

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

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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.

About the Business Barometer

This edition of the Business Barometer reports the results of a stratified sample of 120 private firms. The survey covers their assessment of economic growth and the results of their operations over the third quarter (January-March) of FY 2016/2017. It also summarizes their expectations for overall future economic performance as well as their own activities for the fourth quarter (April-June) of FY 2016/2017.

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Business Barometer

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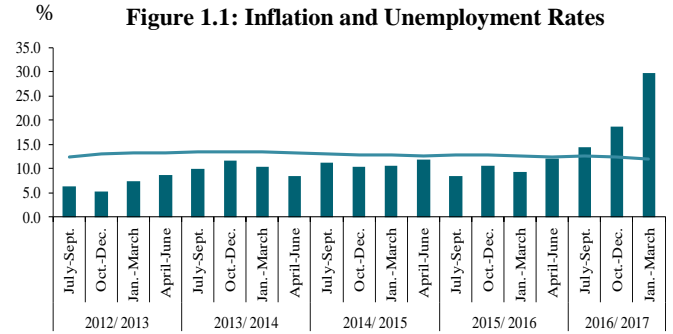
Overview

This edition of Business Barometer (BB) presents the survey results of a stratified panel of 120 firms regarding their perceptions about the performance of the Egyptian economy and own business for the third quarter of FY2016/2017 (January-March 2017) and their outlook for the fourth quarter (April-June 2017) of the same year.

Survey results indicate a relative decline in the impact of exchange rate liberalization with the stabilizing of the foreign exchange market. However, the effects are still evident through continued high operating cost and the effect thereof on prices during the period under review. With respect to outlook, the BBI for both SMEs and Large firms witnessed an increase compared the last two years. This can be attributed largely to the new legislations recently introduced by the government, including the industrial licensing and investment laws, which are viewed by the business community with cautious optimism.

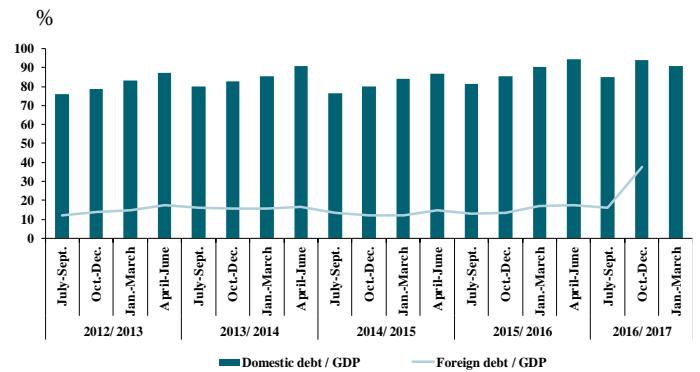
According to the Central Bank of Egypt (CBE) data, the **balance of payments** achieved a total surplus of US\$7 billion during the first half of FY2016/2017 (July-December 2016), 73 percent of which was realized during the period that witnessed the exchange rate liberalization. During the second quarter of the same year (October-December 2016), the current account deficit declined by 13.1 percent compared to the corresponding period in 2015. The trade deficit declined by about US\$2 billion or 10.1 percent during the period July-December 2016.

Figure 1.1: Inflation and Unemployment Rates



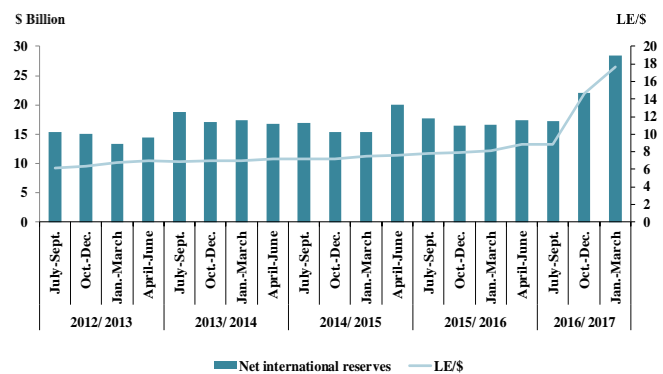
Source: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

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



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

Figure 1.3: Net International Reserves and the Exchange Rate (LE/\$)



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

The **budget deficit** during the period July 2016-March 2017 fell to EGP 273.3 billion (8 percent of GDP) against 9.4 percent of GDP during the corresponding period of the previous fiscal year.

Total **revenues** rose to EGP 363.7 billion during the same period (July 2016-March 2017) compared to EGP 291.1 billion during the corresponding period of the previous fiscal year. The increase in total revenues is mainly due to a rise in tax revenue to EGP 268.9 billion against EGP 212.4 billion in the corresponding period of the previous fiscal year.

Total public **expenditure** increased to EGP 631.4 billion during the period, a growth of 18.4 percent over the corresponding period of last year.

Total domestic and foreign **public debt** at end of March 2017, according to the CBE, amounted to about EGP 3.49 trillion, equivalent to about 107.9 percent of GDP. External public debt at end of December 2016 was about US\$67.3 billion against US\$55.8 billion in June 2016. Total domestic public debt amounted to EGP 3.1 trillion pounds, equivalent to 90.9 percent of GDP. This increase in domestic public debt is due to the financial burden resulting from resolving some financial issues among state agencies, especially with the insurance and pension funds and the Egyptian General Petroleum Corporation.

The **unemployment** rate fell in January-March 2017 to 12 percent compared to 12.4 percent in October-December 2016, and 12.7 percent in the corresponding quarter of 2015.

Annual core inflation rose slightly to 31.46 percent in April 2017 compared to 30.91 percent in March 2017. Monthly core inflation grew slightly by 1 percent in April 2017, from 0.96 percent in March 2017 (Figure 1-1). This rise in monthly inflation can be attributed to the rise in the prices of vegetables, fruit and some commodities.

Net international reserves at end of April 2017 rose to US\$28.6 billion from US\$17.23 billion at end of September 2016 (Figure 1-3). It is worth noting that net international reserves are at their highest since 2011 (US\$30.5 billion in January-March 2011 - see Issue No. 37 of the Business Barometer).

Business Barometer Index (BBI)

A rise in the BBI in Q3 of FY2016/2017 (January-March 2017)

Survey results for the quarter January-March 2017 revealed that the BBI rose to 54 points from 45 points in the previous quarter (October-December 2016), thereby approaching its highest level in April-June 2015 (Figure 2-1).

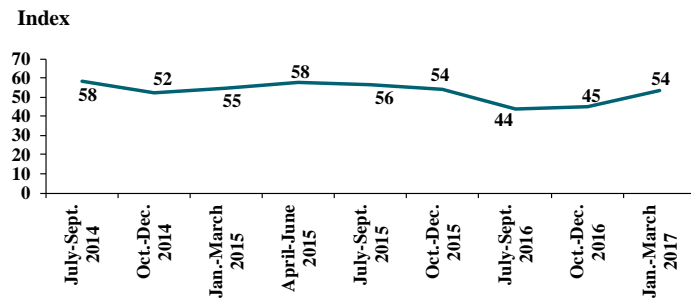
Firms' outlook for the last quarter of FY2016/2017 (April-June 2017) is less optimistic than the previous quarter. The outlook index fell slightly to 51 points from 52 points in the previous quarter, which may be explained by the state of anticipation by the business community regarding new investments, employment, capacity utilization, in addition to concerns about rising interest rates and inflation, and slow economic growth (Figure 2-2).

BBI for large firms and SMEs

The BBI for large firms rose from 49 points in October-December 2016/2017 to 60 points in January-March 2016/2017. The outlook index rose from 51 points in January-March 2017 to 64 points in April-June 2017. This is due to the launch of legislative reforms with the issuance of the new investment and industrial licensing laws (Figure 2-3).

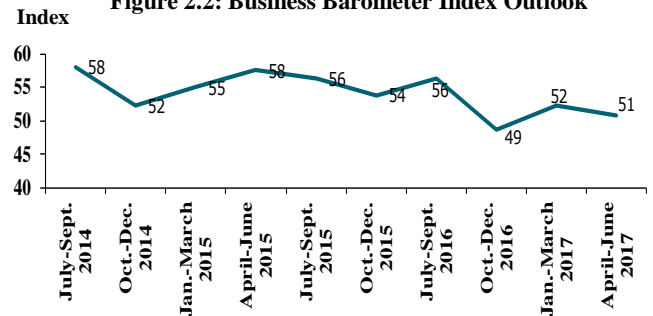
With respect to SMEs, the BBI rose from 46 points in October-December 2016/2017 to 53 points in January-March 2016/2017. Their outlook index also increased from 53 points in January-March 2017 to 59 points in April-June 2016/2017. However, this rise in the outlook index in April-June 2016/2017 was lower compared to large firms because of the continued state of anticipation by SMEs regarding the effects of establishing the SME development authority and the absence so far of tangible changes that support firms in this sector (Figure 2-4).

Figure 2.1: Business Barometer Index Evaluation



*Data for the quarters (Jan-March and April-June 2016) is unavailable.

Figure 2.2: Business Barometer Index Outlook



*Data for the quarters (July-September & October-December 2016) is unavailable.

Figure 2.3: Business Barometer Index

A- Large Firms

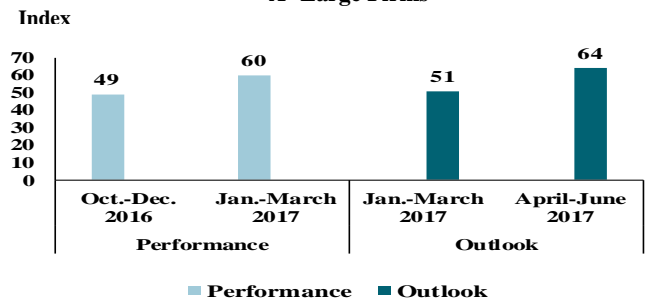
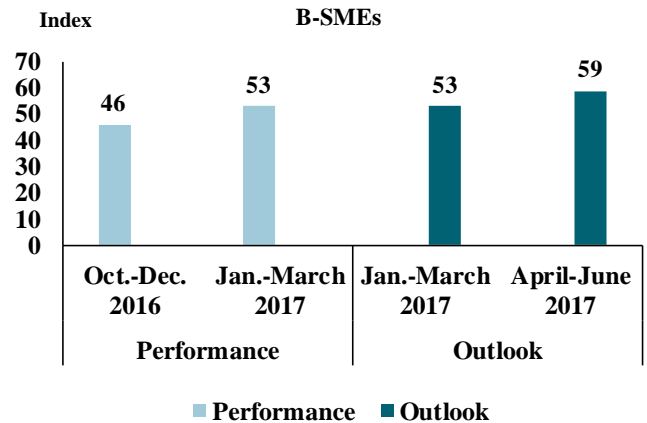


Figure 2.4: Business Barometer Index

B-SMEs



Source: Survey results.

Past Performance of Businesses

Improvement in all economic activity indicators

Economic Activity

The results of assessing the past performance of large firms reveal a rise in production and domestic sales and a decline in the inventory index (i.e., increased level of inventory) in the quarter under review (January-March 2017). This can be attributed to higher economic growth and capacity utilization, driven mainly by demand growth and increased domestic consumption. Capacity utilization increased by 53.8 points while exports fell to 66.7 points in January-March 2017 from 70 in October-December 2016 (Figure 3-1).

Survey results for SMEs reflect higher growth of economic indicators for production, exports and domestic sales during January-March 2017 compared to the previous quarter and to large companies, while results for economic growth were similar to large companies.

SMEs reported a relatively higher rate of capacity utilization, reflecting energizing the role of SMEs in substituting imports whose prices rose in the wake of exchange rate liberalization, with higher demand on locally produced inputs. Firms also reported a decline in the inventory index during the period under review, which could be attributed to higher commodity prices and lower consumption.

Figure 3.1: Economic Activity
 A. Evaluation: Large Firms

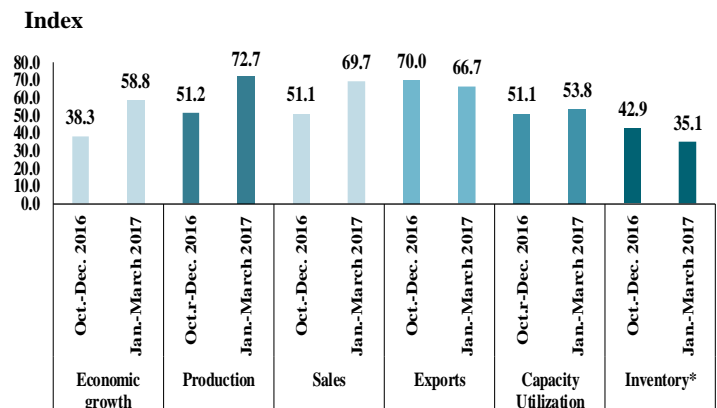
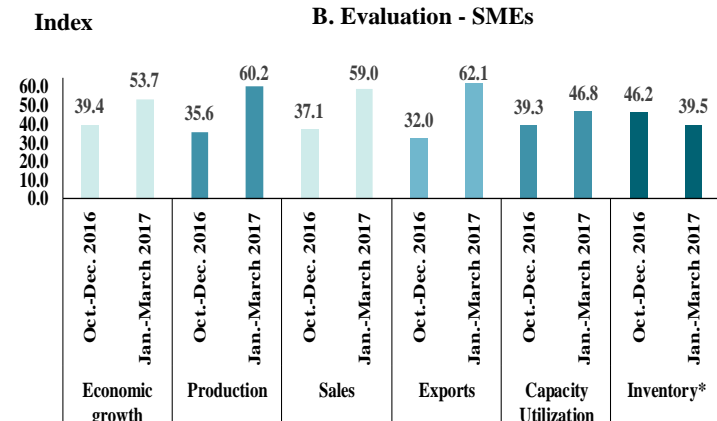


Figure 3.2: Economic Activity
 B. Evaluation - SMEs



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

Prices and Wages

Lower input and final product prices indices, and higher wages

Large firms reported lower input prices during January-March 2017 compared to the previous quarter, being affected by the slowdown in world prices as well as the import substitution policy, which led to a decline in final product prices. However, this decline in input prices is still below the mean (50 points) (see the Methodology in the Appendix). Meanwhile, wages rose during the period, which can be attributed to annual wage increases that usually take place at end of December of each year (Figure 3-3).

The results for SMEs are generally similar but slightly less than those of large firms between the quarter under review and the previous quarter. This is due to the continued lack of financial and investment flexibility of these firms (Figure 3-4).

Investment and Employment

Higher investment and employment indices in large firms and SMEs

Contrary to the second quarter of FY2016/2017 (October-December 2016), the results of large firms indicate a rise in investment and employment as a result of stabilizing economic fundamentals. The investment index rose from 44.8 points in the second quarter to 64.1 points in the third quarter (January-March 2017), while the employment index rose from 48.5 points to 57.8 points during the same period (Figure 3-5).

Survey results regarding investment and employment for SMEs were similar to large firms. The investment index rose from 37 points in the second quarter to 47.1 points in the third quarter, while the employment index rose from 47.9 points to 49.1 points during the same period. It is noteworthy that this rise in the employment and investment indices is still below the mean (50 points) (see the Methodology in the Appendix). The rise in employment and investment indices can be attributed to rationalization of imports due to their higher prices after liberalization of the exchange rate, as well as to the higher demand on locally produced inputs (Figure 3-6).

Figure 3.3: Prices and Wages

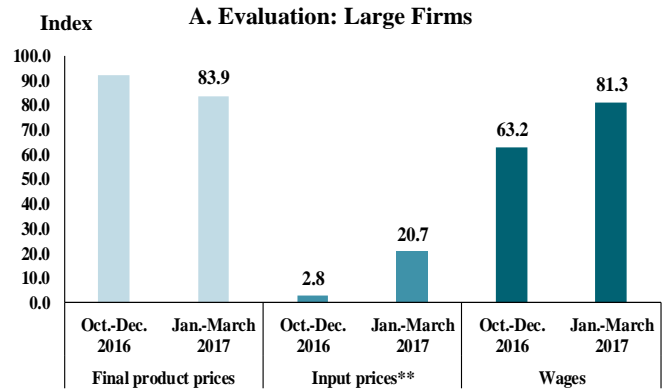


Figure 3.4: Prices and Wages

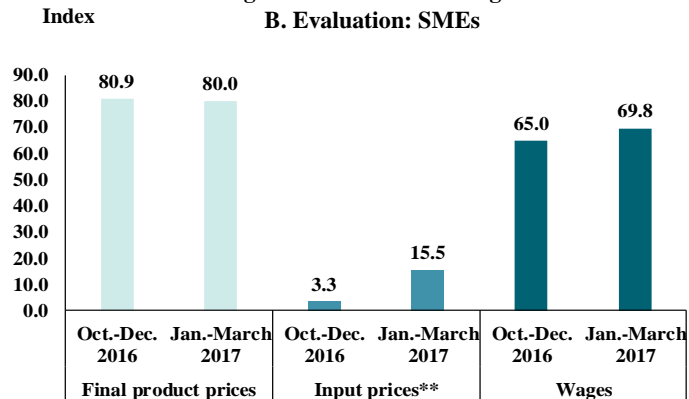


Figure 3.5: Investment and Employment

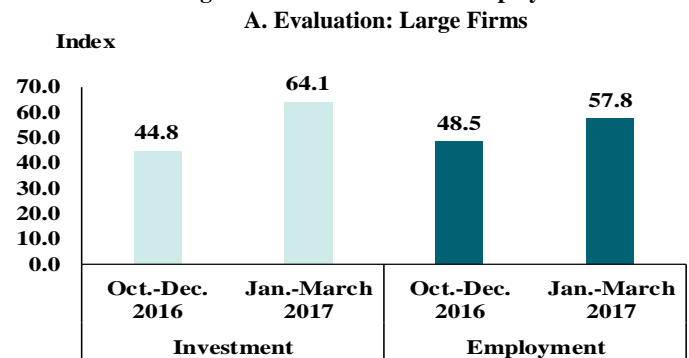
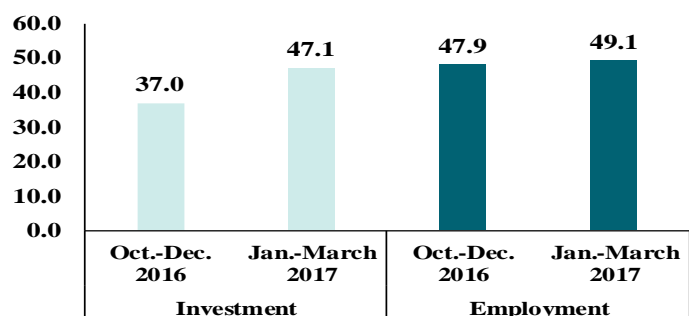


Figure 3.6: Investment and Employment



Source: Survey results.

** 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.

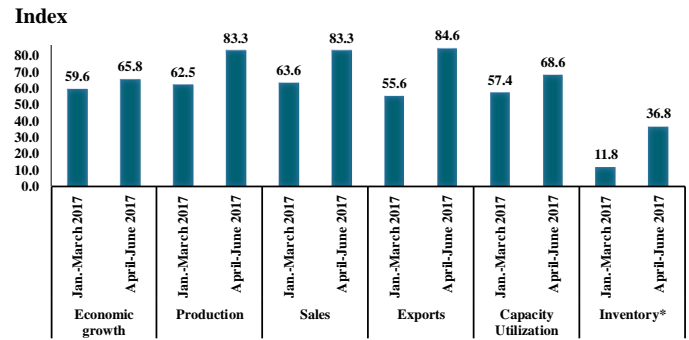
Business Strategy Going Forward

Large firms and SMEs are cautiously optimistic about economic growth

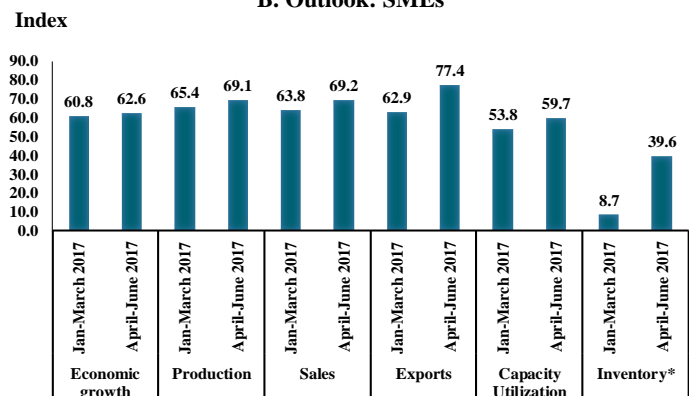
The expectations of both large firms and SMEs for April-June 2017 reflect cautious optimism on the part of the business community regarding the economic reform program and its impact on realizing economic balance in the short run. Expectations of large firms for economic growth were relatively cautious, while the outlook for production, domestic sales, exports and capacity utilization were more optimistic. Expectations are less optimistic for inventory in the same period (Figure 4-1).

The outlook of SMEs was similar to that of large firms, with the former reporting cautious expectations about economic activity, albeit more optimistic for exports (Figure 4-2).

**Figure 4.1: Economic Activity
 A Outlook: Large Firms**



**Figure 4.2: Economic Activity
 B. Outlook: SMEs**



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.

Prices and Wages

Expectations of higher input prices and a slight decline in wages

Large firms expect the decline in input and final product prices to continue during the last quarter of FY2016/2017. They also expect lower wages, which can be attributed to firms' pegging incentives to the volume of sales.

The outlook of SMEs is similar to that of large firms, with the former expecting lower input and final product prices, along with slightly lower wages (Figure 4-4).

Investment and Employment

Expectations of a slight increase in investment and employment indices

Expectations by large firms regarding employment and investment during April-June 2017 are more optimistic compared to January-March 2017 (Figure 4-5).

The outlook of SMEs regarding employment and investment was more optimistic, reflecting views of future expansion in employment (Figure 4-6).

Figure 4.3: Prices and Wages

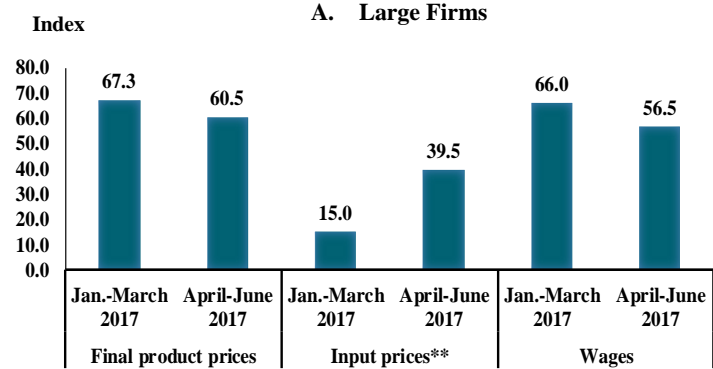


Figure 4.4: Prices and Wages

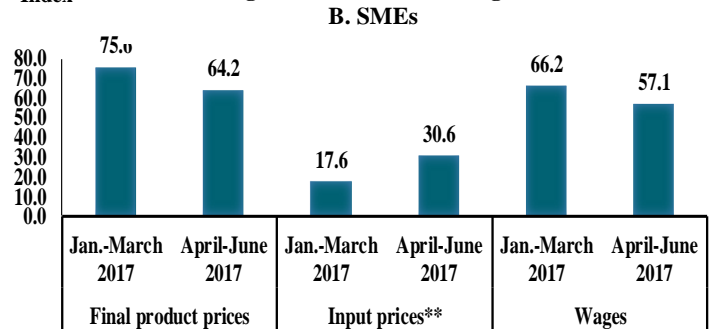


Figure 4.5: Investment and Employment

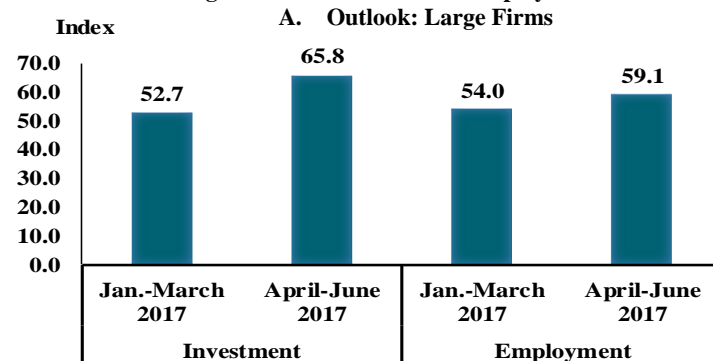
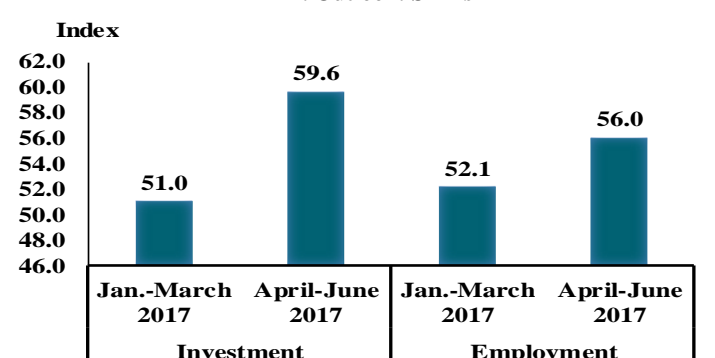


Figure 4.6: Investment and Employment



Source: Survey results.

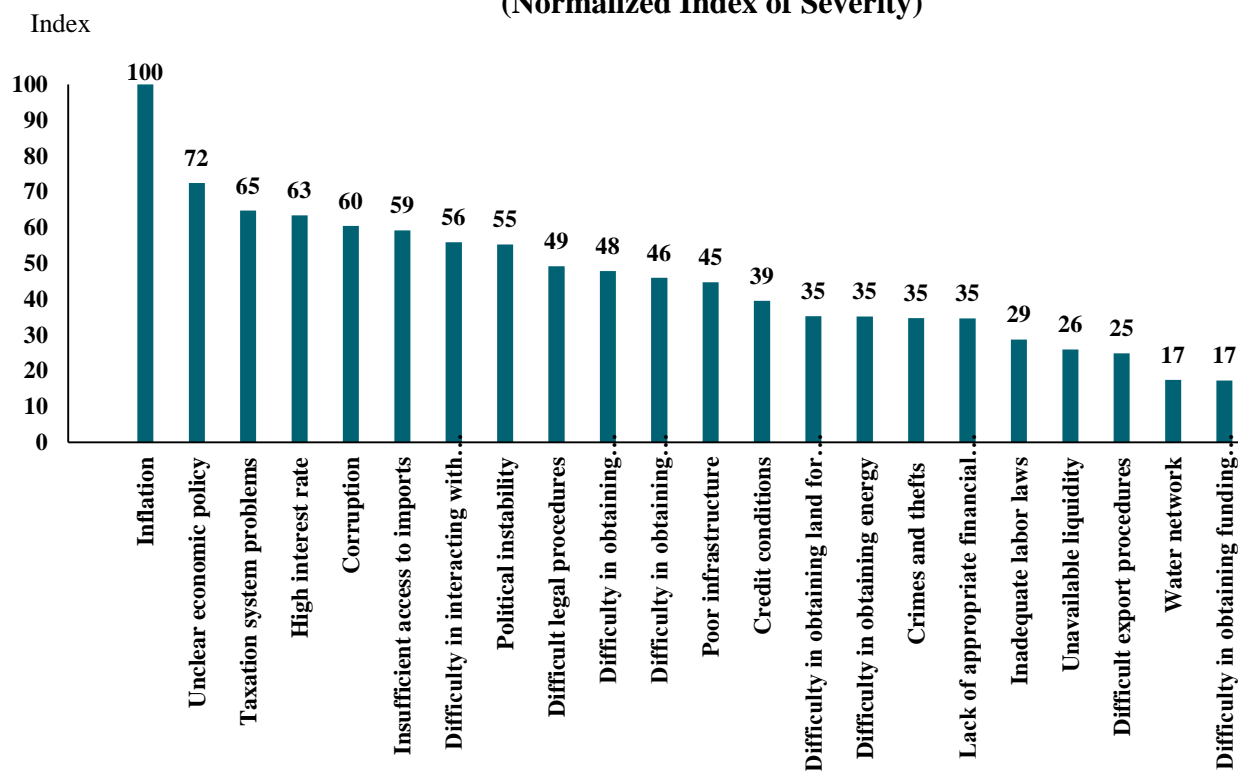
** The index for input prices is inverted to indicate the negative effect of the increase in input prices on businesses. Hence, a lower value of this index indicates higher input prices.

Business Constraints

Major constraints: inflation, unpredictable and inconsistent economic policies, tax policies, and high lending interest rates.

Firms cited inflation as the most severe constraint encountered during January-March 2017, especially as continued high inflation rates reflected on production cost and price levels and hence demand in the domestic market. Inconsistent and unpredictable economic policies came in next, followed by tax policies and high lending interest rate (Figure 5).

Figure 5: Major Constraints Facing the Business Sector (Normalized Index of Severity)



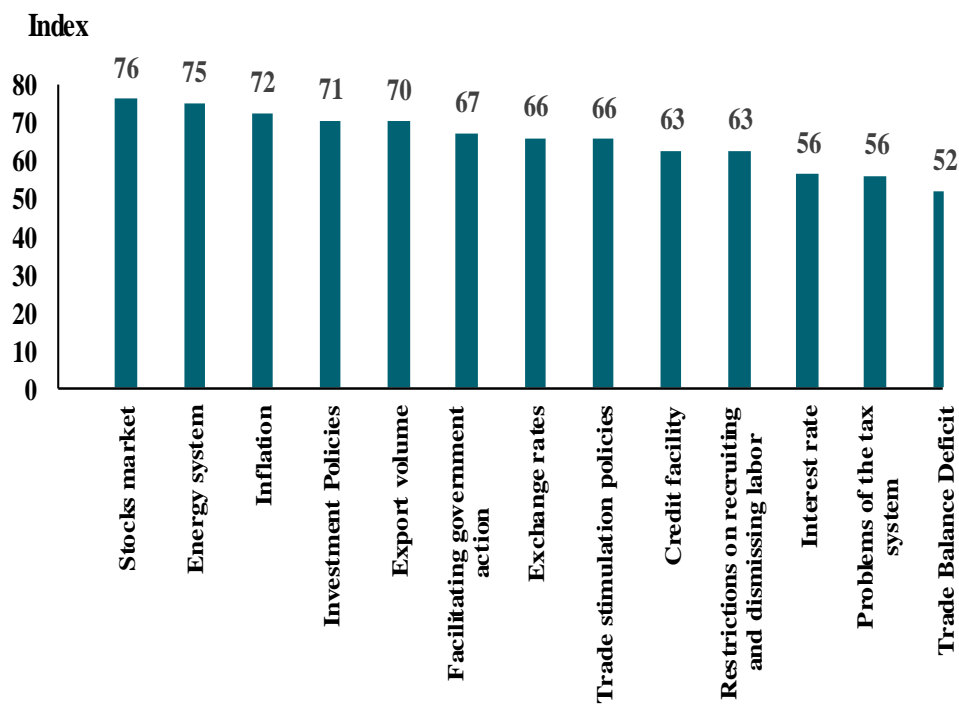
Source: Survey results.

Policy Expectations

The stock market, energy, inflation, and investment policies were at the forefront of expectations of the business community

The majority of firms expect adoption of reform policies in the stock market to absorb investments, and introduction of less expensive and more diversified financing instruments with the rise in interest rates. Firms also expect the adoption of new reform policies in the energy sector and the continuation of its current restructuring (Figure 6).

Figure 6: Policy Expectations



Source: Survey result.

Commentary on Survey Results

Overall, expectations of large firms and SMEs for the period April-June 2017 were more optimistic compared to January-March 2017. Firms expect higher economic growth, production, domestic sales, exports, employment, capacity utilization and investment during April-June 2017. This optimism can be attributed to the start of reaping the benefits of economic reforms, and the issuance of the new investment and industrial licensing laws.

However, this optimism on the part of firms has been cautious given the persistence of inflationary pressures, inconsistent and unpredictable economic policies and rising interest rates.

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 A1. Sectors' Past Performance for all Firms (January-February-March 2017)¹

Index	Manufacturing			Construction			Tourism			Transportation			Communications			Financial Services								
	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²				
Economic growth	35	32	33	51	33	67	0	60	50	42	8	65	30	60	10	56	33	17	50	43	47	33	20	60
Economic activity																								
Production	46	26	28	57	73	13	13	76	58	33	8	69	40	50	10	60	50	17	33	57	67	27	7	74
Sales	43	27	30	55	73	13	13	76	58	33	8	69	30	60	10	56	50	17	33	57	67	27	7	74
Exports	56	44	0	70	0	0	0	0	38	50	13	58	33	67	0	60	50	0	50	50	0	100	0	50
Inventory	43	35	22	42	40	53	7	39	50	33	17	38	40	50	10	40	50	33	17	38	71	29	0	22
Level of capacity utilization	9	63	28	44	33	60	7	58	17	67	17	50	20	50	30	47	0	33	67	25	43	57	0	64
Prices																								
Final product prices	83	17	0	85	93	7	0	94	75	25	0	80	67	11	22	70	50	33	17	63	53	47	0	68
Intermediate input prices	91	9	0	9	100	0	0	0	58	42	0	29	70	30	0	23	60	40	0	29	30	70	0	41
Wage level	68	32	0	76	53	47	0	68	50	50	0	67	40	60	0	63	33	67	0	60	73	27	0	79
Primary inputs																								
Investment	14	63	23	47	20	67	13	52	17	67	17	50	10	80	10	50	17	33	50	38	69	31	0	76
Employment	15	68	17	50	33	60	7	58	8	92	0	52	0	100	0	50	17	50	33	44	7	93	0	52

Table A2. Sectors' Outlook for all Firms (April-May-June 2017)¹

Index	Manufacturing			Construction			Tourism			Transportation			Communications			Financial Services								
	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²	Higher	Same	Lower	Index ²				
Economic growth	48	42	11	63	67	33	0	75	58	42	0	71	40	50	10	60	17	50	33	44	33	60	7	58
Economic activity																								
Production	63	25	12	70	73	20	7	78	75	25	0	80	50	40	10	64	50	50	0	67	73	7	20	75
Sales	63	26	11	71	73	20	7	78	75	25	0	80	50	40	10	64	50	50	0	67	73	7	20	75
Exports	78	22	0	82	0	0	0	0	71	29	0	78	67	33	0	75	67	33	0	75	75	25	0	80
Inventory	34	53	13	43	13	80	7	48	58	42	0	29	56	33	11	33	67	33	0	25	73	20	7	22
Level of capacity utilization	38	52	10	59	53	47	0	68	27	73	0	58	44	44	11	62	33	67	0	60	53	47	0	68
Prices																								
Final product prices	35	65	0	61	80	20	0	83	50	50	0	67	30	70	0	59	50	50	0	67	33	67	0	60
Intermediate input prices	63	35	2	27	73	27	0	21	17	83	0	45	30	70	0	41	40	60	0	38	20	80	0	44
Wage level	28	72	0	58	13	87	0	54	25	75	0	57	40	60	0	63	17	83	0	55	13	87	0	54
Primary inputs																								
Investment	29	66	5	57	67	33	0	75	50	50	0	67	30	70	0	59	17	67	17	50	50	50	0	67
Employment	28	67	5	57	20	80	0	56	17	83	0	55	30	70	0	59	17	83	0	55	27	73	0	58

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 A3. Survey Results: Summary of Past Performance of all Firms (January-February-March 2017)¹

Indicator	SMEs				Large Firms			
	Percent			Index ²	Percent			Index ²
	Higher	Same	Lower	53	Higher	Same	Lower	60
Economic growth	35	41	24	54	46	31	23	59
Economic activity								
Production	49	27	24	60	65	27	8	73
Sales	47	28	24	59	62	27	12	70
Exports	45	45	10	62	50	50	0	67
Inventory	47	35	18	40	48	48	4	35
Level of capacity utilization	15	60	25	47	28	56	16	54
Prices								
Final product prices	76	21	3	80	81	19	0	84
Intermediat input prices	82	18	0	15	74	26	0	21
Wage level	57	43	0	70	77	23	0	81
Primary inputs								
Investment	15	61	24	47	44	56	0	64
Employment	11	74	14	49	27	73	0	58

Table A4. Survey Results: Summary of Outlook of all Firms April-May-June 2017)¹

Indicator	SMEs				Large Firms			
	Percent			Index ²	Percent			Index ²
	Higher	Same	Lower	59	Higher	Same	Lower	64
Economic growth	46	43	10	63	50	46	4	66
Economic activity								
Production	61	27	12	69	81	15	4	83
Sales	61	28	12	69	81	15	4	83
Exports	71	29	0	77	82	18	0	85
Inventory	41	49	10	40	46	46	8	37
Level of capacity utilization	37	57	7	60	56	40	4	69
Prices								
Final product prices	44	56	0	64	35	65	0	60
Intermediat input prices	56	43	1	31	35	65	0	39
Wage level	25	75	0	57	23	77	0	57
Primary inputs								
Investment	35	61	4	60	48	52	0	66
Employment	24	73	3	56	31	69	0	59

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.