

The escalation of the Ukraine-Russia war affects business operations, dampening Uganda's business climate.

Executive summary

The Business Climate Index (BCI) remained below full potential for the tenth consecutive quarter since the first quarter of 2020. The business perceptions in the current quarter (April-June) declined by 16 basis points from 80.1 in the previous quarter (January-March) to 64.1 in the current quarter (April-June). The below potential performance in business sentiment was primarily brought about by the unfavourable business environment, high input costs, and low product prices largely driven by the ongoing war in Ukraine and the sanctions imposed on Russia. In particular, the export bans destabilised the supply chains of essential products such as crude oil, natural gas, cereals (maize, rice and wheat), sunflower oil, and fertilisers leading to general price increases during the current quarter. Meanwhile, business perceptions in the services sector were more subdued relative to those of the agriculture and manufacturing sectors. This was because of a less favourable business environment, lower business activity, reduced product prices and high input costs. Business perceptions for the next quarter are pessimistic due to the anticipated low product prices, high input costs, low business optimism and turnover.



Source: Rising prices for cereals due to the Russia-Ukraine war, Photo: Daily Monitor, April 2022

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 (UBoS), Census of Business Establishment 2011, first tracked in 2012. Over time, the panel element has enabled us to track the business environment in Uganda. This current quarterly bulletin covered 170 business establishments. The BCI is computed based on the following business evaluation indicators: 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 wage. 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 the quarter", "normal for the quarter", "below average for the 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 deteriorated, we would code such a response 0; it would be coded 1 if the business climate did not change and 2 if the business climate improved.

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, the business climate index is computed as the weighted arithmetic mean of individual business evaluation indicator indices. The index does not consider the magnitude of change in the data but considers the general direction of movement in the key indicators. The index is sensitive to the direction instead of the magnitude of the change in business conditions. The indices range from 0 to 200. The interpretation of the BCI is such that if the score is above 100, it points to an improving business climate. Scores below 100 imply that the general business conditions are getting worse. And a score of 100 points for unchanged business conditions.

Also, the index analyses the evolution of challenges facing businesses during April-June 2022 by identifying which business constraints became more of a problem and less of a problem. For each of the business constraints, we asked if it was "more of a problem", "unchanged", or "less of a problem". We also ask business managers to indicate how each identified business constraint has evolved during the quarter. The resultant weighted indices range from -100 to 100, with positive scores suggesting that we perceive a particular constraint 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.

Findings

Business climate perceptions decline, and future outlook remains pessimistic.

Figure 1 indicates a decline in the conditions for doing business in the current quarter (April-June, 2022) by 16 percentage points to 64.1, from 80.1 in the previous quarter (January-March, 2022). The decline in the conditions for doing business in Uganda during the period under review resulted from a general deterioration in all sub-indices, namely, the product cost, input costs, capacity utilisation, and salaries, among others, that were all below potential (below 100). This indicates that, like the previous quarter (January-March 2022), the economy is operating at less than its full potential.

The decline in the index was driven primarily by the continued escalation of the Ukraine- Russia war that has continued to destabilise global supply chains, impacting prices of some food crops and fuel prices, consequently triggering inflation pressures that worsened the conditions of doing business in Uganda. In particular, the war exacerbated the prices of goods and services, input costs, capacity utilisation, salaries and reduced business optimism.

In addition, unfavourable macroeconomic factors, insufficient demand, unfavourable tax policy, and increased corruption and bribery continued to be the binding constraints to business competitiveness. It was reported to be more of a problem in the current period. Considering the unfavourable macroeconomic factors, Uganda's inflation during the quarter spiked by 6.8 percent (annual headline) and 5.5 percent (core inflation) in June (2022) compared to 2.7 percent and 2.3 percent, respectively, during the last quarter. In the same vein, the Uganda shillings depreciated by 3.1 percentage points against the dollar. Indeed, by June 2022, the government, through the Central Bank, responded to the ongoing inflation pressure by tightening the monetary policy to prevent a significant upward drift of inflation expectations.

Specifically, the Bank of Uganda (BOU) increased the Central Bank Rate (CBR) by 1 percentage point to 7.5 percent. In addition, the 7-day interbank weighted average rate rose by 54 basis points to 7.3 percent in the quarter to June 2022. The Bank of Uganda aimed the tightening monetary policy stance to controlling prices. However, high-interest rates made borrowing more expensive to the business community and reduced household purchasing power, dampening general economic activity.

Business climate index by sector

In the current quarter, the conditions for doing business across all three sectors (agriculture, manufacturing and services) were below full potential. While business sentiments in the manufacturing and service sector declined, there was a slight improvement in the perceptions of doing business in agriculture (Figure 2). In this regard, the agriculture sector increased by 3.7 points to 59.8 from 56.1 points registered in the previous quarter. On the other hand, the manufacturing sector decreased by 6.2 points to 90.8 from 97.0 registered during the last quarter. Similarly, the service sector declined immensely by 22.8 points to 61.4 from 84.2 points in the previous quarter (January-March, 2022). The improved performance of business perceptions in the agriculture sector in the current quarter was attributed to the ability to start a new business, capacity utilisation, and better product prices of agricultural goods.

Similarly, business sentiments in the manufacturing and services sector declined in the current quarter compared to the previous one (January-March, 2022) because of the unfavourable business environment, fall in business activity, low product pieces, and low business turnover, among others. The escalating war in Ukraine could have amplified the service sector's negative performance since it resulted in imported inflation, which substantially hiked the general prices of goods and services in the economy. Indeed, the Bank of Uganda's (BOU) Monetary Policy Committee (MPC) increased the CBR from 6.5 percent to 7.5 percent, thus making credit access and investment difficult hence dampening the service sector.

Figure 1 The Business Climate Assessment

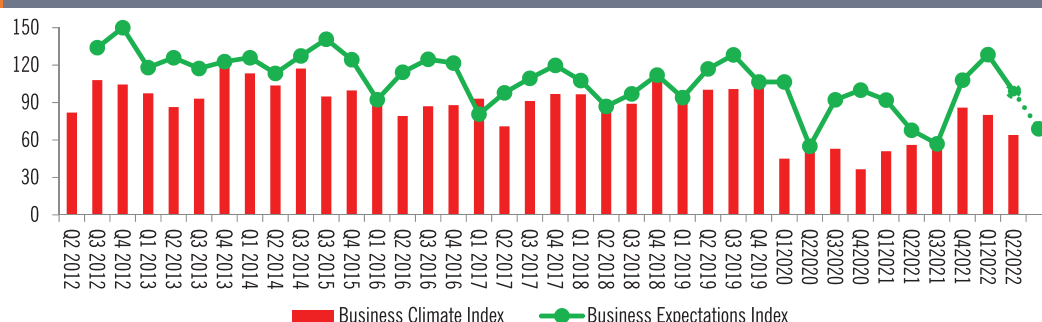
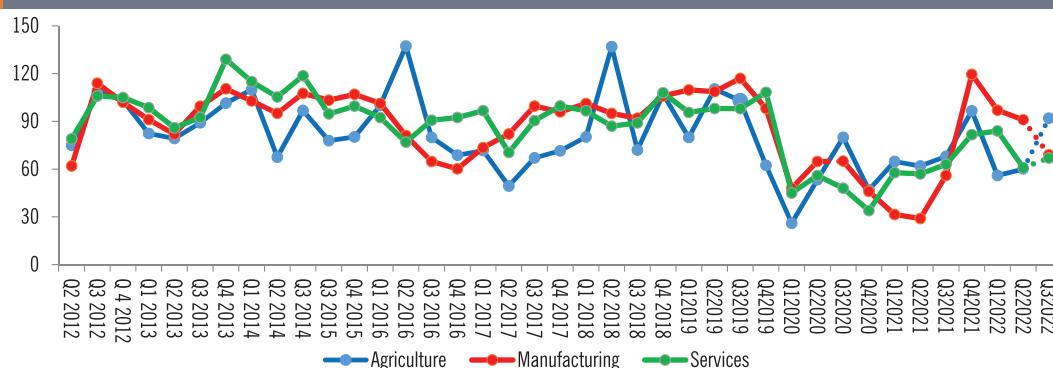


Figure 2 Business Climate Index by Sector



Challenges in doing business

In contrast to the previous quarter (January-March, 2022), the top five most pressing constraints to doing business for the current quarter include; macroeconomic factors and insufficient demand (Figure 3). This was alongside the persistent business challenges (unfavourable tax policy, corruption and bribery, electricity unavailability, inadequate transport infrastructure). These have not changed since last quarter. This suggests that Ugandan businesses' primary policy and regulatory constraints are rather persistent. As mentioned above, the observed macroeconomic volatilities could have been amplified by the escalating Ukraine-Russia invasion that has exacerbated global demand-supply imbalances, which heightened the energy, firm inputs prices and exchange rate volatilities.

Similarly, insufficient demand could have emanated from the rise in commodity prices. According to UBOS, inflation increased to 6.3 percent, up from 4.9 percent in April, resulting from the rise in fuel prices by nearly 55 percent. The registered surge in essential commodity prices was against a backdrop of the escalation of the Russia-Ukraine war and the pandemic-related supply chain distortions, especially in Asia¹. In addition, the shilling-dollar exchange rate was more volatile in the quarter under review on a depreciation path, with heightened depreciation in June 2022. According to the Bank of Uganda, the Uganda Shilling lost 3.1 percent of its value to the US dollar month-on-month and 5.8 percent year-on-year in June 2022. This was at the back of bearish sentiments occasioned by the tightening of monetary policy by the United States central bank (The Fed), causing nervousness amongst the offshore investors in Uganda².

How have the business constraints evolved over the last period?

Similar to the previous quarter (January-March, 2022), macroeconomic factors, unfavourable tax policy, and insufficient demand were major challenges to doing business in the current quarter (Figure 4). This

indicates the persistence of some of these challenges from the previous quarter. In addition, firms reported electricity unavailability to be more of a problem in the current quarter.

The global economy still yet to recover from the COVID-19 pandemic has been set back further by the war, resulting in a downward revision of the macroeconomic growth forecasts. Imbalances in the macroeconomic factors could be explained by rapid weakening of the Uganda shilling against the US dollar coupled with rising food and energy prices that worsened the inflation outlook in the current quarter. As a consequence, higher business costs are likely to spread into consumer prices, thereby pushing inflation higher in the coming months. Indeed, the Bank of Uganda statistics indicate that annual headline and core inflation are now forecast to average 7 percent and 6.1 percent, respectively, in 2022, which is higher than earlier projections. In addition, inflation is projected to peak in the second quarter of 2023 before gradually declining to stabilise around the medium-term target of 5 percent by mid-2024.

Future business outlook: July-September 2022

Like the previous quarter, businesses are pessimistic about near-term developments. The expected index for July-September is 68.6 (Figure 1) and is 30.5 index points lower than the current quarter's expectation which is 99.1 points. Generally, the decline in the conditions of doing business in the next quarter are expected to relapse most from anticipated low product prices, high input costs, low business optimism and capacity utilisation.

The anticipated favourable sentiments for doing business in the agriculture sector are attributable to the anticipated improvement in business activity, business turnover, profits, capacity utilisation and business optimism. However, sectoral differences in the expected business environment exist. In this regard, lower business confidence

Figure 3 Business Constraints (%)

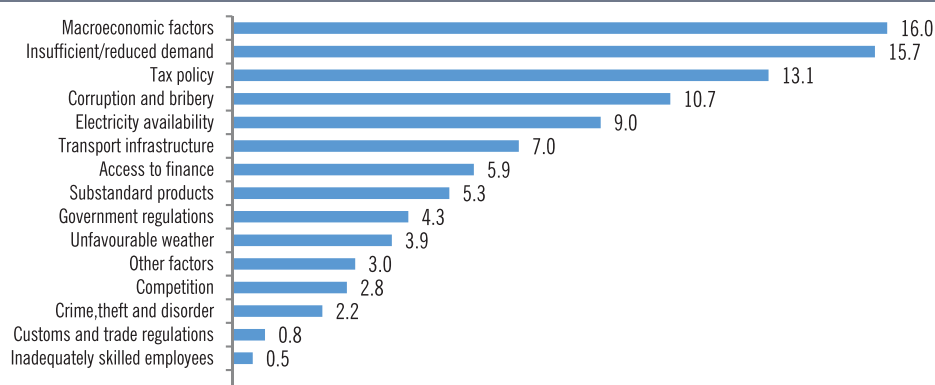


Figure 4 The evolution of business constraints (% of businesses)

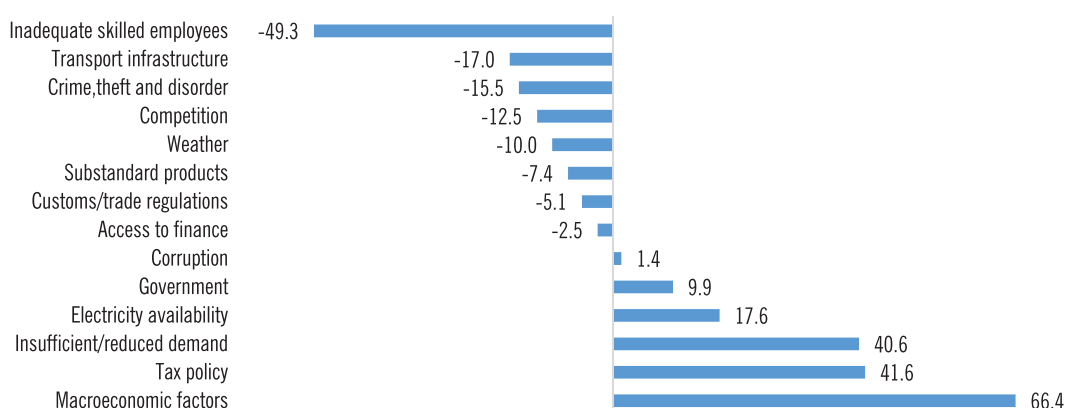
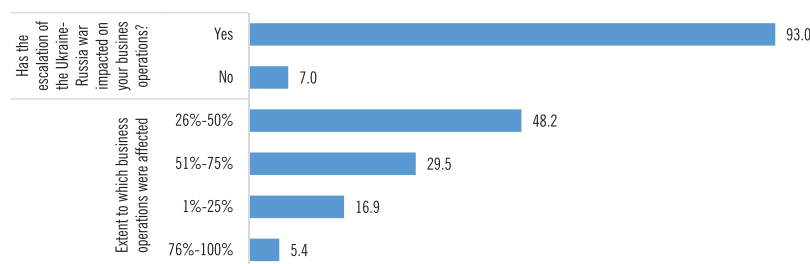


Figure 5 Effect of the escalation of the Ukraine-Russia war on business operations in Uganda, %

is expected in the manufacturing and service sectors than in agriculture. In particular, the service sector is anticipated to suffer more than the manufacturing sector, while the agriculture sector is expected to have a sharp improvement. The expected indices are 91.9, 68.9, and 67.1 for agriculture, manufacturing and services.

In contrast, the expected unfavourable business environment in the manufacturing and service sectors is anchored around the anticipated deterioration of the general activity, product prices, optimism, reduction in capacity utilisation, and high input costs exacerbated by the escalation of the conflict between Russia and Ukraine which has resulted into heightened global supply chain disruptions and economic uncertainty.

Question of the quarter

Effect of the escalation of the Ukraine-Russia war on business operations

In this quarter, we sought to understand the impact of the Ukraine-Russia war on business operations and the extent to which business operations were affected.

In particular, we asked: (i) “Has the escalation of the Ukraine-Russia war impacted your business operations?” (ii) “If Yes, by what percentage?”

Results (Figure 5) indicate that most businesses in our sample (93 percent) were adversely affected by the Ukraine-Russia war. Among the firms affected by the war, 48.2 percent reported that their business operations were affected by 26 and 50 percent. Meanwhile, 29.5 percent of the firms reported that their business operations declined by 51 and 75 percent. In addition, 16.9 percent of firms reported a decrease in business operations by less than 26 percent. Indeed, most of the businesses reported having been affected by the escalation of the Russia-Ukraine war are in the service sector. Therefore, the government needs to adopt targeted interventions that lower the cost of doing business, such as increasing access to affordable credit and long-term finance for Small and medium enterprises (SMEs) and large enterprises while managing debt and rising inflation.

Conclusions

Perceptions about doing business in Uganda in the current quarter (April-June 2022) worsened compared to the previous quarter (January-March 2022). The decline in the conditions for doing business was due to the relapse of all sub-indices, namely business environment, turnover, input costs, product prices, and optimism, among others, being all below potential (below 100). This reflects poor business environment performance caused by the escalation of geopolitical conflict in Ukraine that has disrupted the supply of essential commodities such as fuel, cereals, fertilisers, and sunflower oil, which increased the overall cost of doing business in the current quarter.

Just like in the previous quarter, some business constraints persisted. In this regard, macroeconomic factors, insufficient demand, unfavourable tax policy, unreliable electricity, poor transport, corruption and bribery were critical constraints to business competitiveness in the current quarter (April-June, 2022). Considering future expectations, business sentiments for the next quarter (July-September 2022) will deteriorate in the manufacturing and services sector; however, positive sentiments in the agriculture sector are expected. The next quarter will see below-potential sentiments for all the sectors, with the lowest expectations in the service sector. The expected unfavourable business perceptions in the service sector are anchored around the anticipated deterioration of product prices, turnover, high input costs, low business optimism, reduction in capacity utilisation, and high labour costs, possibly signalling business risks associated with the persisted Russia-Ukraine conflict. Considering the effect of the escalation of the Ukraine-Russia war on business operations, most businesses suffered a decline in business operations because of the high commodity prices and the increased cost of doing business during the quarter under review. Therefore, the government needs to adopt targeted interventions that lower business costs, such as increasing access to affordable credit and long-term finance for SMEs and large enterprises while managing debt and rising inflation.

Endnotes

- <https://www.monitor.co.ug/uganda/business/prosper/economic-managers-wait-and-see-mode-as-soaring-prices-bite-3840940>
- <https://www.bou.or.ug/bou/bouwebsite/bouwebsitecontent/publications/QuarterlyStateofEconomy/publications/Quarterly-Economic-Reports/2022/Jun/SOE-report-June-2022-Final.pdf>

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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