Towards Sustainable Development

The Uganda Business Climate Index

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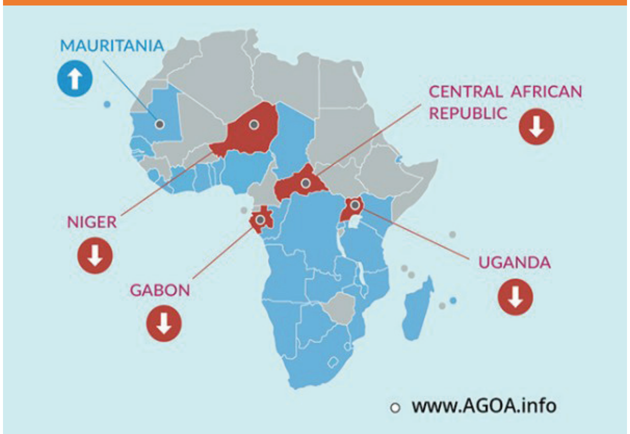
Business sentiments decline as the suspension of Uganda from the Africa Growth Opportunity (AGOA) Act eligible countries bites.

Executive Summary



Source: AGOA.info

The Business Climate Index (BCI) declined by 11 points from 109 in the previous quarter (October-December 2023) to 98 in the quarter under review (January to March 2024). The drop in capacity utilization, increase in input costs, low profitability, and decline in the general business environment are the factors attributed to this decline in business environment sentiments. At the sectoral level, the sentiments for doing business in the service sector improved by 17 points from 83 in the previous quarter to 100 points in the quarter under review. In the same light, the indices for the agriculture and manufacturing sectors increased from 77 and 96 to 82 and 100 points, respectively. As expected, the major business constraints were the same as those reported in the previous quarters, including unfavourable tax policy, macroeconomic factors, insufficient demand, electricity unavailability, and access to finance. Over the quarter, there was an increase in the severity of tax policy, unfavourable macroeconomic environment, crime, theft and disorder, transport infrastructure, corruption, and insufficient demand as business constraints. The projections for the next quarter indicate that conditions for doing business are expected to decline further, with the index decreasing from 103 to 97. In particular, the service, manufacturing, and agricultural sectors are expected to experience a decline in business sentiments from 100, 100, and 82 to 95, 87, and 78 respectively. The suspension of Uganda from AGOA was cited as an issue of concern by 48 percent of businesses surveyed, of which 46 percent reported their businesses might experience a loss in the market, while 54.3 reported a loss of investment partners.

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 overtime to track the business environment in Uganda.

The following indicators are used to compute the BCI: 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”. 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 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.

The period should be Jan-Mar 2024, not April-June 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 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.

Figure 1 **The Business Climate Assessment**

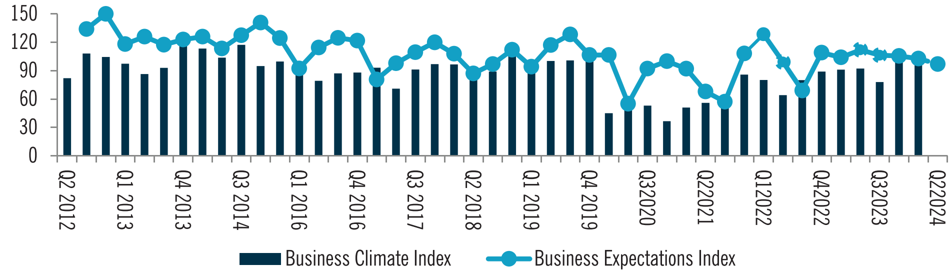
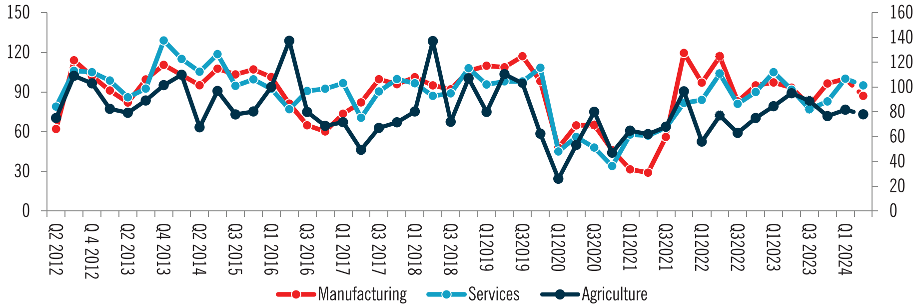


Figure 2 **Business Climate Index by sector**



Results

Conditions for doing business deteriorated over the quarter under review and the future outlook remains pessimistic.

During the quarter under review (January-March 2024), the conditions for doing business declined by 11 points, from 109 to 98 (Figure 1). The decline in business environment sentiments occurred due to factors such as the decrease in capacity utilization, increase in input costs, low profitability, and deterioration in the general business environment. Unlike the previous quarter (October to December 2023), the economy operated at less than full potential since the index for the quarter under review is less than 100.

The decline in business conditions can also be partially blamed on the increase in annual headline inflation. This rise in inflation was primarily driven by higher costs in two key areas: services and food crops, as well as a notable increase in the price of liquid fuels compared to the same period in the previous year. Specifically, headline inflation rose by 0.8 percent, moving from 2.6% in the previous quarter (October-December 2023) to 3.4% in February 2024. This increase in the general price level led to a decline in consumer demand, reflecting the broader impact of rising inflation on economic activity.

The Business Climate Index categorized by sector.

Across the three sectors tracked by the BCI (agriculture, manufacturing, and services), the conditions for doing business improved in the quarter under review. The service sector experienced the highest improvement in business sentiments, with the agricultural and manufacturing sectors following suit. Precisely, the sentiments for doing business in the service sector improved by 17 points from 83 in the previous quarter to 100 points in the quarter under review. In the same light, the indices for agriculture and manufacturing sectors improved by 5 and 4 percentage points respectively, from 77 to 82 and 96 to 100, see Figure 2.

The improved service sector performance is a result of a rise in turnover, a boom in business activity, and an increase in profitability. On the other hand, the improvement in the manufacturing sector is attributed to increase in capacity utilisation and reduced production costs.

In the agricultural sector, the business sentiments remained below full potential despite registering an improvement. The slight improvement in the conditions for doing business in the sector was mainly driven by improved labour availability, reduced labour costs, a rise in profits, and the favourable weather conditions especially the sufficient rains in most parts of the country during second planting season (July-December 2023), which resulted in higher harvests.

Challenges in doing business.

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

Figure 3 **Business Constraints (%)**

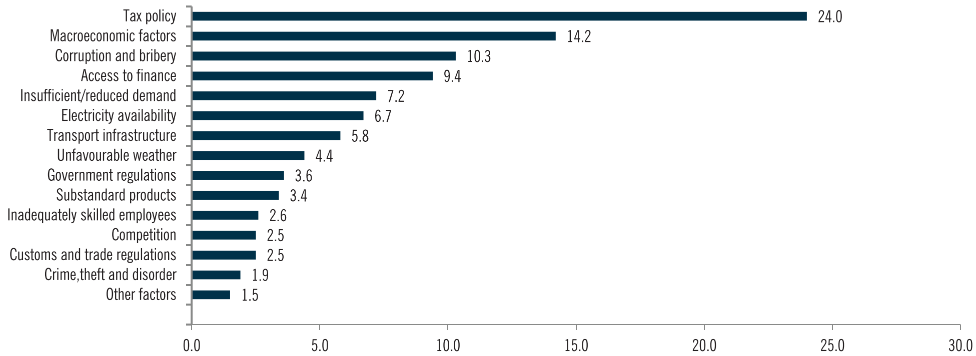


Figure 4 The evolution of business constraints (% of businesses)

last quarter, October -December 2023, implying that some business constraints are rather persistent.

The evolution of business constraints

The results (Figure 4) indicate that the severity of the top two business constraints (Figure 3) faced by businesses increased over the quarter under review. Unlike the previous quarter, the severity of crime, theft and disorder, transport infrastructure, corruption and insufficient demand also increased during the quarter under review. Conversely, competition, weather, government, regulations (customs/trade), substandard products, access to finance, inadequate skilled employees and electricity availability became less of a problem during the quarter under review.

Future business outlook: April-June-2024

Projections indicate businesses are more pessimistic about near-term developments than they were in the previous quarter. The business expectations index for next quarter i.e April-June 2024 is 97, which is below the full potential mark (100) and is 6 index points less than the quarter under review (Figure 1). In particular, it is expected that business sentiments across all three sectors will decline and remain below their full potential in the next quarter. Specifically, the expected indices for these sectors are 95 for services, 87 for manufacturing, and 78 for agriculture compared to the 100 for both services and manufacturing, and 82 for agriculture (Figure 2). These results clearly indicate a forecasted underperformance in business sentiments across all sectors for the next quarter.

The expected underperformance in the next quarter could be attributed to several factors, including the uncertainty surrounding the global economic outlook, shilling depreciation, and tight domestic financial conditions, which may dampen domestic demand. Additionally, the short-term inflation projections by the Bank of Uganda shows that inflation is expected to exceed the target level (5 percent). This is because of rising geopolitical tensions in the Middle East that may disrupt the supply chain, the possibility of rising energy prices, tightening global financial conditions that may cause a further depreciation of the shilling exchange rate, and adverse weather patterns[1].

The anticipated inflation hike has significant repercussions for both the demand and supply sides of the economy. On the demand side, it may dampen household real incomes, leading to reduced consumer spending and negatively impacting various businesses reliant on domestic consumption. Conversely, on the supply side, increased inflation is likely to elevate the costs of essential inputs, which could squeeze profit margins, hence frustrating business operations.

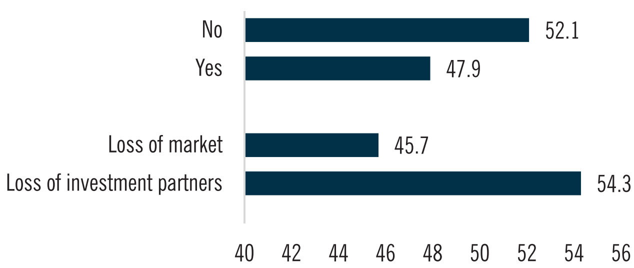
Question of the quarter

In this quarter, we sought to understand the extent to which Uganda's suspension from the African Growth Opportunity (AGOA) Act eligible countries affected businesses. Following the enactment of the Anti-homosexuality Act (AHA) on 26 May 2023, the United States, in retaliation, suspended Uganda and three other African countries from this scheme in December 2023. AGOA, a U.S. trade initiative, provides eligible Sub-Saharan African countries duty-free access to U.S. markets for a wide range of products.

Therefore, the suspension of Uganda from the list of countries eligible for AGOA trade could have had significant effects on businesses-especially because Ugandan businesses may lose their duty-free access to the U.S. market, making their exports more expensive and less competitive compared to those from countries still covered under AGOA. This could have led to reduced export volumes and potential loss of market share in the U.S., a key trade partner. In addition, with the higher tariffs imposed on Ugandan goods entering the U.S., export revenue from key sectors such as textiles, apparel, and agricultural products could have declined. This probable revenue loss has a ripple effect on businesses, including reduced profitability and investment. Particularly, we asked (i) "Has the suspension of Uganda from the African Growth Opportunity Act (AGOA) affected your business?" (ii) "If Yes, why?"

Results indicate that 48 percent of businesses were affected by the suspension of Uganda from the AGOA Act-eligible countries (Figure 5).

Figure 5 The extent to which the suspension of Uganda from the African Growth Opportunity (AGOA) Act has had an effect on businesses



1 Monetary policy statement by the Bank of Uganda, April 2024.

The relatively large share is explained by the fact several businesses are benefiting indirectly from AGOA Act provisions such as hotels- many of whom depend on American tourists. Of those affected, 46 percent reported that their businesses experienced a loss in the market, while 54.3 reported a loss of investment partners. The loss in sales/ market could be due to the fact that the Ugandan businesses lost their duty-free access to the U.S. market, which made their exports more expensive and less competitive compared to those from countries still covered under AGOA.

Conclusion

Conditions for doing business in Uganda declined by 11 index points, from 109 in the previous quarter (October-December 2023) to 98 in the quarter under review. The decline in business environment sentiments is attributed to the decline in capacity utilization, increased input costs, low profitability, and the decline in the general business environment.
The service sector registered the highest improvement in business sentiments, followed by the agricultural sector and then the manufacturing sector. Precisely, the sentiments for doing business in the service sector improved by 17 points from 83 in the previous quarter to 100 points in the quarter under review. In the same light, the indices for agriculture and manufacturing sectors improved by 5 and 4 points, up from 77 and 96 to 82 and 100 points respectively. The improvement in sectoral performance is mainly attributed to the rise in turnover, a boom in business activity, a rise in profitability, increased capacity utilization, and reduced production costs.

Similar to the previous quarter (October – December 2023), some business constraints persisted. In this regard, the persistent challenges to doing business in the quarter under review are perceived unfavourable tax policy, macroeconomic factors, insufficient demand, electricity unavailability, corruption and bribery.

The projection for the next quarter (April-June 2024) shows an expected decline in conditions of doing business by 6 index points from 103 to 97 points. Business sentiments across all three sectors are expected to decline and remain below their full potential in the next quarter, with the anticipated indices for these sectors being 95 for services, 87 for manufacturing, and 78 for agriculture, compared to 100 for both services and manufacturing and 82 for agriculture. The anticipated underperformance could be attributed to several factors, such as the uncertainty surrounding the global economic outlook, shilling depreciation, and tight domestic financial conditions, which could dampen domestic demand and the expected rise in inflationary pressures. The suspension of Uganda from AGOA affected 48 percent of businesses surveyed. Of these affected, 46 percent reported their businesses will most likely experience loss markets, while 54.3 reported a potential loss of investment partners.

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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