ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

The Uganda Business Climate Index

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Nathan Sunday, Rehema Kahunde, Corti Paul Lakuma, and Brian Sserunjogi

Above potential performance in Agriculture and Service sectors improve business climate with a more optimistic future

Photo: Man weeding cabbage garden
Daily Monitor, May 22, 2019

Executive Summary

The Business Climate Index (BCI) slightly improved from 95.61 in the previous quarter (January-March 2019) to 100.28 in the current quarter (April-June 2019). These changes were largely driven by improvement in performance in the agriculture and service sectors. Favourable business perceptions in the agriculture sector are attributed to improved late season rains which lifted crop prospects in different parts of the country. The positive effects of rainfall on business climate were bolstered by improved perceptions of sales turnover, increase in business activity, incoming new business, reduction in inputs cost, and general business optimism during the quarter. Moreover, perceptions about future business sentiment (June–September2019) indicate further improvement in business performance largely driven by anticipated increase in sales turnover, business activity, labour availability, reduction in input cost, reduction in labour costs, and increase in profitability of businesses. Business sentiments across all sectors are expected to remain above potential in next quarter (June–September2019).

Data and methods

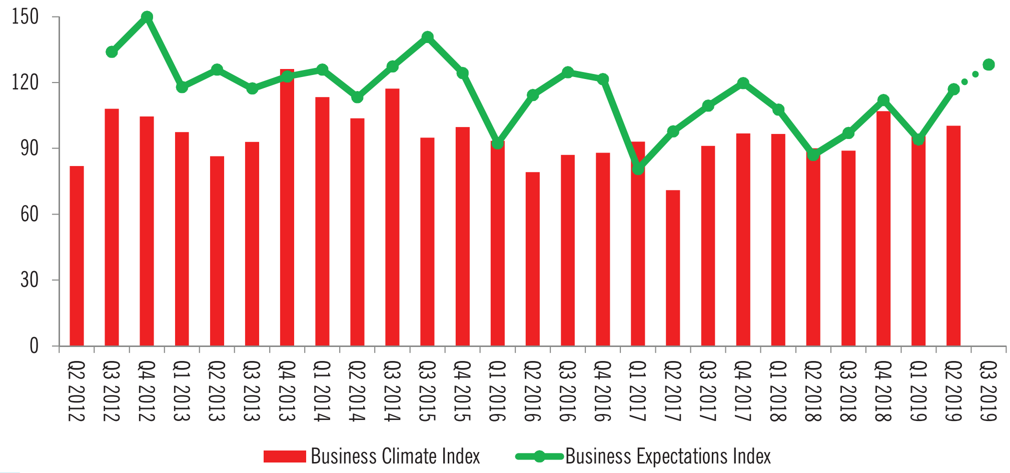
The data used in computing the Business Climate Index (BCI) is a panel of businesses based on the Uganda Bureau of Statistics Census of Business Establishment 2011, first tracked in 2012. This current quarterly bulletin covered 171 business establishments. The panel element has enabled us to track business 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 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 April-June 2019 by identifying the most pressing constraints. Specifically, 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 identified business constraints we asked if it either "more of a problem",

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



1 Solid lines show period under review.

"unchanged", or "less of a problem". A weighting system similar to what is described above is used in the analysis for the evolution of challenges.

Results

Business climate improved, and perceptions about the future remain optimistic.

Results indicate that the Business Climate Index improved by 4.67 percentage points to 100.28, during the current quarter (April-June 2019), from 95.61 points in the preceding quarter (January-March 2019). The improvement was on the backdrop of increased sales turnover, incoming new business, reduced input cost, increased business activity, and general business optimism. Figure 1 shows that the conditions for doing business improved. As earlier mentioned, this recovery is largely attributed to improved rainfall in late April 2019 which allowed planting in drought-affected northern and eastern and replanting of failed crops in central and southern parts of the country (FAO, 2019).[1]The improved late-season rains also lifted crop prospects in different parts of the country. In addition, increase in flow of credit particularly to the service sector also contributed to improvement in perception about business environment.

Figure 1 also indicates that business managers interviewed expect business environment to improve further in the coming quarter (July–September 2019). This sentiment is largely driven by anticipated increase in sales turnover, reduced labour cost, availability of labour, increase in business activity, and reduction in input cost. This is expected of the third quarter of the year (July–September 2019).

The Business Climate Index by Sector

During the current quarter, business sentiments improved across all sectors, except manufacturing, when compared to the previous quarter. Perceptions of business conditions in the agriculture sector improved the most. The agriculture sector index posted a 30.44 points increase to 110.38 from 79.94 points in the last quarter (Figure 2). As earlier mentioned, improvement in the agriculture sector was largely driven by improved rainfall. The positive sentiments in the agriculture sector were bolstered by improvement in general business environment, reduction in input costs, favourable output prices, high sales turnover and increase in new business during the quarter. Only capacity utilization and labour costs slightly deteriorated by 1.19 and 0.63 percentage points respectively.

Perception of business conditions in the services sector registered the second best improvement —a rise by 2.41 points to 98.07 from 95.67 in the previous quarter. Improvement in the services sector came on the backdrop of increase in business activity, increased sales turnover, improved capacity utilization, and new business activities. In addition, business activity in services sector must have been boosted by increase in commercial bank credit to the sector. According to Bank of Uganda, the stock of commercial banks credit to services sector increased by 489.3 billion between the current and previous quarter.

In the manufacturing sector, business sentiments marginally declined by 1.03 points to 108.76 in the current quarter from 109.79 in the previous quarter. The decline was occasioned by an environment of deterioration in the general business environment, unfavourable prices, declining business activity, high labour costs, and declining capacity utilisation. The unfavourable sentiments in the manufacturing sector can be explained by unfavourable exchange rates. In this quarter, the domestic currency depreciated to UGX 3745 from UGX 3,694 per unit of dollar in the previous quarter increasing the costs of imported inputs. In addition, the increase in inflation rates could have also affected business activity in the manufacturing sector by increasing the cost of production. According to the Uganda Bureau of Statistics (UBoS), the inflation rate increased from 2.9 percent in the previous quarter to 3.4 percent in the current quarter.

Challenges in doing business

The top three most important constraints (Figure 3) for doing business for the current quarter were perceived to be electricity

1 http://www.fao.org/giews/countrybrief/country.jsp?code=UGA

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

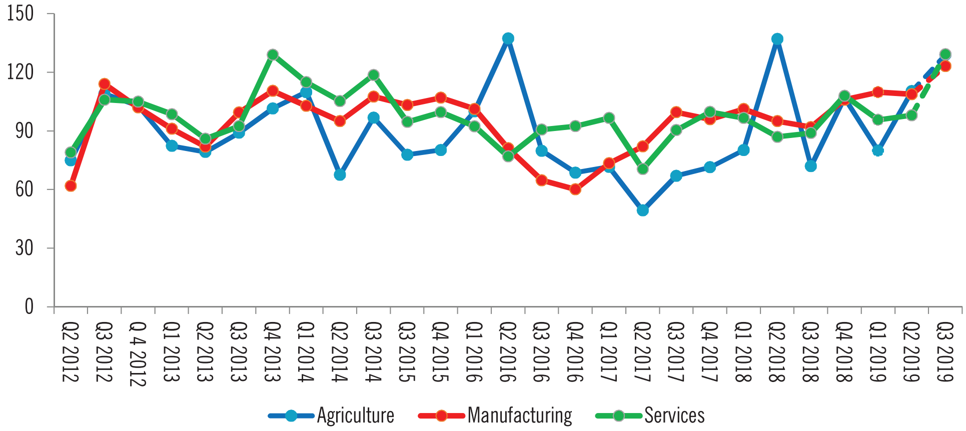
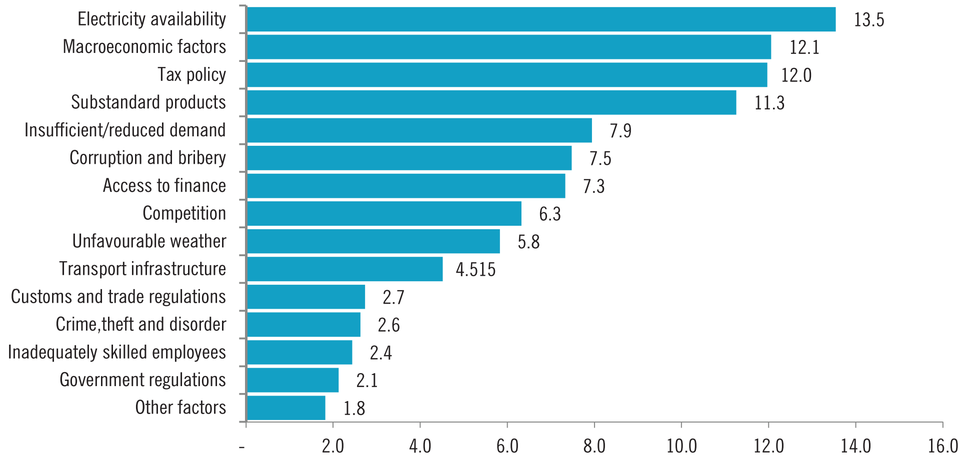


Figure 3: **Business Constraints, %**



in-availability, worsening macroeconomic environment, and unfavourable tax policy. The worsening in the macroeconomic environment is explained by relative increase in inflation and weakening of the domestic currency against the dollar. Between first quarter and the second quarter 2019, inflation worsened by 0.5 percentage points largely driven by core inflation which increased by 0.8 percentage points. As earlier mentioned, domestic currency depreciated as well.

How have the business constraints evolved over the last period?

Unlike the previous quarter, where perceived unfavourable tax policy, substandard products, and worsening macroeconomic were the most frequently cited problems, in this quarter, electricity in-availability and unfavourable macroeconomic environment, and corruption and bribery became more of a problem. Macroeconomic conditions—especially increasing prices and weakening of the domestic currency are likely to be influenced by reduced export earnings amidst constant demand for imports. Similar to the previous quarter, poor transport infrastructure and inadequate skilled employees became less of a problem in the quarter under review.

Future business outlook: July – September 2019

Similar to last quarter, businesses continue to be optimistic about near term developments. The expected index for July– September 2019 is anticipated to be at 128.16, and this 11.19 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 41.13 points from 87.84 registered in the last quarter to 128.97 in the coming quarter. The manufacturing sector is expected to increase by 10.64 basis points from 112.63 reported in the last quarter. Similarly, the service sector is expected to increase by 9.49 points from 119.78 reported in the last quarter. The favourable business expectations in all the sectors are largely anchored on anticipated increase in sales turnover, increased availability of labour, reduction in labour costs, increase in business activity, and reduction in input cost.

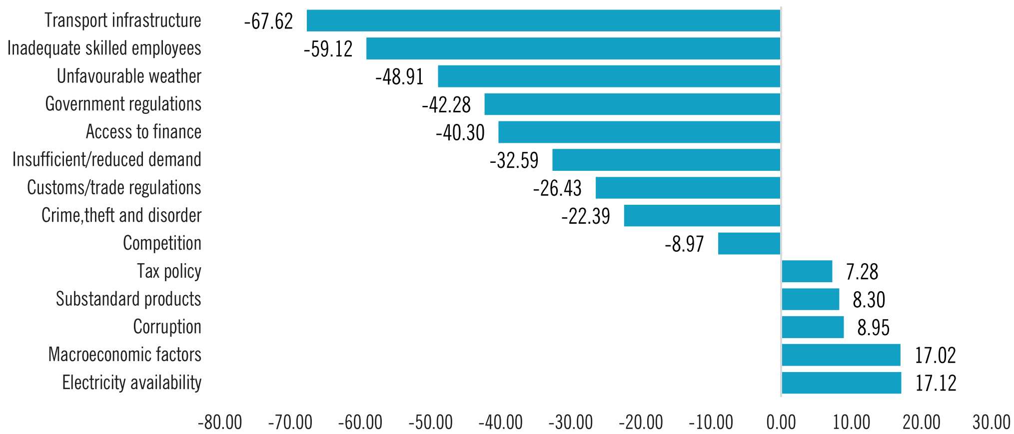
Question of the Quarter

Reduction in lending rates.

In this quarter, we sought to understand how the reduction in lending rates affected access to credit and business activity. And if so by what proportion? We approached this by asking each business whether the decrease in lending rates had increased access to credit and the proportion by which business activity increased as a result of increased access to credit. In particular, we asked:

Has the decrease in the lending rates increased your access to credit this quarter (April – June 2019)? By what proportion has business activity increased as a result access to credit?

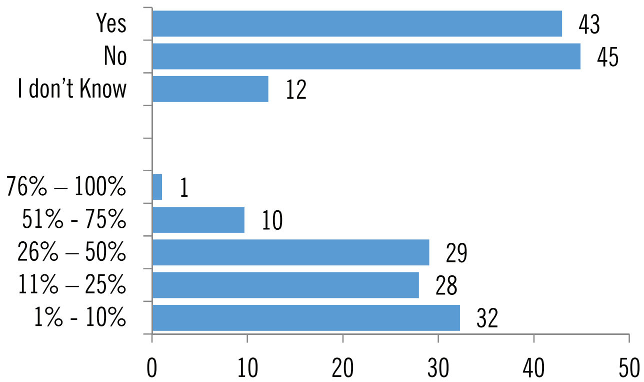
Figure 4: **The evolution of business constraints (% of businesses)**



Results in Figure 5 indicate that overall, only 43 percent of businesses reported that decline in lending rates increased their access to credit. This could be because the 1.23 percent reduction in lending rates (from 20.7 percent in the previous quarter to 19.5 percent in the quarter under review) was too small to bring about a big increase in access to credit (BOU data).[2] Furthermore, at least 40 percent of the businesses reported more than 25 percent increase in business activity as result of increased access to credit.

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

Figure 5: **Change in business activity due to increase in credit access, %**



Conclusions

Perceptions about the business environment in Uganda have slightly improved, raising from 95.61 in the previous quarter to 100.28 in the current quarter. The agriculture sector registered the highest improvement largely explained by improved rainfall in late April. The performance of the service sector also marginally improved due to increase in credit follow to the sector. On the other hand, business climate in manufacturing sector deteriorated slightly by 1.03 points, largely driven by unfavourable general business environment, unfavourable prices, declining business activity, high labour costs, and declining capacity utilisation. 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 business activity, high sales turnover, a fall in input costs, availability of labour, and decrease in labour cost. With regards to constraints, electricity in-availability, worsening macroeconomic and unfavourable tax policy became more of a problem in the current quarter. The increase in credit access and business activity linked to reduction in lending rates calls for measures to lower commercial banks' lending rates in Uganda

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.

Address
Economic Policy Research Centre
Plot 51, Pool Road, Makerere University Campus
P.O. Box 7841, Kampala, Uganda
Tel: +256-414-541023/4
Fax: +256-414-541022
Email: eprc@eprcug.org

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