

**Performance & Expectations of
the Egyptian Business Sector**

About the Egyptian Center for Economic Studies

The Egyptian Center for Economic Studies (ECES) is an independent, non-profit think tank that conducts specialized economic research, drawing on international experience and constructive discussions among various stakeholders. ECES's main objective is to propose sound economic policies, and institutional and legislative reforms that contribute to sustainable development in Egypt, all on the basis of combined economic efficiency and social justice.

Strategic Direction

Economic efficiency and social justice are of core interest to ECES. Combined, they constitute the Center's strategic direction. ECES research and activities focus on studying past, present and future challenges facing the Egyptian economy, whether they are related to macroeconomic stability, microeconomic efficiency, or political economy aspects both on the internal and external dimensions. In its analysis, ECES is keen on adopting a comprehensive approach that encompasses legislative, institutional, policy and structural aspects of whatever problem or area addressed, not to mention implementation mechanisms. In all its activities, ECES relies on its competent team of in-house researchers, in addition to collaboration with external experts and like-minded think tanks as needed.

ECES Board of Directors

Omar Mohanna, *ECES Chairman, and Chairman, Suez Cement Group of Companies*

Mohamed Taymour, *ECES Vice Chairman, and Chairman Pharos Holding Co. for Financial Investments*

Tarek Zakaria Tawfik, *ECES Secretary General, and Managing Director, Cairo Poultry Group (CPG)*

Alaa Hashim, *ECES Treasurer, and Chairman, TRANSCENDIUM*

Ahmed Abou Ali, *Partner, Hassouna & Abou Ali Law Offices*

Aladdin Sabaa, *Founder, Beltone Financial Holding Co.*

Ahmed Fikry Abdel Wahab, *General Manager and CEO, EGA - Egyptian German Automotive*

Hazem Hassan, *ECES Board Member, and Chairman, KPMG Hazem Hassan Management Consultants*

Hisham El Khazindar, *Co-Founder and Managing Director, Qalaa Holdings*

Mohamed Kassem, *Chairman, World Trading Co., Egypt*

Mohamed Zakaria Mohie El Din, *Chairman & Managing Director, National Company for Chemical Industries – NASYDCO*

ECES Staff

The Center's staff is comprised of a high-caliber and interactive team of economists, researchers, editors and administrators. Read more about the ECES team in the following link:

<http://www.eces.org.eg/Staff.aspx>

Executive Management

Abla Abdel Latif - Executive Director and Director of Research

Magda Awadallah - Deputy Executive Director for Finance and Administration

Research Department

Diaa Nouredine - Advisor

Mohsen Adel – Advisor*

Rama Said - Senior Economist

Noura Abdelwahab - Senior Economist

Maye Ehab - Economist

Mohamed Ali - Economist

Khaled Wahid – Statistical Analyst*

Alia Abdallah - Research Analyst

Yara Helal - Research Analyst

Hoda El-Abbadi - Research Analyst

Hossam Khater - Research Assistant*

Ahmed Fathy - Research Assistant*

Editorial and Translation Department

Yasser Selim - Managing Editor

Fatima Ali - Editor/ Translator

Information Technology

Kadry Sayed - IT Manager

Ebrahim El Embaby - IT Assistant

Finance and Administration Department

Mohamed Leheta - Senior Accountant

Amani Medhat - Executive Assistant to the Executive Director

Menna Mahmoud - Events, Operations and Membership Officer

Mohamed Atef - Staff Assistant

Hussein Mohamed - Support Staff

Omar Mowafy - Support Staff

Tarek Abdel Baky - Support Staff

Waleed Ibrahim – Support Staff

* The *Business Barometer* research team.



Business Barometer

Issue No. 41 - 2016

Contents

Overview

Performance Indicators

Business Strategy Going Forward

Constraints Facing the Business Sector

Commentary on Survey Results



Overview

This edition of the Business Barometer (BB) presents the survey results of a stratified panel of 127 firms regarding their perceptions about the performance of the Egyptian economy and assessment of their own business for the first quarter of FY2016/2017 (July-September) and their outlook for the second quarter of FY2016/2017 (October-December). Regarding outlook, the Business Barometer Index (BBI) dropped 8 points, reflecting business concerns.

The survey results reflect the impact of exchange rate liberalization, whether through the rise in operation costs and the consequent impact on prices during the period, or through the emergence of signs of a future tendency to increase investments despite growing challenges in the short term. This signals an alarm for the government to revisit its economic stimulus policies, especially in light of the three overriding concerns of businesses, namely, availability of foreign currency, rising inflation rates, and slow growth.

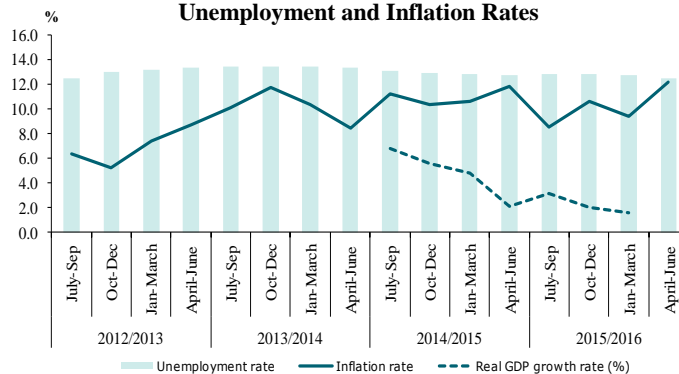
On the fiscal front, Egypt's macroeconomic transactions with the outside world during FY2015/2016 resulted in an overall deficit in the balance of payments amounting to about \$2.8 billion against a total surplus of \$3.7 billion during the previous fiscal year.

According to a Central Bank of Egypt (CBE) report, the current account deficit rose to \$18.7 billion in FY2015/2016 compared to around \$12.1 billion in FY2014/2015. The capital and financial account posted net inflows of about \$19.9 billion compared to \$17.9 billion during the same period.

The Ministry of Finance (MOF) has finalized the closing account of FY20 15/2016, with total expenditures amounting to LE 818 billion, and total revenues amounting to LE 491.5 billion. Total deficit stood at LE 339.5 billion (12.2 percent of GDP).

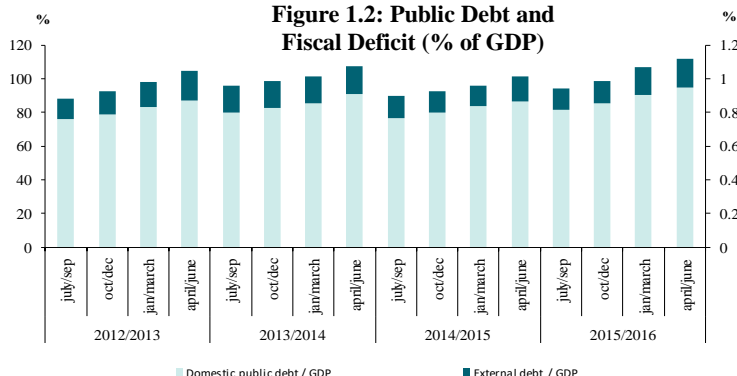
Egypt's total external debt jumped by \$7.7 billion (16 percent) in FY2015/2016 to \$55.8 billion, compared to \$48.1 billion in 2014/2015, according to a CBE report.

Figure 1.1: Real GDP Growth, Unemployment and Inflation Rates



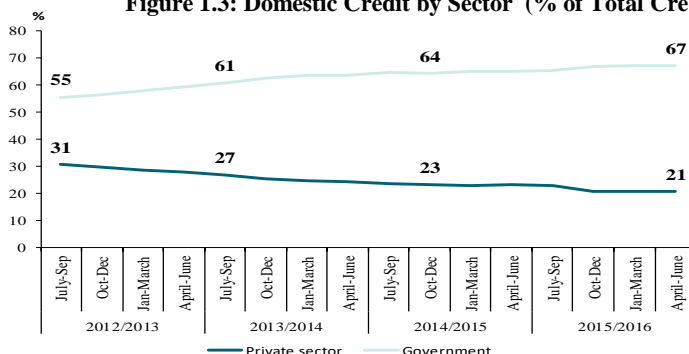
Sources: Ministry of Planning, CAPMAS, and the Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

Figure 1.2: Public Debt and Fiscal Deficit (% of GDP)



Sources: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues, and the Ministry of Finance.

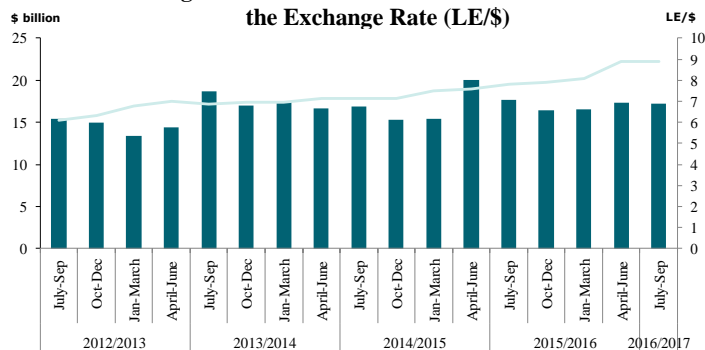
Figure 1.3: Domestic Credit by Sector (% of Total Credit)



Source: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, Various Issues.

* Exchange rate for the period October-November.

Figure 1.4: Net International Reserves and the Exchange Rate (LE/\$)



Source: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

*Data for this quarter is an average for October and November.

* In July 2016, Egypt honored several payments on its external debt.

* In July 2016, Egypt honored several payments on its external debt.

*Data for this quarter is an average for October and November.

Past Performance of Businesses

The BB survey results for the previous quarter (July-September 2016) reflected pressures exercised by the shortage in foreign currency and the consequent decline in the availability of raw materials and production inputs as well as their high cost. This caused the BBI to decline to 44 points, driven mainly by the drop in the growth outlook index to 31 points, its lowest level in two years.

The production and domestic sales indices recorded their lowest level during the same period, each posting 44 points, which is a clear indication of the pressures on the production and sales decisions due to difficulties faced by the Egyptian economy during that time, which led to uncertainty.

Most indices recorded a similar decline due to the impact of the above developments on the volume of exports, product prices and on the ability of firms to set their inventories in light of the higher exchange rate and the lack of foreign currency liquidity, resulting in high inflation and interest rates during the period.

Figure 2.1: Business Barometer Index

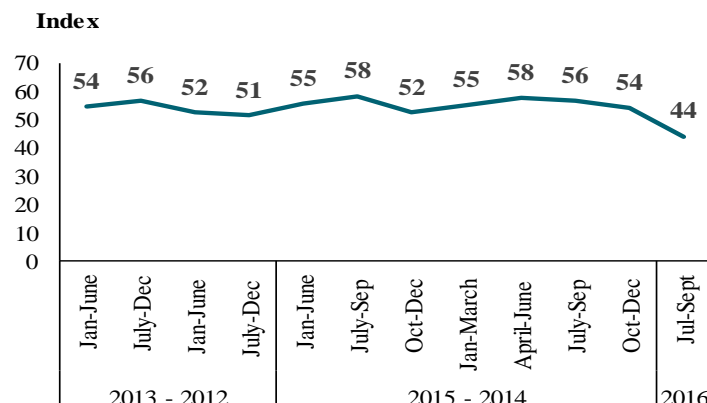


Figure 2.2: Economic Growth

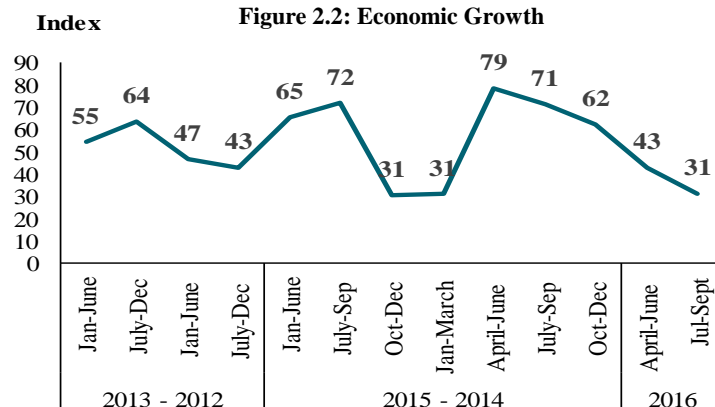


Figure 2.3: Production

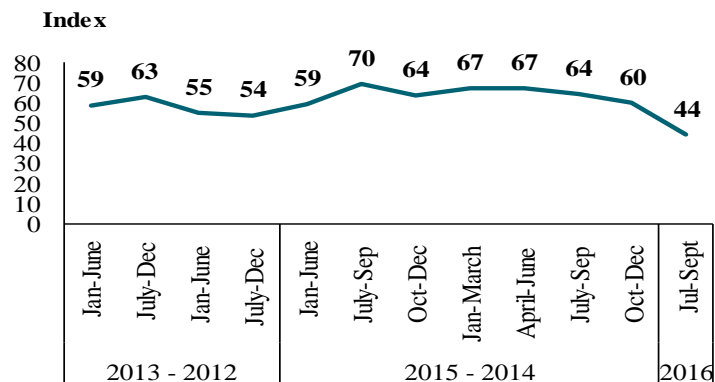


Figure 2.4: Domestic Sales

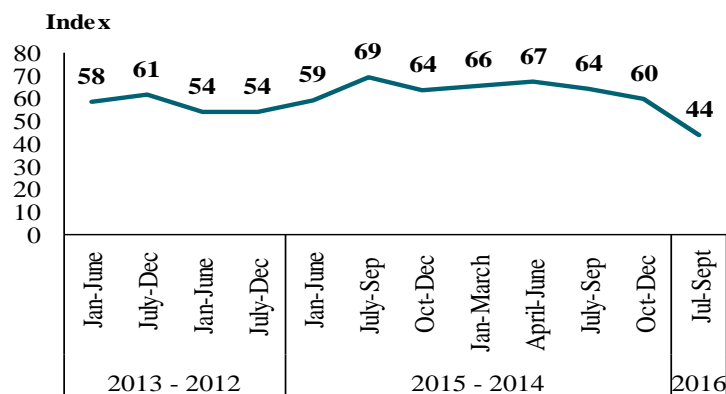




Figure 2.5: International Sales

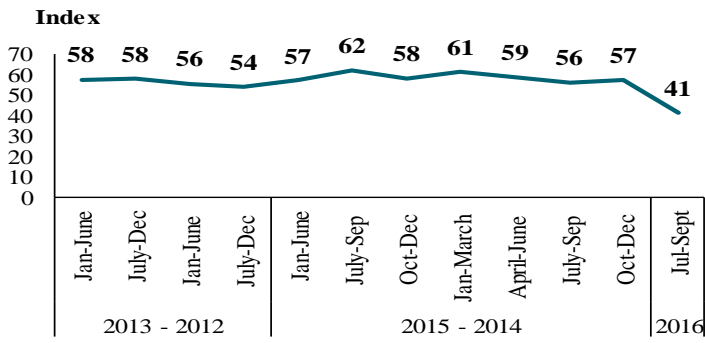


Figure 2.6: Inventory *

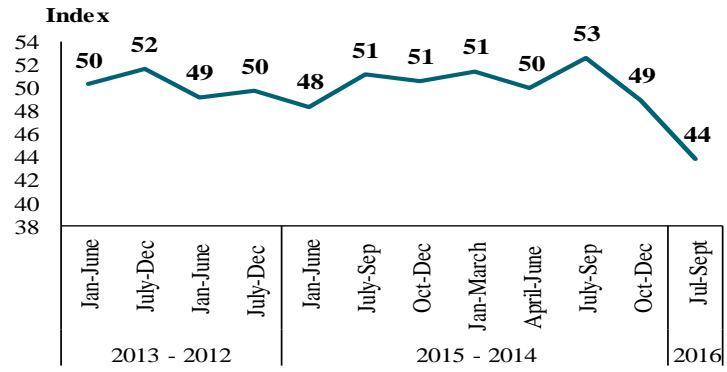


Figure 2.7: Capacity Utilization

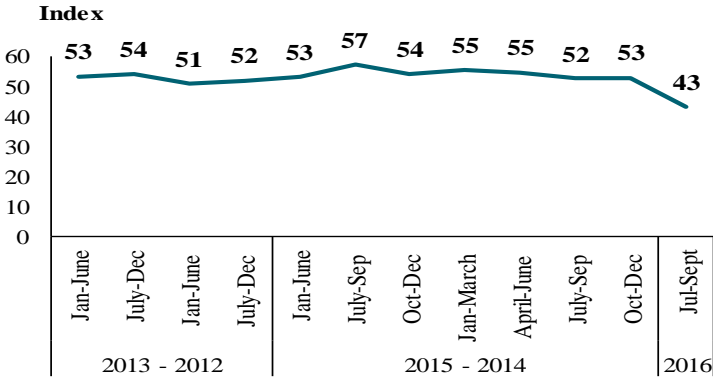


Figure 2.8: Final Product Prices

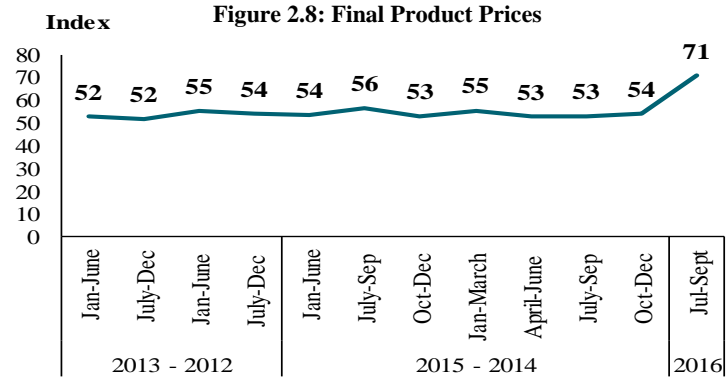


Figure 2.9: Input Prices **

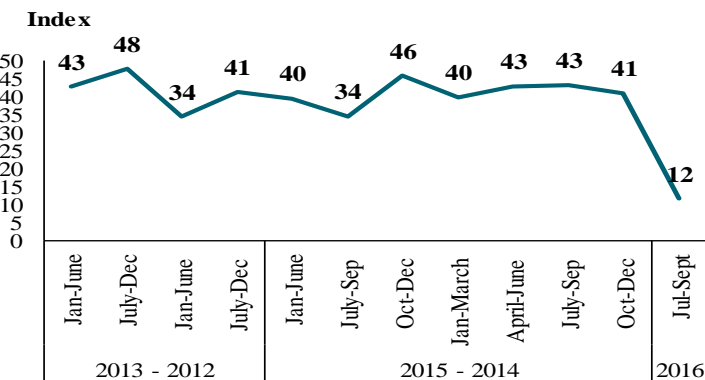


Figure 2.10: Wages

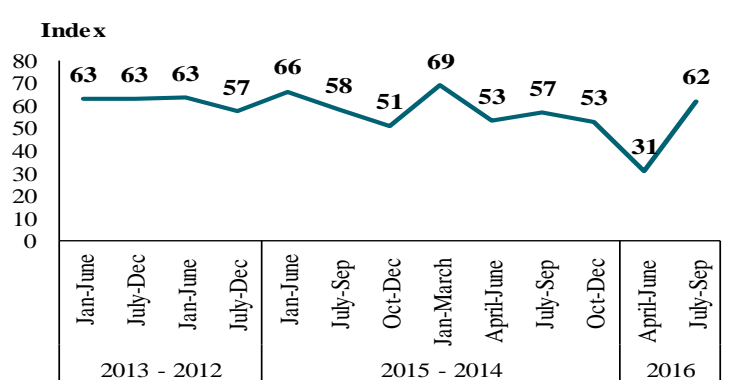


Figure 2.11: Investment

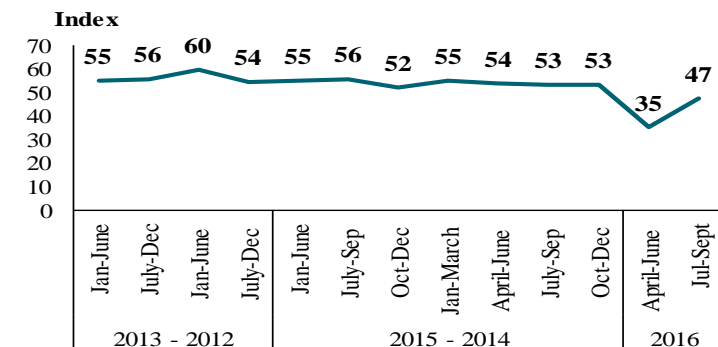
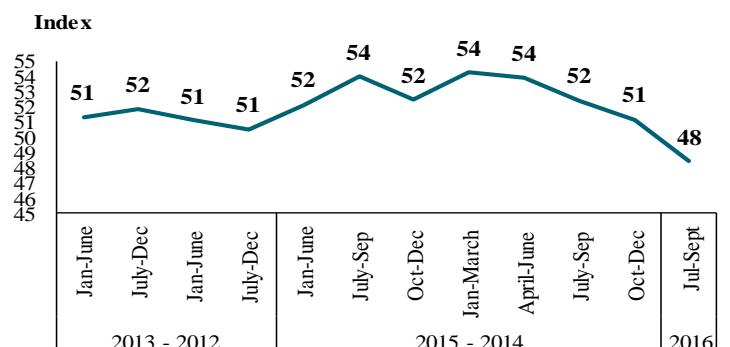


Figure 2.12: Employment



Source: Survey results.

* The index for inventory is inverted to indicate the negative impact of its increase on businesses. Hence, a higher inventory index indicates lower inventory.

** The index for input prices is inverted to indicate the negative effect of the increase in input prices on businesses. Hence, a lower value of this index indicates higher input prices.

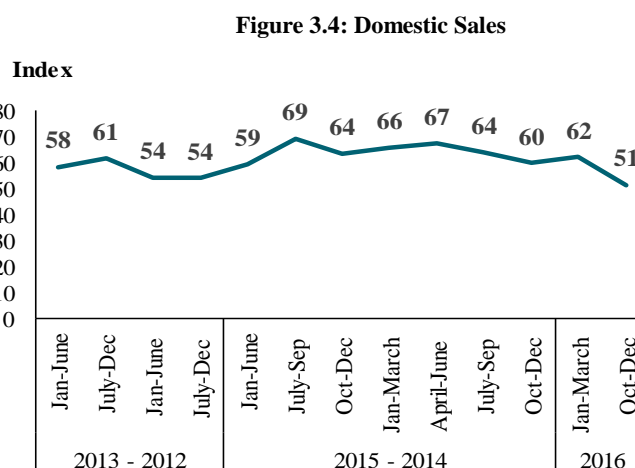
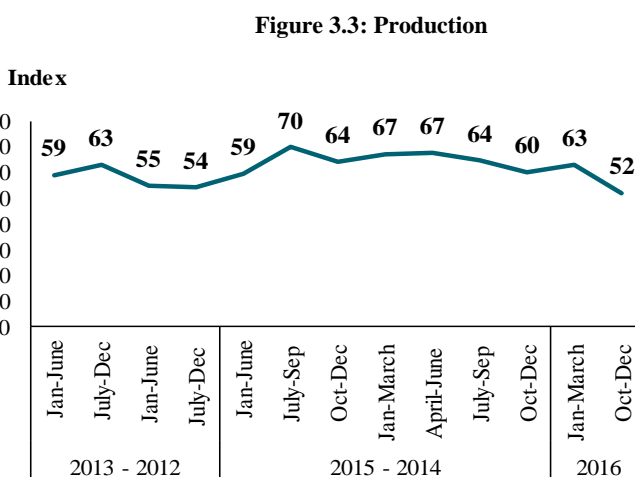
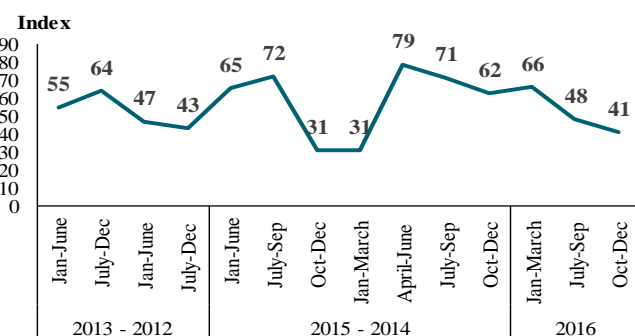
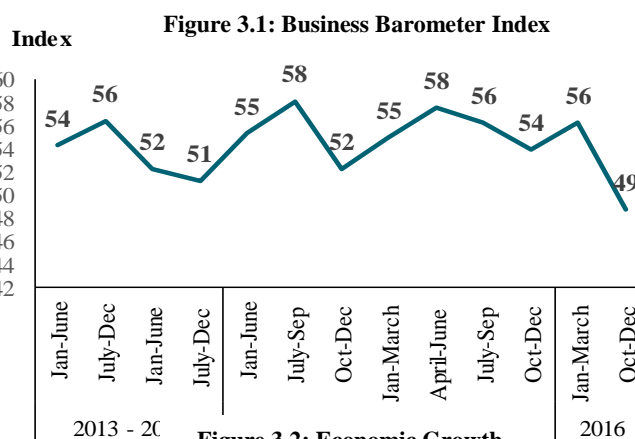
Business Strategy Going Forward

Firms' outlook for the second quarter (October-December) of FY2016/2017 reflects their concerns about declining performance in light of the recent economic decisions and uncertainty about the period of time the Egyptian economy needs to achieve balance in the short term. Accordingly, firms' outlook for economic growth was cautious, especially that the current measures taken by the government to stimulate the economy are still less than those required to lift the economy from the current slowdown. Specifically, the BB outlook index recorded 49 points, its lowest level in two years.

According to survey results, the business sector expects lower growth rates due to declining dollar resources, high operation costs and rising inflation. Although the economic growth index declined to 41 points, it is still higher than its lowest level recorded at the beginning of 2015 (31 points). This drop in the growth outlook reflects business estimates in the survey that production would decline due to increased input costs and shortage in foreign currency resources, as well as the increase in domestic prices following liberalization of the exchange rate.

The business outlook was affected by the rise in inflation and its impact on wages. A tendency to increase wages is expected in the last quarter of the year, with the index scoring 63 points, which is close to its highest level in two years recorded in the first quarter of 2015.

Despite cautious survey results, the investment index saw its highest quarterly increase in two years, scoring 51 points, reflecting the stable outlook of businesses in the medium and long terms. However, the index is still below its highest level recorded in the third quarter of 2014 (56 points). This requires the government to speed up taking further stimulus measures, most importantly modifying the legislative regime related to the investment climate and its procedures.



Source: Survey results.



Figure 3.5: International Sales

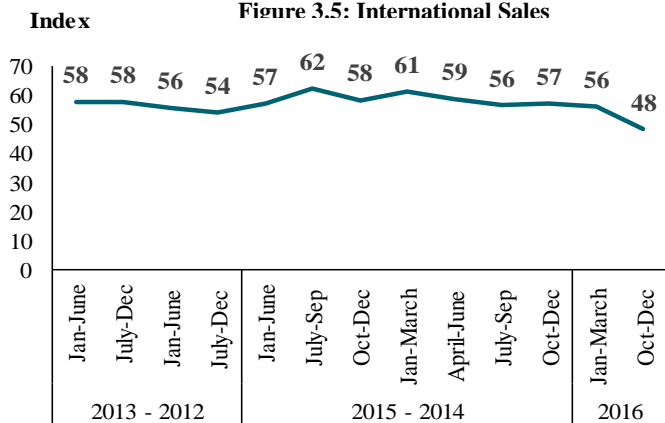


Figure 3.6: Inventory *

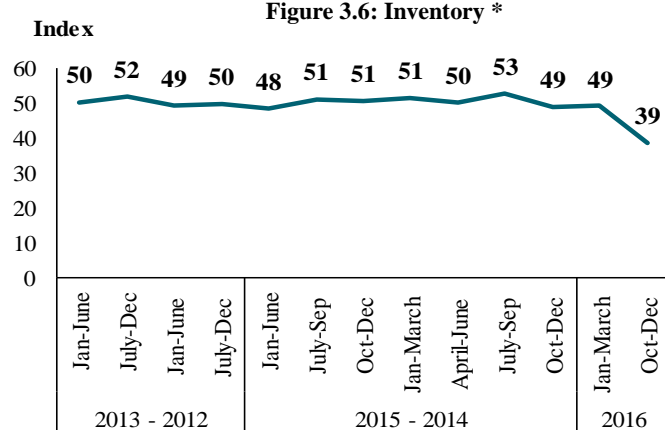


Figure 3.7: Capacity Utilization

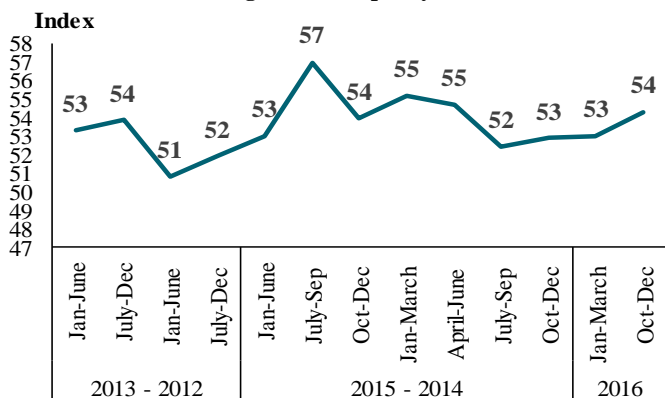


Figure 3.8: Final Product Prices

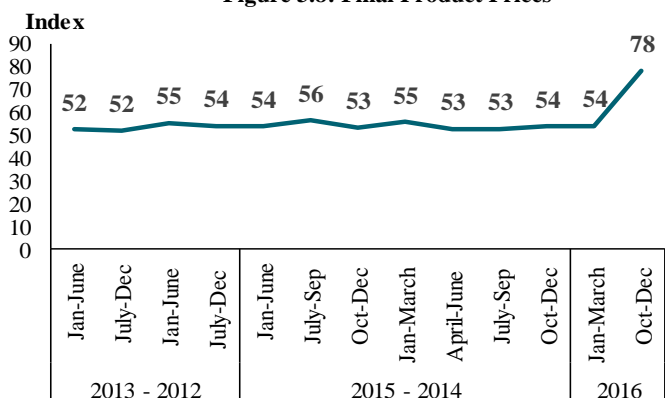


Figure 3.9: Input Prices **

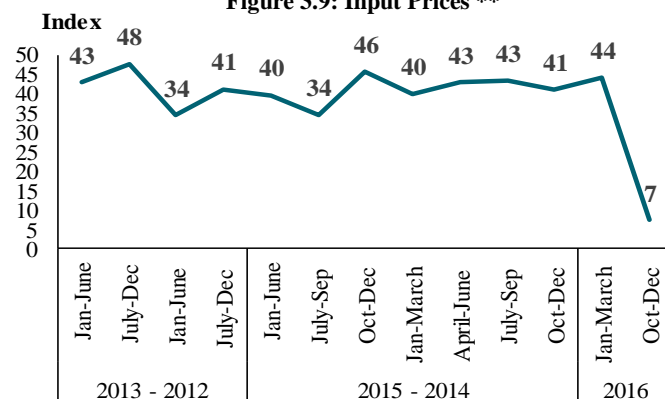


Figure 3.10: Wages

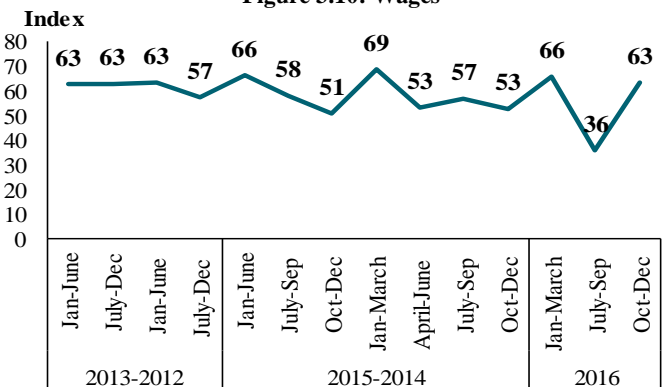


Figure 3.11: Investment

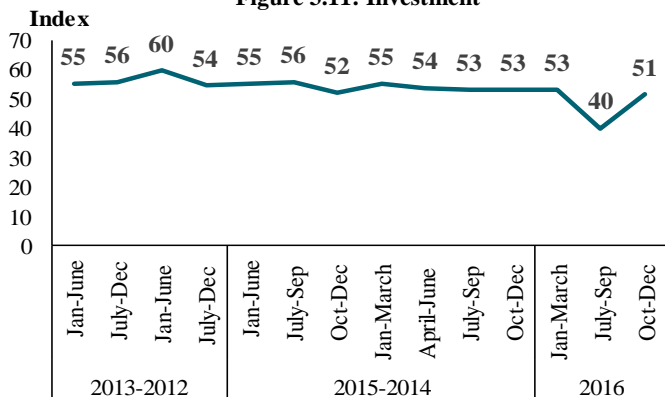
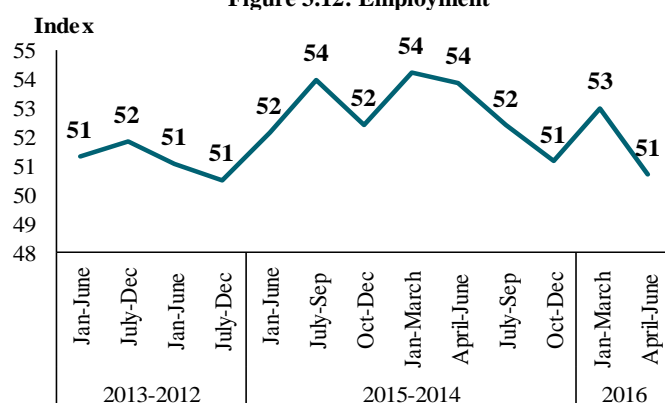


Figure 3.12: Employment



Source: Survey results.

* The index for inventory is inverted to indicate the negative impact of its increase on businesses. Hence, a higher inventory index indicates lower inventory.

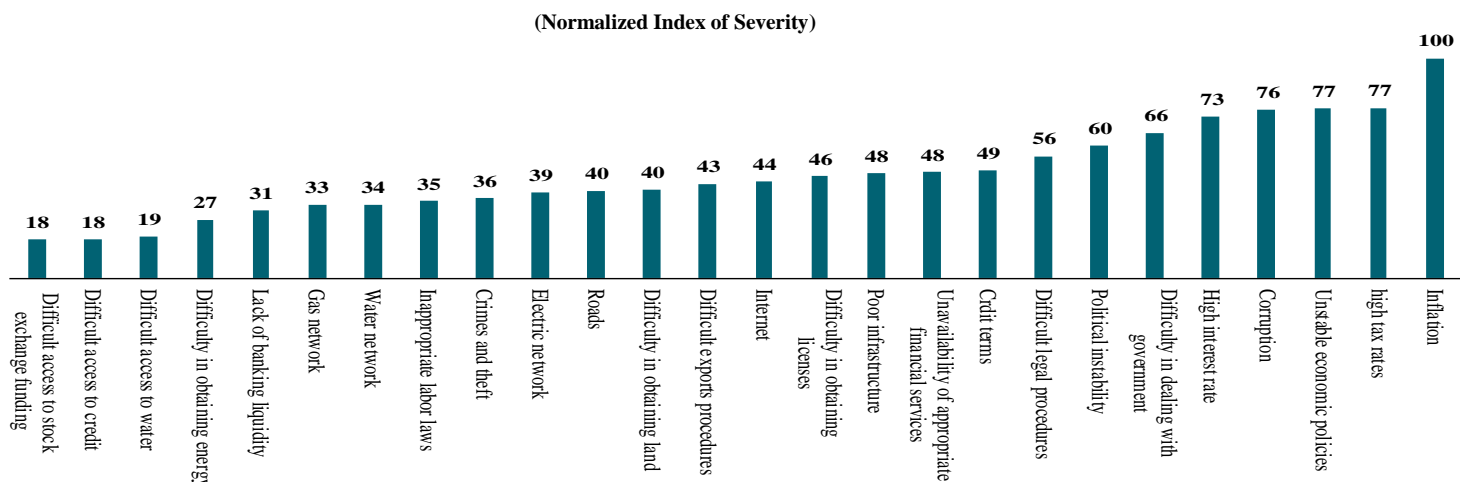
** The index for input prices is inverted to indicate the negative effect of the increase in input prices on businesses. Hence, a lower value of this index

Business Constraints

Major Constraints: Inflationary pressures, exchange rate, interest rate, and the trade balance deficit

The Figure 4 shows the major constraints facing businesses in a descending order according to their severity from the perspective of surveyed firms. Firms expressed their concern about inflation, especially that the depreciation of the pound against foreign currencies and the increase in domestic fuel prices fueled business concerns, particularly SMEs, about production costs and prices in the domestic market. The exchange and interest rates came second in conjunction with the Central Bank’s successive steps to liberalize the exchange rate followed by raising the interest rate.

Figure 4: Major Constraints Facing the Business Sector
(Normalized Index of Severity)



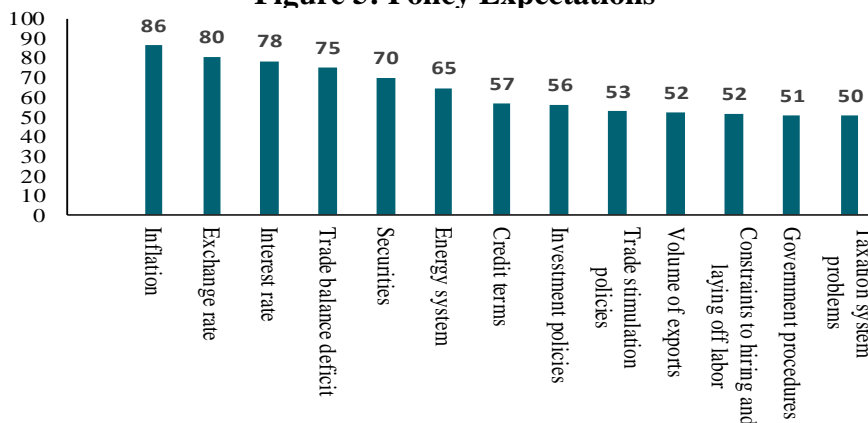
Source: Survey results.

Policy Expectations

Policy Expectations: Measures to curb inflation; promote growth; and take social justice into account

In light of the higher exchange rate and increased fuel prices in the domestic market, the government needs to adopt measures to reduce the impact thereof on inflation and the prices of production inputs, while maintaining economic growth and taking social justice into account.

Figure 5: Policy Expectations



Source: Survey result.



Commentary on Survey Results

Despite the decline in indices, the exchange rate liberalization and the adoption of a strong economic reform program still reflect optimism in the medium and long terms. We see signs of improved confidence in economic growth potential, even if these signs are temporary and subject to government's commitment to a comprehensive economic reform program that includes stimulus policies.

However, survey results point out the need to boost external demand through measures such as export development, attracting more investments and addressing investment climate problems in light of the current shortage in foreign currency, which is expected to continue until the end of the first quarter of FY2016/2017. Addressing the shortage in foreign currency liquidity is a prerequisite for achieving economic stability, especially that further inflationary pressures may lead to more government deflationary policies.

Improving the legislative infrastructure of the Egyptian economic climate would improve economic performance, especially if substantive measures are taken to reform the tax and industrial licensing systems; modify the investment law and land allocation mechanisms; and issue a law to regulate and stimulate the SMEs sector.

Egypt's economic policy is in need of urgent rebalancing. The existing risks are due to unusually low productivity growth, which reflects negatively on possible improvements in living standards in the future. Domestic and external debt levels are historically high, posing risks to financial stability. Further, the room for maneuver on the monetary front is notably tight.

Hence, the Egyptian economy is no longer able to rely on the current growth model, which brought it to this crossroads. There is an urgent need to re-balance economic policy in order to achieve stronger, more balanced and sustainable growth. The growth model, which caused this dilemma, should be abandoned, and monetary policy should be relieved of its longstanding burdens.

This requires substantive changes in the direction of both fiscal and monetary policies, in order for fiscal policy to cope with the boom-bust cycles in a more systematic manner, and monetary policy to monitor those cycles in terms of overall risk with a view to maintaining financial balance.

Appendix

Following an elaboration of the methodology used in calculating the index, this appendix will present tables that give a numerical representation of survey results.

Methodology of the Index

The index aims at calculating a single figure for the responses of firms on each variable.

The index's equation is:

$$X = \frac{I+S}{100+S} \times 100$$

where *I* is the share of firms reporting an increase and *S* the share of firms reporting same.

The index is designed to have a maximum of 100 when all firms report an increase, a minimum of 0 when all firms report a decrease and a middle value of 50 when all firms report no change. Between 0 and 100, the index grows proportionally with larger shares of "increase," and inversely with larger shares of "decrease," while the change in "same" is given less effect by including it in the numerator and the denominator. A higher index thus reflects a better business climate and vice versa. It is worth noting that the index is inverted for inventories and input prices as increases of these two variables reflect an adverse business climate for firms. The Business Barometer Index is a simple average of the variables' indexes, calculated once for large firms and once for SMEs, both for evaluations and expectations.

Table 1: Survey results: Summary of business sector past performance (July-September 2016)¹

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Service Sector			
	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²
	Higher	Same	Lower	43	Higher	Same	Lower	45	Higher	Same	Lower	34	Higher	Same	Lower	42	Higher	Same	Lower	45	Higher	Same	Lower	44
Economic growth	10	25	65	28	14	64	21	48	0	56	44	36	9	27	64	29	33	0	67	33	0	36	64	27
Business activity																								
Production	23	29	49	40	21	64	14	52	22	56	22	50	18	36	45	40	0	33	67	25	55	27	18	64
Domestic sales	22	30	48	40	29	57	14	55	22	67	11	53	18	36	45	40	0	33	67	25	45	27	27	57
International sales	26	30	43	43	0	50	50	33	25	50	25	50	0	50	50	33	0	0	100	-	0	0	0	-
Inventory	46	32	22	41	15	77	8	48	11	67	22	53	55	18	27	38	33	33	33	50	29	29	43	56
Level of capacity Utilization	10	51	39	41	21	71	7	54	22	44	33	46	0	60	40	38	0	67	33	40	22	44	33	46
Prices																								
Final product prices	67	31	3	75	43	50	7	62	56	44	0	69	64	36	0	73	33	67	0	60	30	70	0	59
Intermediate input prices	90	8	3	10	85	15	0	13	86	14	0	13	80	20	0	17	100	0	0	-	50	50	0	33
Wage level	38	62	0	62	43	57	0	64	33	67	0	60	40	60	0	63	67	33	0	75	30	60	10	56
Primary inputs																								
Investment	8	70	22	46	21	71	7	54	0	100	0	50	0	80	20	44	0	0	100	-	27	64	9	56
Employment	11	70	19	48	14	79	7	52	0	100	0	50	0	73	27	42	0	67	33	40	30	60	10	56

¹Numbers represent percent of total responses. Higher, same and lower may not add up to 100 due to rounding.

²Equal to the simple average of the variables' indexes. The index's method of calculation is provided in the appendix.

Table 2: Survey Results: Summary of Business Sector Outlook (October-December 2016)¹

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Service Sector			
	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²
	Higher	Same	Lower	56	Higher	Same	Lower	51	Higher	Same	Lower	51	Higher	Same	Lower	50	Higher	Same	Lower	45	Higher	Same	Lower	57
Economic growth	22	19	59	34	57	14	29	63	44	33	22	58	18	27	55	36	33	0	67	33	45	9	45	50
Business activity																								
Production	28	35	37	47	79	14	7	81	67	11	22	70	27	18	55	38	67	0	33	67	45	36	18	60
Domestic sales	28	38	35	47	79	14	7	81	33	33	33	50	27	18	55	38	67	0	33	67	45	36	18	60
International sales	31	28	41	46	25	25	50	40	75	0	25	75	25	50	25	50	0	100	0	50	0	0	0	-
Inventory	47	41	12	38	38	54	8	40	50	25	25	40	45	36	18	40	50	50	0	33	25	75	0	43
Level of capacity Utilization	26	50	24	51	43	50	7	62	100	0	0	-	18	36	45	40	33	33	33	50	38	63	0	62
Prices																								
Final product prices	78	14	8	81	86	14	0	88	43	43	14	60	90	10	0	91	33	67	0	60	33	56	11	57
Intermediate input prices	92	6	1	7	92	8	0	8	100	0	0	-	100	0	0	-	100	0	0	-	60	40	0	29
Wage level	43	54	3	63	64	36	0	74	0	89	11	47	73	18	9	77	0	100	0	50	45	45	9	63
Primary inputs																								
Investment	17	62	22	48	79	14	7	81	14	71	14	50	18	55	27	47	0	33	67	25	30	60	10	56
Employment	16	71	13	51	21	71	7	54	11	78	11	50	9	73	18	47	0	67	33	40	18	64	18	50

¹Numbers represent percent of total responses. Higher, same and lower may not add up to 100 due to rounding.

²Equal to the simple average of the variables' indexes. The index's method of calculation is provided in the appendix.

**Table 3: Survey Results: Summary of Business Sector Past Performance (by size) (July-September 2015)¹**

Indicator	SMEs Companies				Large-sized Companies			
	Higher	Percentage Same	Lower	Index ²	Higher	Percentage Same	Lower	Index ²
Economic growth	10	24	66	28	8	50	42	39
Business activity								
Production	19	31	50	38	37	45	18	56
Domestic sales	19	31	49	38	34	47	18	55
International sales	12	41	47	38	29	29	41	45
Inventory	42	31	27	44	32	56	12	43
Level of capacity Utilization	10	47	43	39	18	71	12	52
Prices								
Final product prices	69	28	3	76	37	63	0	61
Intermediate input prices	89	10	1	10	83	14	3	15
Wage level	43	56	1	63	29	71	0	58
Primary inputs								
Investment	7	67	26	44	17	78	6	53
Employment	43	56	1	63	13	82	5	52

¹ Numbers represent percent of total responses. Higher, same and lower may not add up to 100 due to rounding.

² Equal to the simple average of the variables' indexes. The index's method of calculation is provided in the appendix.

**Table 4: Survey Results: Summary of Business sector outlook (by size) (October-December)¹**

Indicator	SMEs Companies				Large-sized Companies			
	Higher	Percentage Same	Lower	Index ² 46	Higher	Percentage Same	Lower	Index ² 56
Economic growth	19	22	58	34	54	11	35	59
Business activity								
Production	30	30	39	47	58	26	16	67
Domestic sales	27	34	39	45	58	26	16	67
International sales	19	38	43	41	48	19	33	56
Inventory	41	43	16	41	55	42	3	32
Level of capacity Utilization	23	50	27	49	55	37	8	67
Prices								
Final product prices	73	19	8	77	75	22	3	80
Intermediate input prices	93	8	0	7	91	6	3	8
Wage level	45	49	6	63	42	58	0	63
Primary inputs								
Investment	16	58	26	47	46	49	6	63
Employment	18	66	16	51	11	82	8	51

¹ Numbers represent percent of total responses. Higher, same and lower may not add up to 100 due to rounding.

² Equal to the simple average of the variables' indexes. The index's method of calculation is provided in the appendix.