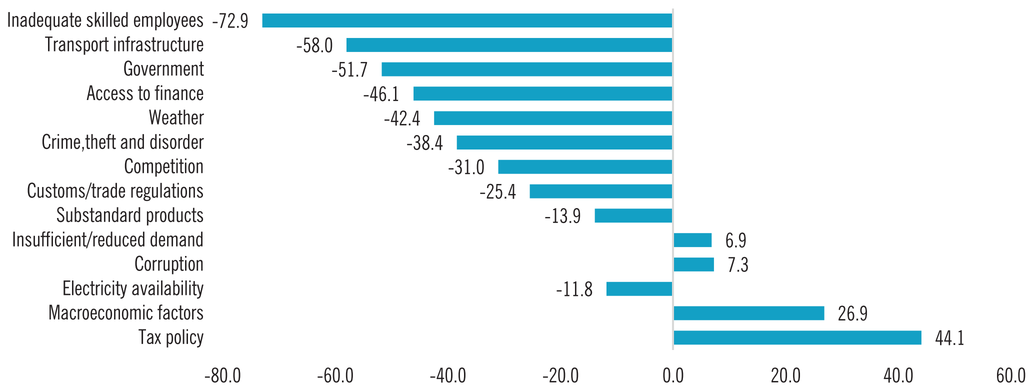
At the sectoral level, the Agriculture sector is expected to operate above its full potential, with a 17 percentage point improvement in the condition of doing business, increasing from 89 in the current quarter to 106 in the next quarter (Figure 2). This optimism stems from the expectation of sufficient second-season rains, which will improve crop and livestock production.

Additionally, future expectations about doing business by sector indicate that, compared to the quarter July-September, 2023, the conditions of doing business in the manufacturing sector are expected to improve by 21 percentage points, increasing from 80 in the current quarter to 101 in the quarter of October-December, 2023. In the same vein, there are expectations that the services sector will witness a notable improvement of 42 percentage points in the conditions for doing business, with an increase from 77 in the current quarter to 119 in the next quarter. The increase is mainly expected due to the favourable macroeconomic environment, which is essential for business activity to thrive. For instance, the annual core inflation declined from 3.3 percent in August to 2.4 percent in September, while headline inflation declined from 3.5 percent in August to 2.7 percent in September 2023.[5] Such an environment is of great vitality in anchoring business expectations and confidence among businessmen. On a positive note, the depreciation of the Ugandan Shilling against the Dollar is anticipated to increase demand for exports, thereby encouraging more production.

Question of the quarter

In this quarter, we sought to understand the extent to which businesses were affected by the protests in Kenya. Being a landlocked country, Uganda relies significantly on Kenya for exportation and importation, using the Mombasa port as the primary gateway for essential goods,

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

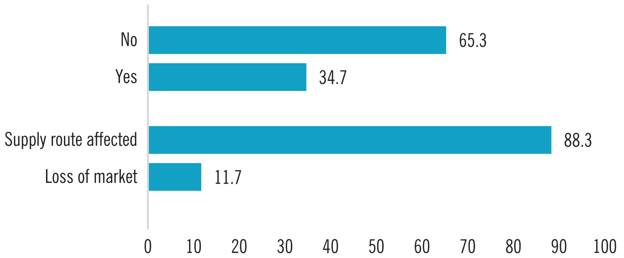


like fuel. Therefore, the riots could have disrupted cross-border trade flows and investments by causing cargo losses, damages, and delays.[6] Particularly, we asked (i), "*Have the protests in Kenya hindered the operations of your business*?" and (ii), "*If yes, how*?"

Figure 5 demonstrates that the protests in Kenya had an impact on at least 3 in every 10 businesses. Of those affected, 88.3 percent reported that their supply route was affected, which is clear evidence that the riots indeed paralysed the transportation of goods. Furthermore, the survey revealed that 11.7 percent of the impacted businesses reported a loss of market for their goods. This signifies that the protests disrupted the physical movement of products and had downstream effects on the market demand for these goods. The unrest influenced the decline in market share for some businesses. This highlights the secondary economic implications of the protests, especially on consumer confidence and purchasing behaviour.

The disruptions in the supply chain and the subsequent loss of market share collectively attest to the complex and interconnected consequences of social and political unrest on the economic fabric of a region. Understanding these dynamics is crucial for the rest of the East African Community partner states to put in place effective strategies for mitigating the occurrence and impacts of such events in the future within the region as a whole.

Figure 5 **The extent to which the protests in Kenya hindered business operations in Uganda**



Conclusion

Conditions for doing business in Uganda in the current quarter (July-September, 2023) declined significantly by 14 percentage points from 92 in the previous quarter to 78 in the current quarter. The decline in business environment sentiments can be attributed to insufficient demand, less favorable product prices, unfavorable macroeconomic factors, slowing regional markets, inadequate electricity supply, and unfavorable tax policy.

The Agriculture sector is expected to operate above full potential at the sectoral level, with a projected improvement of 17 percentage points in the condition of doing business. This improvement will result in an increase from 89 in the current quarter to 106 in the next quarter. This optimism is explained by the anticipated sufficient second-season rains, which will improve crop and livestock production.

Additionally, future expectations about doing business by sector indicate that, for the quarter of October-December 2023 we expect the conditions of doing business in the manufacturing sector to improve by 21 percentage points. The conditions are projected to increase from 80 in the current quarter to 101 in the quarter of October-December, 2023. Similarly, the conditions for doing business in the services sector are expected to improve by 42 percentage points, increasing from 77 in the current quarter to 119 in the next quarter. The increase is mainly expected to stem from the favorable macroeconomic environment that is necessary for business activity to prosper.

Like in the previous two quarters (January- March, 2023 and April-June, 2023), some business constraints persisted. In this regard, the persistent challenges to doing business in the current quarter are perceived unfavourable tax policy, macroeconomic factors, insufficient demand and corruption.

The projection for the next quarter (October-December 2023) shows an expected further decline in conditions of doing business from 106 to 105 despite being above full potential (above 100). The expected drop to 105 is mostly driven by rising fuel prices and the exchange rate depreciation, consequently increasing the costs of imported inputs.

The protests in Kenya affected 34.7 percent of the businesses surveyed, of which 88.3 percent reporting disruptions in their supply routes, indicative of paralysed transportation during the riots. Additionally, 11.7 percent of impacted businesses faced a loss of market for their goods, showcasing broader economic implications beyond physical logistics. This dual impact underscores the intricate consequences of social and political unrest on the region's economic landscape. Recognising these dynamics is crucial for East African Community partner states to devise effective strategies for preventing and addressing such events within the region in the future.

Endnotes

1 https://www.ubos.org/wp-content/uploads/publications/01_2024KEI_131st_Issue_Q1_2023-24_-(Jul-_Sep).pdf
2 https://www.investec.com/content/dam/united-kingdom/downloads-and-documents/wealth-investment/private-client/global-economic-overview/Global-economic-overview-September-2023.pdf
3 https://www.independent.co.ug/fuel-prices-rise-to-a-new-high-of-5400/
4 https://udbl.co.ug/UDB%20Uganda%20Macroeconomic%20Digest_SEPT.pdf
5 Monetary policy statement for September 2023, bank of Uganda accessed at https://ugbusiness.com/2023/10/uganda-economy/monetary-policy-statement-for-october-2023-bous-full-statement
6 https://www.monitor.co.ug/uganda/news/kenya-political-impasse-wrecks-economy-4305850

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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Acknowledgement

The Business Climate Survey team appreciates the support received from all participating business establishments across the country, our partners at the Uganda National Chamber of Commerce and Industry, Kampala City Traders Association and all persons who reviewed and edited this publication.

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