

Lack of information is affecting business operations under the Africa Continental Free Trade Area.

Executive Summary

The Business Climate Index (BCI) improved from 89 in the previous quarter to 91 in the current quarter under review (January to March 2023). Despite the improvement, the conditions for doing business remained below potential. Input costs, production cost, activity, turnover, capacity utilisation and profit drive the improvement. The improvement is across all sectors, with the agriculture sector having the biggest improvement. In the current quarter ended March 2023, Tax policy, macroeconomic factors, insufficient demand, electricity availability, and access to finance was the major constraint to business operations. These same challenges prevailed in the previous quarter ended in December 2022, indicating that business changes in Uganda are persistent. The next quarter's projections indicate that the condition for doing business is expected to improve to 111.9, which is above its full potential. This comes against a backdrop of the expected improvement in all sub-indices and a further easing of global inflation pressures. The manufacturing sector is projected to have the greatest improvement in the conditions of doing business, followed by the services sector and agriculture sector, respectively. The projected indexes for the manufacturing, service, and agriculture sectors are 116, 112 and 93, respectively. Notably, many of the businesses lack sources of information about the African Continental Free Trade Area (AfCFTA), and, most of them are unaware of the AfCFTA. As a result, many are most likely to attain very little gains from trading under AfCFTA.



AfCFTA

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 144 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". 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 means of individual business evaluation indicator indices. The indices range from 0 – 200. The interpretation of the BCI is such that it scores above 100, pointing 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 January-March 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.

Results

Conditions for doing business improve, and the future outlook remains optimistic.

During the current quarter under review (January-March 2023), the conditions for doing business improved by 2 percentage points to 91 (Figure 1). The improvement is attributed to the general improvement in most of the business sub-indices: input cost, product cost, capacity utilisation, activity, turnover, profit, and optimism. Despite the improvement in conditions for doing business, the economy is still operating at less than its full potential, just like the previous quarter (October- December 2022).

The improvement in the condition for doing business is also attributed to the decline in the average exchange rate during the quarter, where the average exchange rate for the previous quarter was UGX 3,757.8 per dollar compared to the UGX 3,709.3 per dollar for the quarter under review. As a result, the more favourable exchange rate reduced the cost of acquiring inputs and products, especially those exported from cross borders. In addition, it has also improved sub-indices such as capacity utilisation, activity, turnover, profit, and optimism.

There was a decline in headline and core inflation during the quarter compared to the previous quarter. Headline inflation declined from 10.5 percent in the quarter ending December 2022 to 9.5 percent in the quarter under review. Similarly, the core inflation declines from 8.7 percent in the previous quarter to 8.1 percent in the quarter under review. The decline stimulated more demand for goods and services; as a result, businesses could sell more during the quarter¹.

The improvement is linked to the changes in the global market, for example, the decline in energy prices, especially the average crude oil price, which edged down by 11.6 percent in the period, the decline in natural gas and coal prices by 35.6 percent and 10.4 percent and non-energy prices declined by 1.5 percent over the same period, as food,

and raw material prices continued to decline².

The business climate index by sector

During the current quarter, the conditions for doing business improved across all sectors, i.e., agriculture, manufacturing, and services sector, albeit variations in the improvement (Figure 2). The agriculture sector had the greatest improvement in the condition for doing business of 9.2 percentage points to 84.5 in the current quarter. The manufacturing sector and the services sector experienced relatively smaller improvements in the conditions for doing business. Respectively, there was a 2.7 percentage point and a 1 percentage point improvement to 97.2 and 90.6 in the manufacturing and services sectors, respectively.

The improvement in the sub-indices such as, activity, turnover, profit, new business opportunities, and capacity utilisation mainly drove the improvement in the condition for doing business in the agriculture sector. In the manufacturing sector, the improvement resulted from improvements in indices such as new businesses, capacity utilisation, product cost, profit, labour, and turnover. Similarly, improving input costs, product costs, turnover, and optimism improved the conditions for doing business in the services sector.

Challenges in doing business.

The top five most pressing constraints to doing business for the current quarter include tax policy, macroeconomic factors, insufficient demand, electricity unavailability, and access to finance (Figure 3). Some of these factors have persisted from the last quarter ended October-December 2022, implying that some business constraints are rather persistent.

The observed macroeconomic volatilities result from the persistence of some macroeconomic factors, such as inflation, which is still persistently higher than the target, despite a slight decline, as earlier explained. In addition, the increased dollar demand led to a 1.6 percent depreciation in the Ugandan Shilling from a period average of Shs 3,685.72 per USD in February to Shs 3,744.52 per USD in March 2023³.

Figure 1 The Business Climate Assessment



Figure 2 Business Climate Index by sector

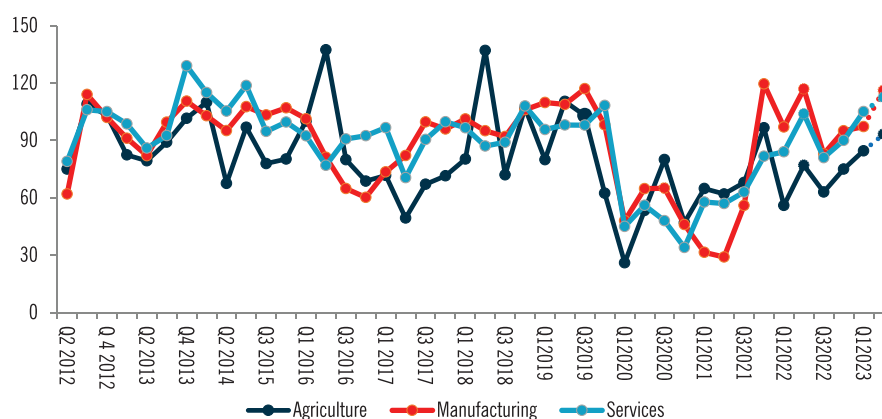
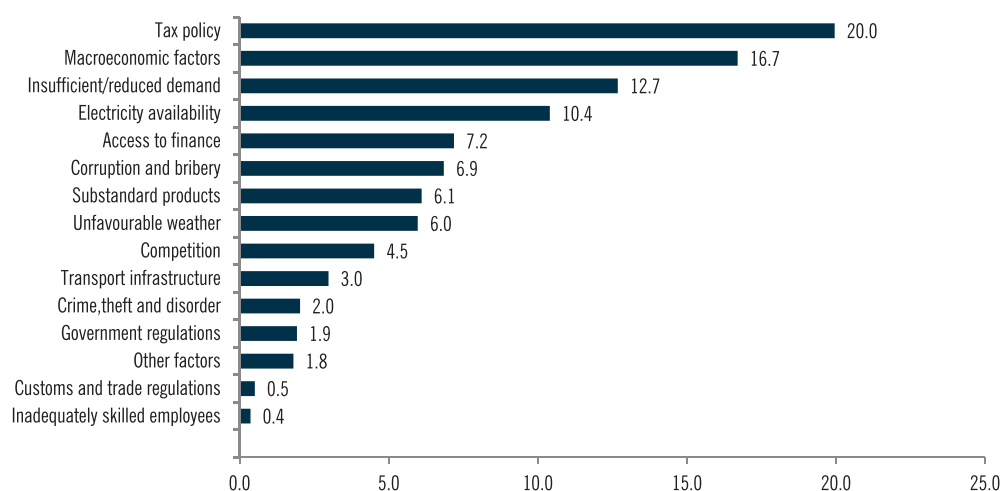


Figure 3 Business Constraints (%)

The problem of insufficient demand is explained by the constantly high prices of goods and services. During the quarter under review, the consumer price index, i.e., headline and core, was 126.4 and 125.8, respectively, compared to 126.2 and 125.2, respectively, in the previous quarter. This persistence affects business sales, profits and is a disincentive to production and business operations.

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 electricity availability (Figure 4). Some of these challenges are the same ones affecting conditions for doing business in the previous quarter (October – December 2023). This means that challenges to doing business in Uganda are persistent.

The macroeconomic conditions continue to bite business activities as the annual headline and core inflation rose to 10.4 percent and 9.0 percent in January 2023 from 10.2 percent and 8.4 percent, respectively, in December 2022⁴. However, the rise appears to have lost momentum compared to the previous trends. In addition, global financial conditions tightened sharply in mid-March following the closures of two regional banks (Silicon Valley Bank and signature bank) in the United States. As a result, intense pressures continue to mount on equities prices, especially in the banking sector. They will likely exacerbate the credit conditions and worsen public finance in developing and emerging markets. Furthermore, the continued geopolitical tensions have continued to affect the supply chains, and as a result, prices of inputs have remained high, affecting the costs of business operations⁵.

The increase in the lending rates negatively affected credit demand and

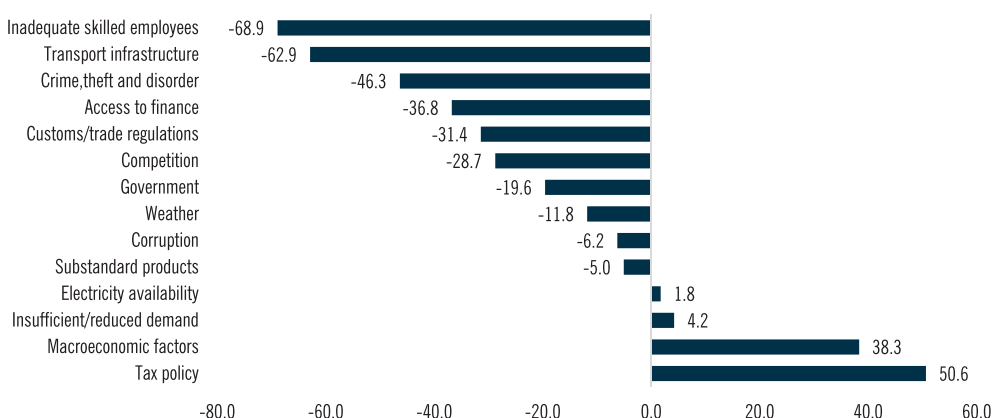
valuation change considering the shilling appreciation. As a result, the total credit to the private sector for January to March 2023 moderated at 9.8 percent compared to 10.2 percent for the quarter ended December 2022. Despite an increase in the number of loan credits, the credit approval rate declined from March 2023 to 60.44 percent from 63.59 percent in the three months to December 2022 in value terms^{vi}.

Future business outlook: April-June 2023

Businesses are optimistic about near-term developments. The next quarter (April-June 2023) index is expected to be above its full potential at 111.9 (Figure 1). This is due to the expected improvement in business conditions in all sub-indices. Considering sectors, the manufacturing and services sectors are expected to operate above full potential, while the agriculture sector is projected to operate below full potential (Figure 2).

The expected condition for doing business by sector indicates that for the April -June 2023 quarter, the manufacturing sector expects the greatest improvement in the condition for doing business of 14.5 percentage points to 116.1 in the next quarter. Mainly, all sub-indices are expected to improve, except the business environment index, which is projected to drop by 45.7 percentage points from the current 168.1.

Similarly, the services sector is expected to have the second-highest improvement in the conditions for doing business of 7.8 percentage points to 112.5 in the next quarter. The improvement is mainly expected to emanate from indices of, Profits, capacity utilisation, business environment, product cost, labour input costs, and turnover.

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

The agriculture sector expects the smallest improvement in the condition for doing business of 0.3 percentage points to 93.2 in the next quarter. The main indices driving this change include business profit, new businesses, product cost and optimism.

Question of the quarter

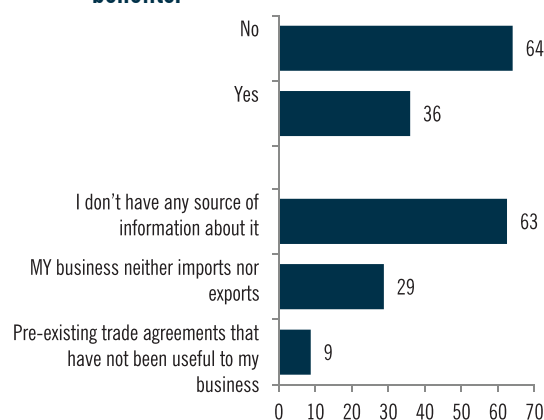
In this quarter, we sought to understand the extent to which businesses are aware of the African Continental Free Trade Area and its rules/benefits.

Particularly, we asked (i) “Are you aware of the African Continental Free Trade Agreement (AfCFTA) and its rules/benefits?” (ii) “If No, why?”

Results presented in Figure 5 indicate that 64 percent of the businesses are unaware of the AfCFTA and its benefits/rules. This is major because most of these businesses (63 percent) do not have any source of information about the AfCFTA. This is followed by 29 percent of the businesses reporting that they neither deal in exports nor imports. Only 9 per cent of the businesses reported that the pre-existing trade agreements that are not beneficial to their businesses are the reason they have not picked interest in understanding the AfCFTA and its benefits/rules.

With more than half of the businesses not aware of the operations of the AfCFTA, they are disadvantaged in enjoying the benefits accrued to it. They are likely to continue facing the existing trade barriers.

Figure 5 The extent businesses are aware of the African Continental Free Trade Agreement and its rules/benefits.



These benefits of the AfCFTA include ease of cross-border trade, dispute settlement, trade, and customs facilitations, among others. For businesses to benefit from the AfCFTA, they need mass business sensitisation on the benefits that come with the AfCFTA.

Conclusion

Conditions for doing business in Uganda in the current quarter (January-March 2023) improved to 91 compared to the previous quarter ended October-December 2022, albeit below full potential. The improvement was a result of improvements in indices, namely, input cost, product cost, capacity utilisation, activity, turnover, profit, and optimism.

Conditions for doing business improved across all the sectors, with the agriculture sector reporting the biggest improvement in conditions for doing business compared to other sectors. The indices driving the improvements in the condition for doing business in the agriculture sector are; the level of business activity, turnover, profit, new business opportunities, and capacity utilisation.

Similar to the previous quarter ended in December 2022, some business constraints persisted. In this regard, the challenges to doing business in the current quarter are tax policy, macroeconomic factors, insufficient demand, electricity availability and access to finance. Similarly, the evolution of business challenges indicates that macroeconomic factors, tax policy, insufficient demand, and electricity availability all continue to hinder business operations.

The projection for the next quarter (April - June 2023) indicates an expected improvement in business condition from 91 to 111.9. This is due to the expected improvement in business conditions in all sub-indices. The manufacturing sector is projected to have the biggest improvement in the condition of doing business, followed by the services sector and agriculture sector respectively. The projected indexes for the manufacturing, service, and agriculture sectors are 116, 112 and 93, respectively. Major sub-indices most likely driving the improvement in the manufacturing sector include activity, turnover, profit, capacity utilisation, input costs, and new businesses.

Businesses are unaware of the existence of the Africa Continental Free Trade Area, with most of them reporting not having any information source about the AfCFTA. As a result, many are bound to miss out on the benefits that come with the AfCFTA.

Endnotes

- <https://www.bou.or.ug/bouwebsite/Statistics/>
- Bank of Uganda Monetary Policy report February 2023
- Ministry of Finance-Performance of the economy report- March 2023.
- Bank of Uganda, 2023. State of the Economy Report – March 2023
- Bank of Uganda, State of the Economy Report – April 2023

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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