ECONOMIC POLICY RESEARCH CENTRE

*Towards Sustainable Development*

# The Uganda Business Climate Index

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## Closure of the Rwanda-Uganda Border and the delay in seasonal rainfall affects the business climate


### *Executive Summary*

*The Business Climate Index (BCI) declined by more than eleven basis points from 107.02 in the previous quarter (October-December 2018) to 95.61 in the current quarter (January-March 2019). The above changes were largely driven by deterioration in performance in the agriculture and service sectors. Business perception in the agriculture sector was affected by closure of the Rwanda-Uganda border and delay in onset of seasonal rainfall in most parts of the country. The negative effects of unfavourable weather on business climate were exacerbated by poor perceptions of labour availability, decreasing profits, reduced business activity, underutilization of capacity and unfavourable overall business environment during the quarter. Nonetheless, perceptions about future business sentiment (April – June 2019) indicate improvement in business performance largely driven by anticipated increase in profits, new businesses, capacity utilisation, decline in input costs, increase product cost, and general business optimism. Business sentiments across all sectors is to remain above potential in next quarter (April –June 2019).*


### 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 176 business establishments. The panel element has enabled us to track business environment in Uganda over time.

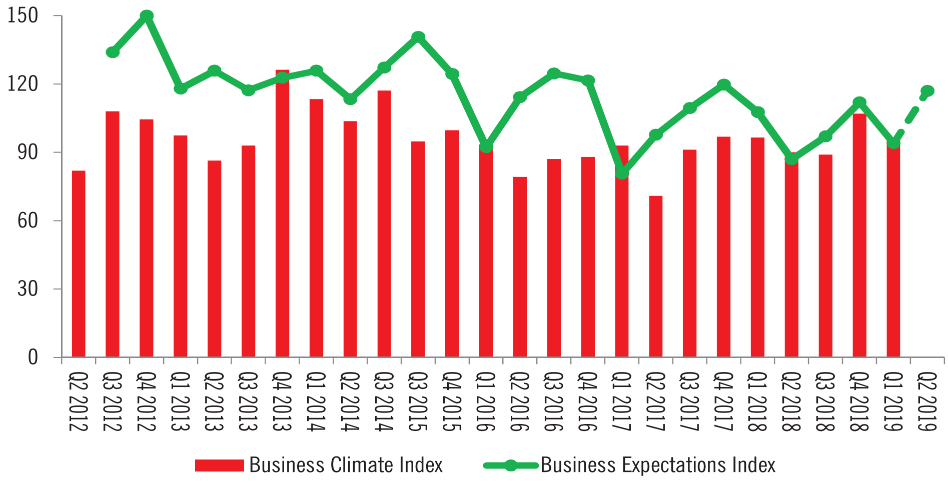
**Photo: Trucks Stranded at the Rwanda-Uganda Border**
*Source: The Observer, June 10, 2019*

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 as follows: "improved", "did not change", "declined" or "above normal for quarter", "normal for quarter", below normal for quarter" or "more favourable", "unchanged", "less favourable". These responses are coded as 0, 1, and 2 respectively. In this case, if a respondent's perception of the business environment is that it deteriorated, such a response would be coded 0, it would be coded 1 if the business climate did not change and 2 if the business climate improved.

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 a similar period a year earlier; and their expectations for the next quarter. Based on the business evaluation indicators explained earlier, the business climate index is computed as the weighted arithmetic mean of indices of the individual business evaluation indicators. The indices range from 0 – 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.

In addition, the index analyses the evolution of challenges facing businesses during January-March 2019 by identifying which business constraints are more of a problem and less of a problem. We also ask business managers to indicate how each of the identified business constraints have evolved over the last full year. For each of the business constraints we asked if it was

Figure 1: **The Business Climate Assessment**[1]




Note: Solid lines show period under review.

"more of a problem", "unchanged", or "less of a problem". The resultant weighted indices range from -100 to 100, with positive scores suggesting that a particular constraint is perceived to be more of a problem in the current quarter; negative scores imply that a constraint is less of a problem; and zero scores point to business constraint whose severity has remained unchanged.

## Results

### Business climate deteriorated, but perceptions about the future remain optimistic.

Results indicate that the Business Climate Index deteriorated by 11.14 percentage points to 95.61, during the current quarter (January-March 2019), from 107.02 points in the preceding quarter (October-December 2018). The downturn was on the backdrop of declining labour availability, decreasing profits, reduced business activity, underutilization of capacity and unfavourable overall business environment. The decline in Business Climate Index is largely attributed to closure of the Rwanda-Uganda border and delay in seasonal rains, which led to inflationary pressure. According to FEWS NET (2019), the delayed and below-average rains in the country are partly attributed to tropical cyclone ***Idai*** in southern Africa, which drove moisture away from the East Africa region.[1] The delay in the rains affected planting in most parts of the country and is thus expected to lead to a below average harvest. In addition, the below average rains have led to significant decline in agricultural labour demand and casual labour wages, reducing household income and food access (FEWS NET, 2019).[2]

Figure 1 also indicates that while current business prospects are unfavourable, business managers interviewed expect business perceptions to improve in the coming quarter (April – June 2019). This sentiment is largely driven by anticipated increase in profits, new businesses, capacity utilisation, decline in input costs, increase product cost, and general business optimism. This is expected of the second quarter of the year (April – June 2019) as business activity gradually increases.

### The Business Climate Index by Sector

During the current quarter, business sentiments deteriorated across all sectors, except manufacturing, when compared to the previous quarter. Perceptions of business conditions in the agriculture sector declined the most. The agriculture sector index posted a 26.84 points decrease to 79.94 from 106.77 points in the last quarter (Figure 2). As earlier noted, the decline in the agriculture sector was largely driven by the delay of the seasonal rainfall in most parts of the country. The negative sentiments in the agriculture sector were exacerbated by inadequate labour, decreasing sales turnover, increased input cost, fall in product cost, decline in profits, and deterioration in general business environment during the quarter. Only business optimism improved slightly by 14.6 percentage points.

Perception of business conditions in the services sector registered the second worst deterioration—a fall by 12.61 points to 95.67 from 108.27 in the previous quarter. The decline in the services sector came on the backdrop of declining business activity, decline in the profits, decline in labour availability, increase in salaries, and deterioration of the general business environment. In addition, a drastic reduction of flow of credit to the service sector in the quarter must have affected business activity significantly. According to the data from Bank of Uganda, flow of commercial bank credit to the service sector reduced to 6.3 billion in the current quarter from 58.3 billion in preceding quarter.[3]

In the manufacturing sector, business sentiments improved by 4.14 points to 109.79 in the current quarter from 105.66 in

1 http://fews.net/east-africa/uganda/key-message-update/march-2019

2 http://fews.net/sites/default/files/documents/reports/Uganda_FSOU_04_2019_Final.pdf

3 https://www.bou.or.ug/bou/rates_statistics/statistics.html

Figure 2: **Business Climate Index by Sector**

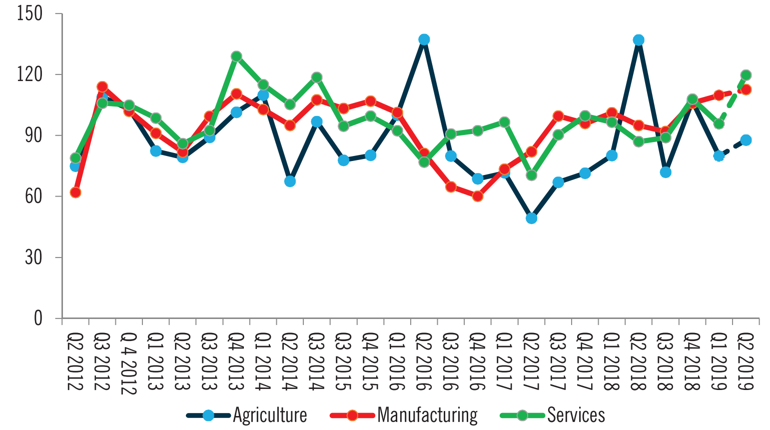
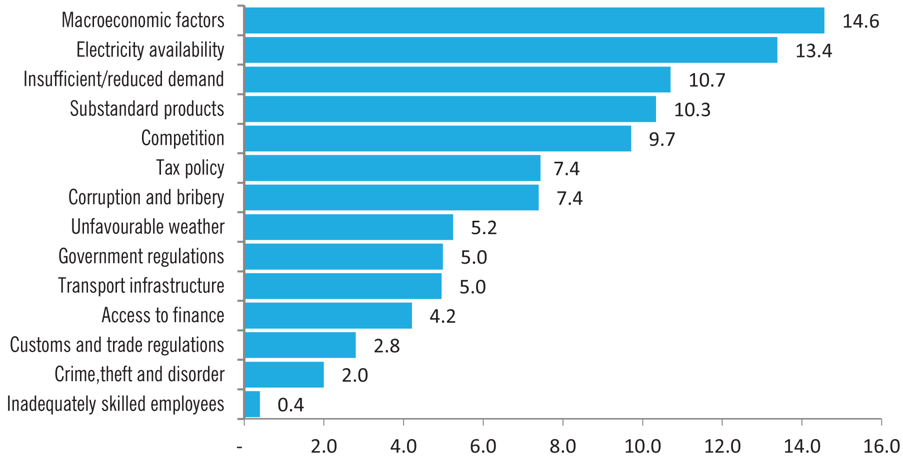



Figure 3: **Business Constraints, %**




the previous quarter. The improvement was on the back drop of high sales turn over, increase in new business activities, increased product costs, increase in business optimism, and reduced wages. The favourable sentiments in the manufacturing sector can be explained by favourable exchange rates. In this quarter, the domestic currency appreciated to UGX 3,694 from UGX 3,745 per unit of dollar in the previous quarter. In addition, the stable lending rates on both the domestic currency and dollar denominated loans supported business activity in the manufacturing sector. Prices of domestic currency denominated loans were relatively stable at 20.7 percent compared to 20.3 in the previous quarter. Meanwhile, dollar denominated loans became cheaper by 1.19 percentage points, from 8.18 to 6.99 in the current quarter.

## Challenges in doing business

The top three most important constraints for doing business for the current quarter were perceived to be worsening macroeconomic environment, electricity in-availability, and insufficient demand (Figure 3). The worsening in the macroeconomic environment is explained by relative increase in inflation. Between January and February 2019, food related inflation worsened by 0.8 percentage points but overall, inflation in the quarter was largely driven by core inflation which increased by 0.7 percentage points from 3.2 to 3.9 percent in the current quarter.

## How have the business constraints evolved over the last period?

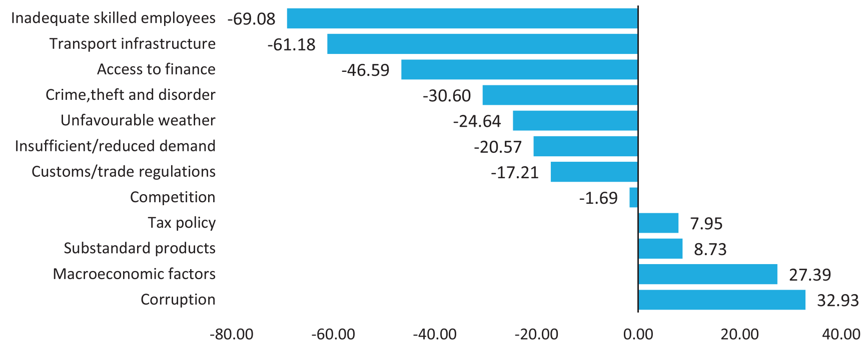
Unlike the previous quarter, where perceived unfavourable tax policy and high electricity cost became more of a problem, in the current quarter, tax policy, substandard products, and worsening macroeconomic environment became more of a problem. The downside macroeconomic conditions were due to inflationary risks exacerbated by delayed rains and the heat wave that hit some parts of the country. As earlier mentioned, weather conditions affected agriculture production and overall food prices. Inflation is also likely to be influenced by reduced export earnings resulting from trade disruptions particularly from border tensions with Rwanda as well as declining financial inflows from donors. The analysis further reveals that inadequate skilled employees, poor transport infrastructure, and constraints to finance were perceived to be less of a problem.

## Future business outlook: April – June 2019

Unlike last quarter, businesses are more optimistic about near term developments. The expected index for April– June 2019 is anticipated to be at 116.97, and this 23.13 percentage points above the current quarter’s expectation.

The expected improvement in the overall business climate is projected to be driven by improvement in all the sectors. The agriculture sector is expected to improve by 11.22 points from

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



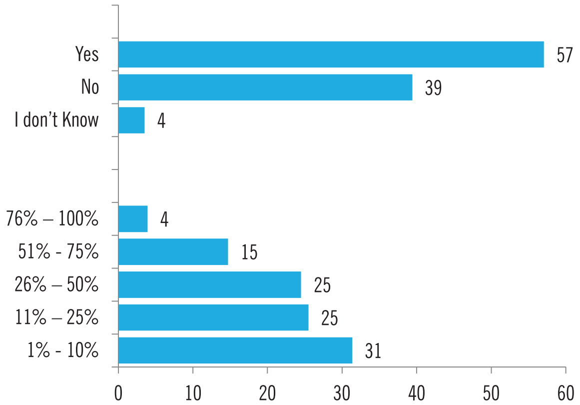

76.61 registered in the last quarter to 87.84 in the coming quarter. The manufacturing sector is expected to increase by 12.53 basis points from 100.10 recorded in the last quarter. Similarly, the service sector is expected to increase by 27.79 points from 91.99 recorded in the last quarter. The favourable business expectations in all the sectors are largely anchored on anticipated increase in new business, increase in capacity utilisation, a fall in input costs, increase in product cost, and increase in business optimism.

## Question of the Quarter

### Rwanda-Uganda border closure.

In this quarter, we sought to understand how the closure of Rwanda-Uganda border affected business activity. And if so by what proportion? We approached this by asking each business how the closure of Uganda-Rwanda border had reduced business activity in this quarter. In particular, we asked:

Figure 5: **Change in business activity due to Rwanda-Uganda border closure, %**




***Has the Rwanda-Uganda border closure affected business activity this quarter (January – March 2019)?***

Results in Figure 5 indicate that, overall, 57 percent of businesses reported a decline in the business activity as a result of the closure of Rwanda-Uganda. More than 80 percent of businesses reported a 50 percent decline in business activity.

## Conclusions

Perceptions about the business environment in Uganda deteriorated and stayed below potential, falling from 107.02 in the previous quarter to 95.61 in the current quarter. The agriculture sector registered the highest decline largely explained by delayed rains in most parts of the country. This points to the need for persistent investment on irrigation infrastructure. The performance of the service sector also deteriorated potentially due to decline in credit follow to the sector. On the other hand, business climate in manufacturing sector improved slightly by 4.14 points, largely driven by high sales turn over, increased new business activities, increased product costs, increase in business optimism and, and reduced wages. The future outlook is more optimistic compared to the current quarter. The optimism is projected to be driven by improvement in perceptions across all the sectors, driven by increase in new business, increase in capacity utilisation, a fall in input costs, increase in product cost, and increase in business optimism. With regards to constrains, tax policy, substandard products, and worsening macroeconomic environment became more of a problem in the current quarter. The inflationary pressure driven by disruptions in regional trade particularly with Rwanda point to a scope for pursuing diplomatic resolution of disagreements between the two neighbours.

*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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