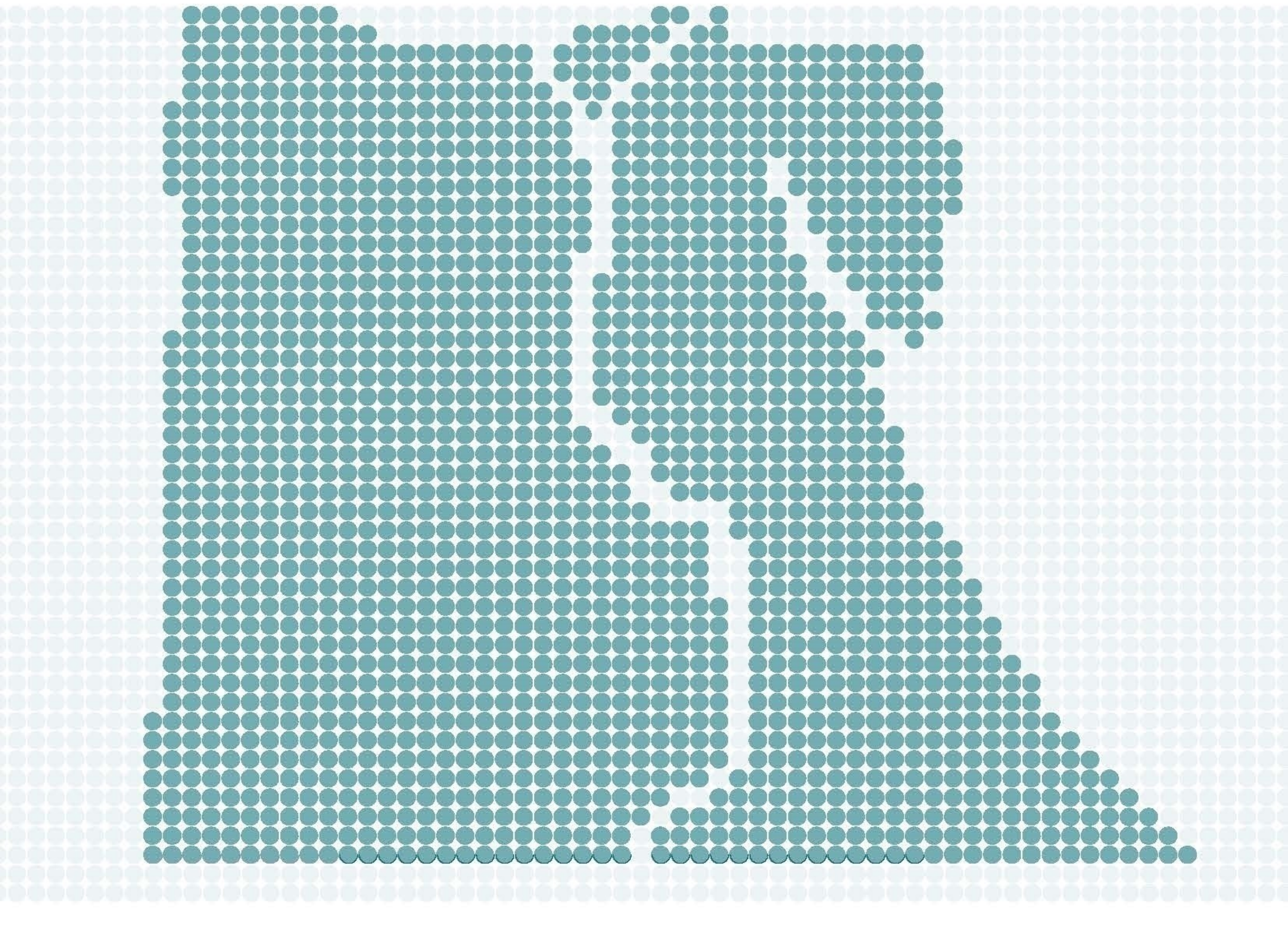
المركز المصري للدراسات الاقتصادية

The Egyptian Center for Economic Studies

Business Barometer

Issue 45 2017



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.

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 first quarter (July-September) of FY2017/2018. It also summarizes their expectations for overall future economic performance as well as their own activities for the second quarter (October-December) of the same fiscal year.

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The Egyptian Center for Economic Studies

Business Barometer

Issue No. 45 – 2017

(December 2017)

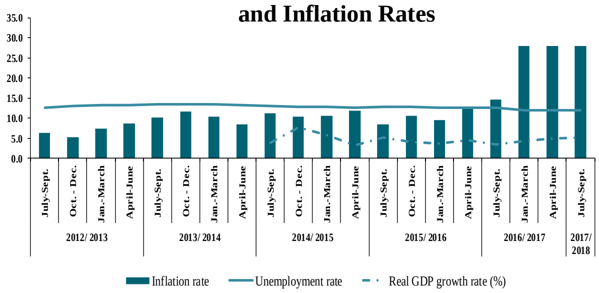
Contents

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 first quarter (July-September 2017) and their outlook for the second quarter (October-December 2017) of FY2017/ 2018. The surveyed firms represent the manufacturing sectors (50 percent), financial services (13 percent), construction (12 percent), transportation (10 percent), tourism (9 percent) and telecommunications (7 percent). The survey also covers a number of micro, small, medium and large firms (as per the Central bank of Egypt CBE definition). According to the survey, the business community is starting the new fiscal year with an optimistic view about the signs of recovery of a number of economic indicators, including GDP growth rate, which rose to 5.2 percent during the first quarter of FY2017/2018, compared to 3.4 percent during the same period of the previous fiscal year. Higher growth rate was reflected in a slight drop in the unemployment rate to 11.98 percent during the first quarter compared to 12.6 percent in the comparable quarter of FY2016/2017, recording its lowest level in two years (Figure 1-1).

On the side of macroeconomic indicators, the inflation rate in the relevant quarter rose on average to 33.4 percent from 31.6 percent in the previous quarter, following the decision to reduce fuel subsidies at the end of June. The Central Bank of Egypt (CBE) faced inflationary pressures by raising overnight deposit and lending rates by 200 basis points (bps) in July for the third time since the decision to liberalize the exchange rate. This quarter saw other measures, including raising electr

Figure 1.1: Real GDP Growth, Unemployment and Inflation Rates

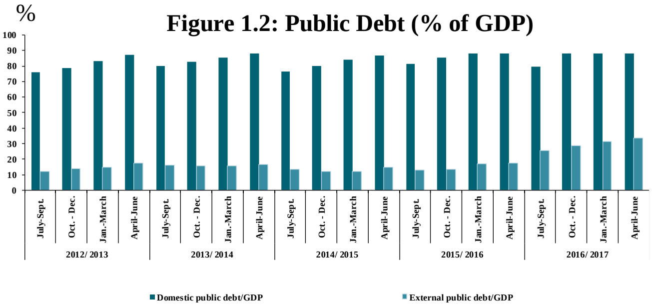


Sources: MoF, *Monthly Statistical Bulletin*, various issues; CAPMAS.
* Data for real GDP growth rate for the period (January- March 2016/ 2017) is primary and may be modified.
* Data for real GDP growth rate for (April-May 2016/ 2017 and July-September 2017/ 2018) is from a press release.

At the fiscal front, recent economic reforms adopted by the state since 2016 led to further improvement in fiscal indicators, including the decline of total deficit to GDP ratio, recording 1.7 percent during July-August 2017 compared to 2.0 percent during the comparable period last year. This decline is mainly attributed to the growth in public revenues at a rate higher than that of expenditures.

The government's policy to finance the deficit by issuing bonds and treasury bills (T-bills) in local or foreign currency continued, increasing domestic debt to about EGP 3160.9 billion at the end of June 2017 (93 percent of GDP). External public debt also rose to $79 billion by the end of June 2017 compared to $55.8 billion at the end of June 2016 (Figure 1-2) according to the latest CBE data.

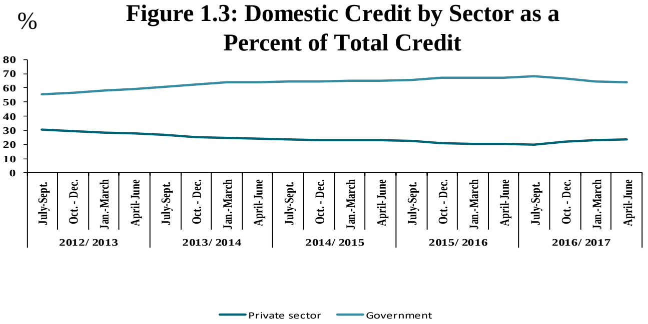
Figure 1.2: Public Debt (% of GDP)



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

The inflated indebtedness and continued borrowing negatively affect the Egyptian economy's competitiveness and credit rating, in addition to exerting further fiscal pressure and limiting the state's ability to meet the constitutional entitlements, which require increasing spending on education, health and scientific research. Also, the credit available to the private sector needed to finance economic activities will also drop, increasing economic recession and leading to the contraction of public revenues (Figure 1-3), according to the latest CBE data.

Figure 1.3: Domestic Credit by Sector as a Percent of Total Credit



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

Net international reserves increased on average in the relevant quarter to $36.3 billion compared to $30.4 billion in the preceding quarter of the same fiscal year. This increase is due to receiving the second tranche of the International Monetary Fund (IMF) loan in July, surplus in the trade balance, increased tourism revenues, Suez Canal revenues, and largely from direct loans and foreigners' investments in T-bills. Foreigners' investments in T-bills amounted to EGP 284 billion during the period following the liberalization of the exchange rate. It should be noted that the average exchange rate against the US dollar dropped slightly in the relevant quarter to EGP 17.71 compared to EGP 18.03 in the previous quarter due to increased dollar resources in the banking system.

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

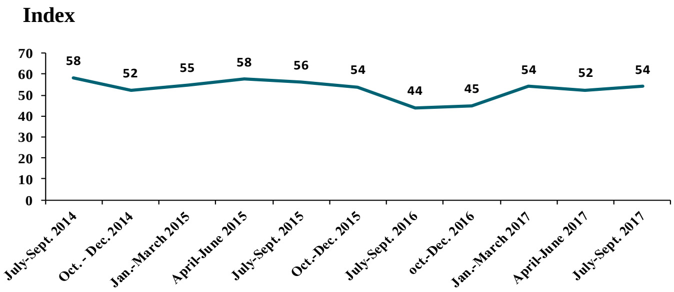
Source: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

Business Barometer Index (BBI)

Improved performance and stable outlook

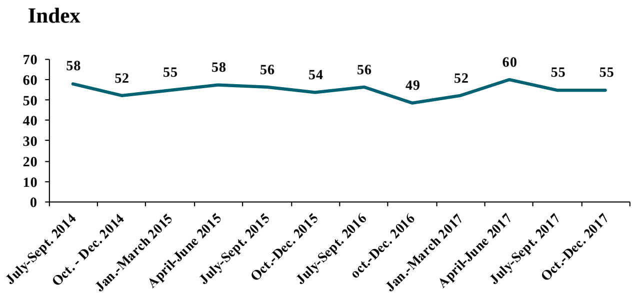
Businesses' overall performance improved by two points during the period July-September 2017 (Figure 2-1) compared to the previous quarter, despite the government's continued implementation of the economic reform program and the impact of reform measures on businesses. For the period October-December 2017/2018, firms' outlook remained stable in value terms compared to the previous quarter (Figure 2-2), but in an upward direction, recording 55 points.

Figure 2.1: Business Barometer Index - Evaluation



* Data for the two quarters of January-March and April-June 2016 are unavailable.

Figure 2.2: Business Barometer Index - Outlook



* Data for the two quarters of April-June, and July-September 2016 are unavailable.

Source: Survey results.

The past performance BBI results (Figure 2-4) for the period July-September 2017 showed improved SMEs performance. Large firms' results are similar to the previous quarter, indicating that large firms are more cautious than small and medium enterprises (SMEs). Both SMEs' and large firms' outlook improved, though the latter's outlook is lower than the former's (Figure 2-3). The difference may be attributed to the fact that large firms recovered and benefited from the liberalization of the exchange rate at a faster pace as shown in the previous issues of Business Barometer. The improvement in SMEs, however, was gradual and accelerated during the relevant quarter.

Figure 2.3: Business Barometer Index
A- Large Firms

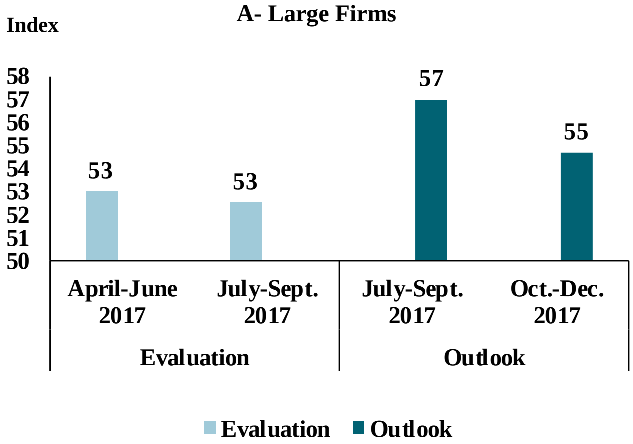
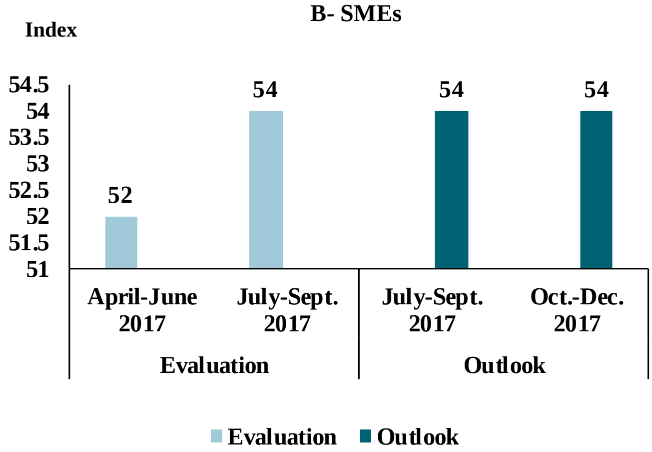


Figure 2.4: Business Barometer Index
B- SMEs



Past Performance of Businesses

Higher Economic Activity indicators for large firms and SMEs

At the economic activity level, large firms consistently reported high domestic sales and exports during the relevant quarter. However, the inventory rose during the relevant quarter, indicating that the increase in production was higher than that of domestic sales and exports, and that the effects of the economic shock is still overshadowing firms' performance. This was reflected in decreased production capacity utilization (Figure 3-1).

Past performance indicators for SMEs were better than large firms, with the former reporting more positive views regarding domestic sales and exports during the period July-September 2017 compared to the previous quarter, resulting in higher production and capacity utilization. The results showed an increase in the economic growth index for SMEs compared to the previous quarter, which may be due to the increased use of local inputs (Figure 3-2).

Sectorally, the service sector reported better performance than the manufacturing sector. In the service sector, communications recorded the best performance, which may be attributed to increased production of the surveyed firms, and was reflected in high domestic sales followed by the tourism sector due to increased tourist arrivals during the relevant quarter. The financial intermediation sector followed, which can be attributed to the significant improvement it saw due to improved performance of the capital market, as indicated in the global competitiveness report 2017/2018. The positive views of the construction and manufacturing sectors declined due to the hike in the prices of raw materials' and difficulty of borrowing. The transportation sector reported the most negative views due to doubling the prices of road services.

Figure 3.1: Economic Activity
A. Evaluation: Large Firms

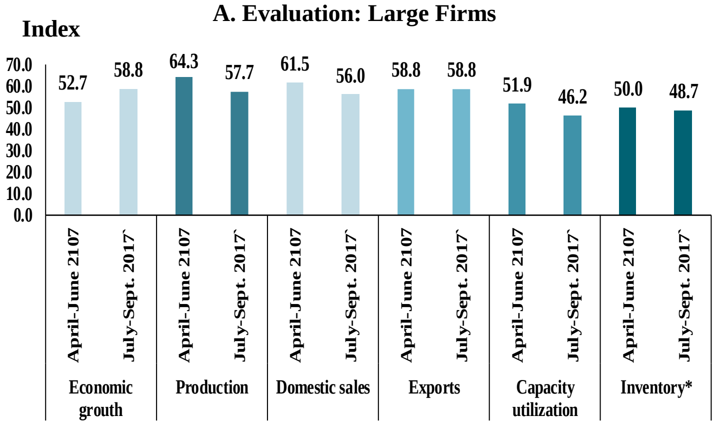
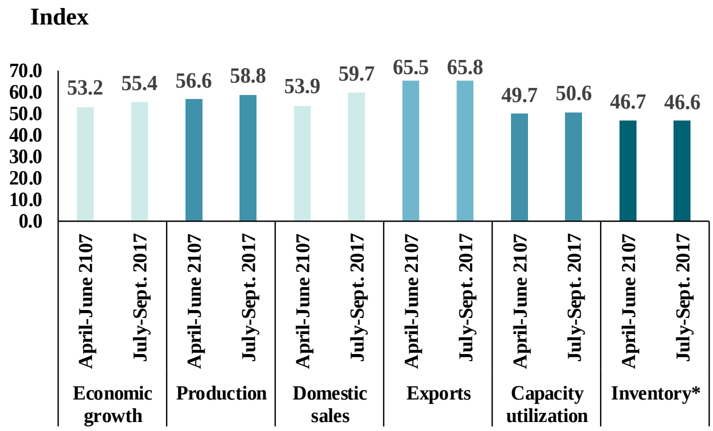


Figure 3.2: Economic Activity
B. Evaluation - SMEs



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 inventory and vice versa.

Increased input and final product prices

The past performance assessment of large firms showed that the rise in the prices of inputs and final products as well as in wages remains high in the quarter under study, though slightly lower than the previous quarter. This is attributed to the economic reform measures adopted during the relevant quarter, including increasing electricity prices and value added tax. SMEs' results are similar to those of the large firms.

Improved investment and employment indices

The investment index improved during the relevant quarter for large as well as medium and small firms. This can be attributed to optimism caused by the government's seriousness in adopting reform measures that will improve the investment climate either through the executive regulations of the investment law or issuance of the executive regulations of the law on facilitating industrial licensing procedures. The employment index for large, small and medium firms rose, reflecting the positive impact of economic reforms (Figures 3-5 and 3-6).

Figure 3.3: Prices and Wages
A. Evaluation: Large Firms

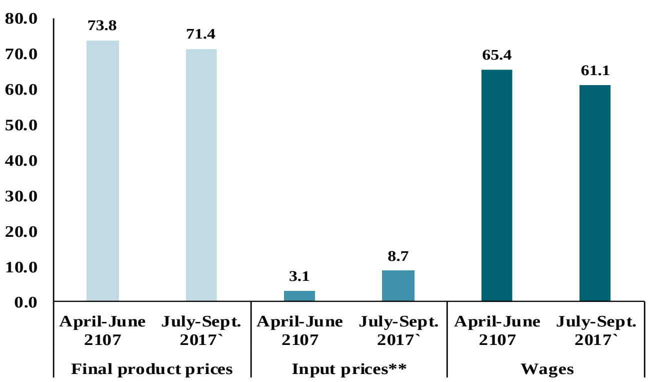


Figure 3.4: Prices and Wages
B. Evaluation: SMEs

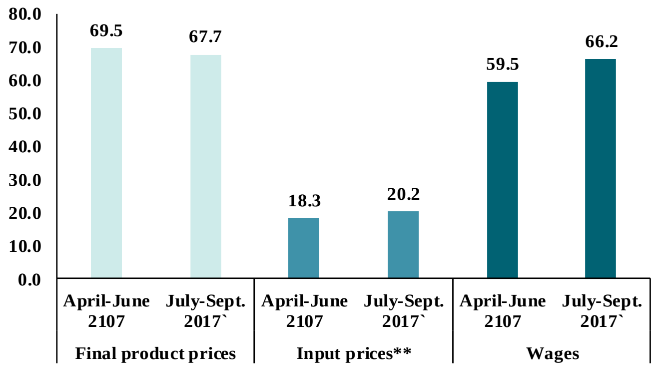
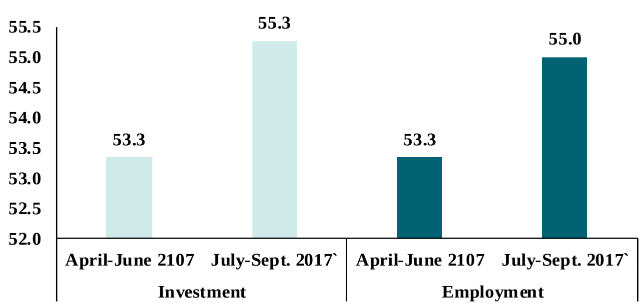
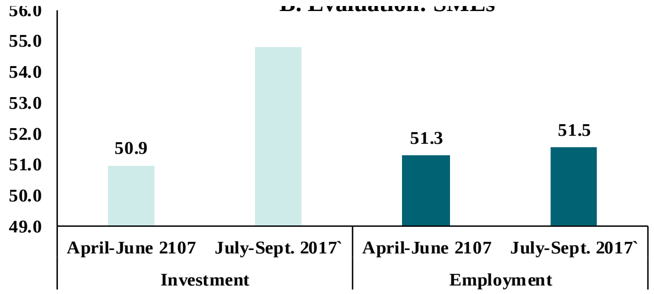


Figure 3.5: Investment and Employment
A. Evaluation: Large Firms





Source: Survey results.

** The input price index is inverted to reflect the negative impact of rising input prices on the BBI. In other words, a lower index indicates higher input prices.

Business Strategy Going Forward

Expectations of improved economic activity for SMEs

Firms' outlook for the second quarter (October – December FY2017/ 2018) is positive, but less optimistic than the previous quarter of the same year. Businesses expect a rise in domestic sales and exports, leading to a continuous rising in the outlook index for production and capacity utilization. Increased positive views on domestic sales may be attributed to the continued positive views on economic growth compared to the previous quarter and to the commitment of respondents to future production plans (Figure 4-1). The results also showed that SMEs outlook for the quarter under study is similar to those of large firms in all economic indicators. However, the inventory level is taking an upward trend.

Sectorally, the highest expectations came from firms operating in financial services and telecommunications, followed by the manufacturing sector. The lowest expectations were from the tourism and transportation sectors, which may be attributed to the lack of future contractual engagements for the surveyed firms in both sectors.

Figure 4.1: Economic Activity
A. Outlook: Large Firms

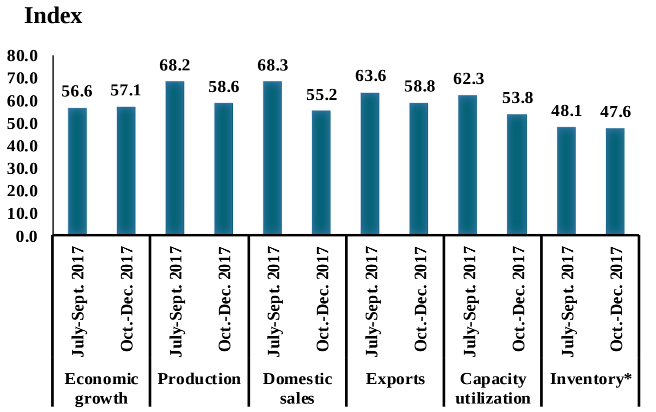
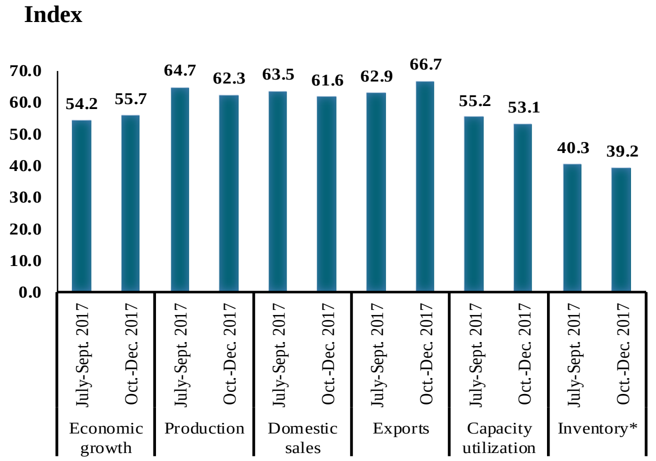


Figure 4.2: Economic Activity
B. Outlook: SMEs



Source: Survey results.
* The inventory index is inverted to reflect the negative impact of rising inventory on businesses. In other words, a higher index indicates lower inventory and vice versa.

Expectations of continued hike in the prices of final products, inputs and wages

Most large firms expect final product prices and wages to remain high, albeit slightly lower than in the previous quarter. They also expect the same for input prices (Figure 4-3), which can be explained by the continued pass-through effect of reducing fuel subsidies and increasing electricity prices in the previous quarter. SMEs results were similar to those of the large firms (Figure 4-4).

Expectations of improved investment and employment

Most large firms expect higher investment and employment during the period October-December FY2017/2018 compared to the previous quarter. This is attributed to the decision to raise the interest rate in the previous quarter and the continued difficulty in obtaining financial services. SMEs' expectations were similar to those of the large firms (Figure 4-6).

Figure 4.3: Prices and Wages
A. Outlook: Large Firms

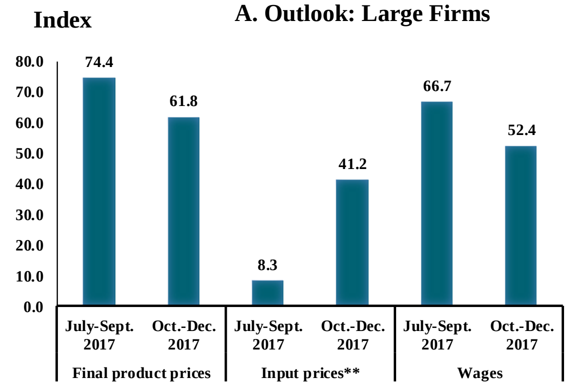


Figure 4.4: Prices and Wages
B. Outlook: SMEs

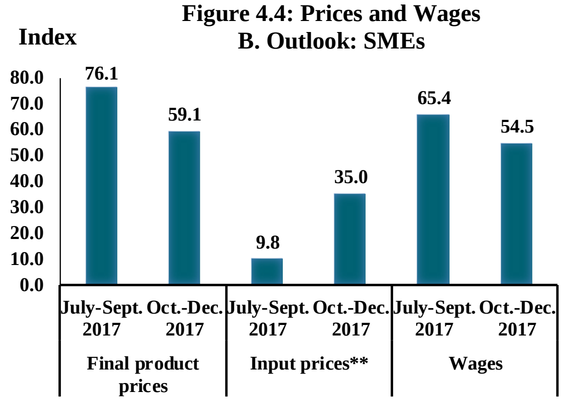


Figure 4.5: Investment and Employment
A. Outlook: Large Firms

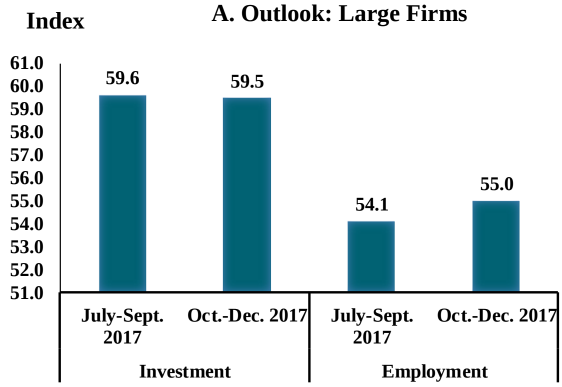
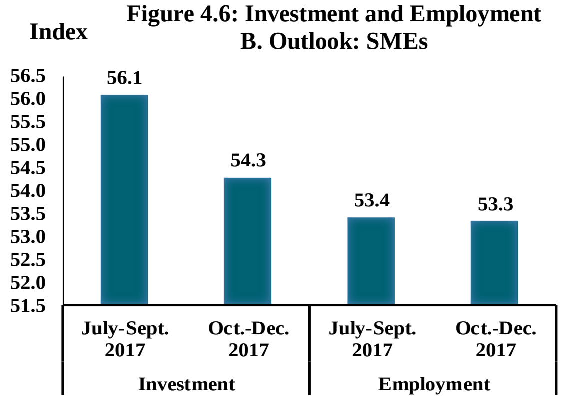


Figure 4.6: Investment and Employment
B. Outlook: SMEs



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.

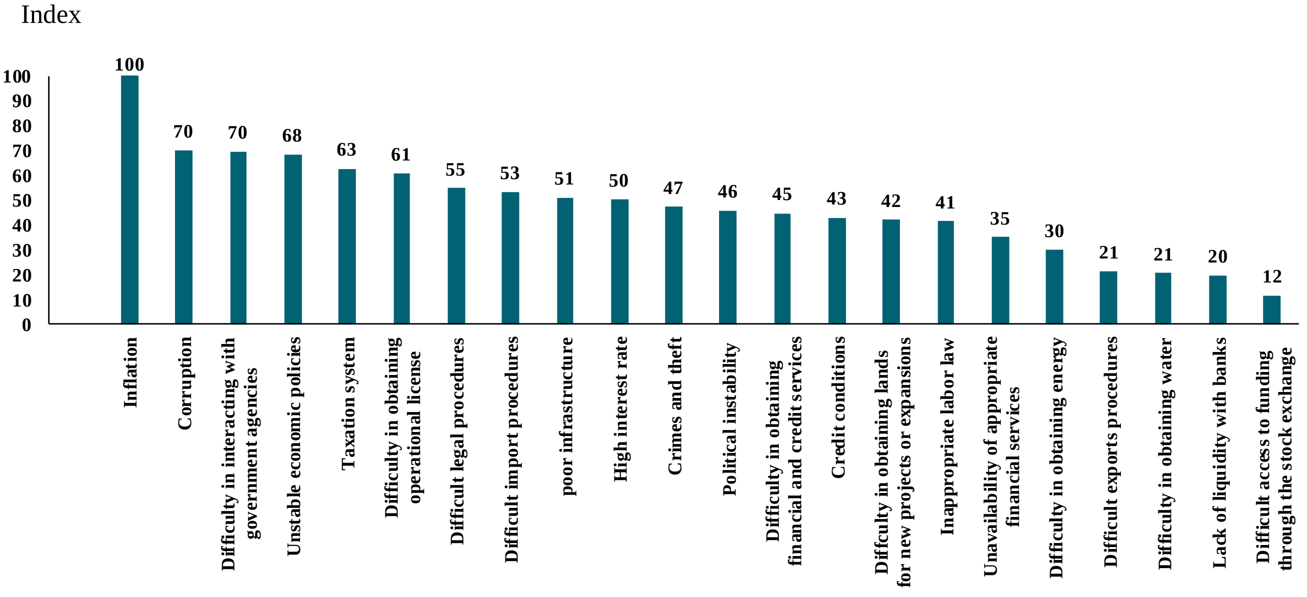
Business Constraints

Major constraints facing the business sector:

Major constraints: inflationary pressures, corruption, difficulty in interacting with government entities and the taxation system

Figure 5 shows the major constraints that faced businesses during the surveyed period, arranged in a descending order of severity. In particular, firms expressed concern about inflation, corruption, difficulty in interacting with government entities, and the taxation system. It is worth noting that the order of constraints remains relatively similar to that of the previous survey, indicating minimal progress in removing constraints. Inflationary pressures remain the most severe constraint due to the reform measures adopted during the relevant quarter. While the government adopted certain measures to control inflation, such as raising interbank depositing and lending rates, businesses considered this decision a constraint. Corruption came second on the list of major constraints facing businesses, signaling the need to adopt more measures to fight corruption. Difficulty in interacting with government agencies came third, followed by the taxation system, including increased value added tax rate. Funding from the equity market was ranked as the lowest constraint.

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



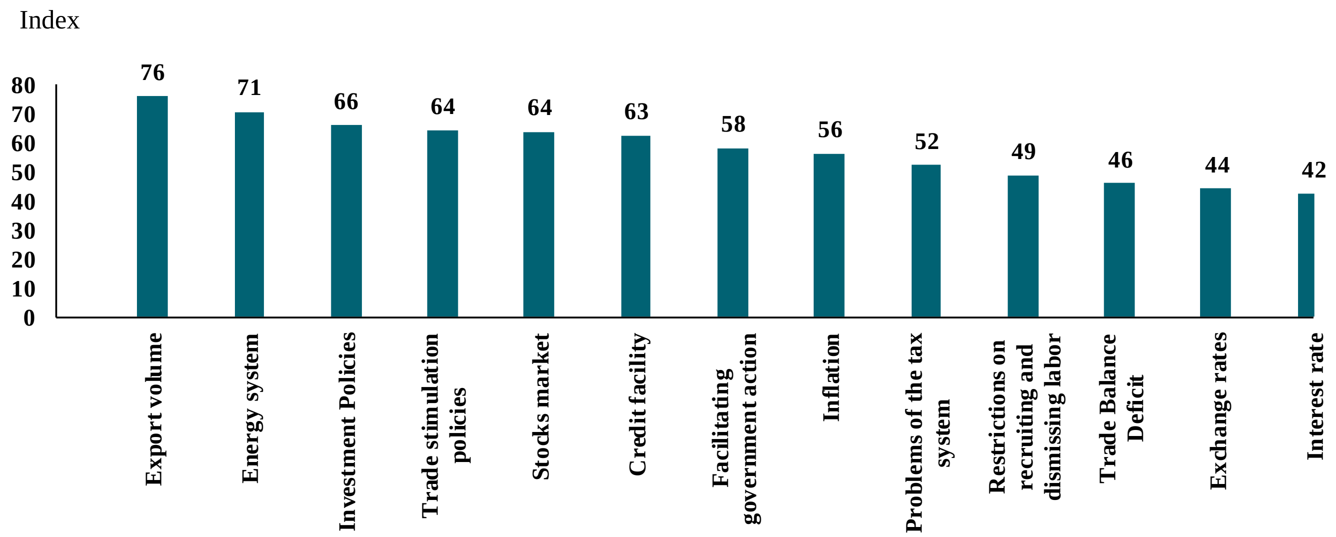
Source*:* Survey results.

Policy Expectations

Expected improvement in exports, energy system and investment policy

According to Figure 6, most firms expect improvements in exports in the coming quarter due to the liberalization of the exchange rate, which gives Egyptian products a competitive advantage in the global markets. They also expect improvement in the energy system and investment policy to avail a more enabling environment to increase foreign direct investments. The government is expected to adopt trade-stimulating policy. However, a large percentage of firms does not expect a reduction in the interest rate due to the monetary policy adopted by the government to control inflation.

Figure 6: Policy Expectations



Source: Survey results.

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:

$$x = \frac{I+S}{\text{١٠٠}+S} \text{ X } 100 \qquad ,$$

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 A-1: Survey Results - Summary of Past Performance of All Firms (by Sector) (July-August-September 2017)[1]

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Intermediation			
	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]
	Higher	Same	Lower	53	Higher	Same	Lower	54	Higher	Same	Lower	56	Higher	Same	Lower	48	Higher	Same	Lower	58	Higher	Same	Lower	56
Economic growth	32	42	27	52	29	64	7	57	70	30	0	77	25	42	33	47	38	63	0	62	47	47	7	64
Economic activity																								
Production	40	32	28	54	50	36	14	63	50	30	20	62	25	50	25	50	75	13	13	78	63	19	19	68
Domestic sales	39	29	32	53	64	21	14	71	60	30	10	69	25	42	33	47	75	13	13	78	67	13	20	71
Exports	48	44	8	64	-	-	-	-	60	20	20	67	33	50	17	56	50	50	0	67	-	-	-	-
Inventory	19	66	15	49	29	50	21	48	30	40	30	50	42	50	8	39	0	80	20	56	33	67	0	40
Capacity utilization	20	59	20	50	7	79	14	48	20	50	30	47	8	67	25	45	14	71	14	50	20	80	0	56
Prices																								
Final product prices	64	31	5	73	36	64	0	61	70	20	10	75	67	33	0	75	14	86	0	54	47	33	20	60
Intermediate input prices	76	24	0	19	79	21	0	18	86	14	0	13	91	9	0	8	71	29	0	22	70	30	0	23
Wage level	50	48	2	66	50	50	0	67	40	60	0	63	42	58	0	63	43	57	0	64	44	56	0	64
Primary inputs																								
Investment	25	68	7	56	29	71	0	58	0	90	10	47	8	92	0	52	25	63	13	54	25	75	0	57
Employment	22	62	17	52	21	64	14	52	20	70	10	53	8	83	8	50	13	88	0	53	19	81	0	55

Table A2. Survey Results: Summary of Outlook of all firms (by Sector) (October- November-December 2017)[1]

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Intermediation			
	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]	Percentage			Index[2]
	Higher	Same	Lower	53	Higher	Same	Lower	54	Higher	Same	Lower	46	Higher	Same	Lower	52	Higher	Same	Lower	60	Higher	Same	Lower	62
Economic growth	33	48	18	55	36	57	7	59	30	70	0	59	9	82	9	50	25	75	0	57	53	40	7	67
Economic activity																								
Production	42	37	22	57	64	29	7	72	30	20	50	42	25	67	8	55	63	25	13	70	88	6	6	88
Domestic sales	44	31	25	57	57	29	14	67	20	20	60	33	25	75	0	57	63	25	13	70	87	7	7	88
Exports	54	42	4	68	-	-	-	-	40	0	60	40	17	67	17	50	100	0	0	100	-	-	-	-
Inventory	28	72	0	42	43	57	0	36	50	50	0	33	17	83	0	45	0	100	0	50	50	50	0	33
Capacity utilization	18	68	13	51	21	71	7	54	20	40	40	43	25	75	0	57	29	71	0	58	31	69	0	59
Prices																								
Final product prices	42	51	7	62	21	71	7	54	40	60	0	63	25	75	0	57	0	100	0	50	40	60	0	63
Intermediate input prices	47	53	0	34	43	57	0	36	43	57	0	36	36	64	0	39	50	50	0	33	25	75	0	43
Wage level	13	85	2	53	14	86	0	54	20	80	0	56	8	92	0	52	25	75	0	57	25	75	0	57
Primary inputs																								
Investment	18	78	3	54	21	71	7	54	0	100	0	50	25	75	0	57	25	75	0	57	38	63	0	62
Employment	13	83	3	53	21	79	0	56	0	100	0	50	0	100	0	50	13	88	0	53	38	63	0	62

[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 A3: Survey Results: Summary of Past Performance of all Firms (by size) (July-August-September 2017)[1]

Indicator	SMEs				Large Firms			
	Percentage			Index2	Percentage			Index2
	Higher	Same	Lower	**54**	Higher	Same	Lower	**53**
Economic growth	36	43	21	**55**	36	55	9	**59**
Economic activity								
Production	45	34	21	**59**	50	18	32	**58**
Domestic sales	48	29	23	**60**	50	14	36	**56**
Exports	52	41	7	**66**	42	42	17	**59**
Inventory	27	57	16	**47**	14	77	9	**49**
Level of capacity utilization	20	62	18	**51**	5	77	18	**46**
Prices								
Final product prices	55	40	5	**68**	64	27	9	**71**
Intermediate input prices	75	25	0	**20**	90	10	0	**9**
Wage level	49	49	1	**66**	36	64	0	**61**
Primary inputs								
Investment	22	73	5	**55**	23	73	5	**55**
Employment	19	66	14	**52**	18	82	0	**55**

Table A4: Survey Results: Summary of Outlook of all Firms (by size) (October-November-December 2017)[1]

Indicator	SMEs				Large Firms			
	Percentage			Index2	Percentage			Index2
	Higher	Same	Lower	**54**	Higher	Same	Lower	**55**
Economic growth	31	55	14	**56**	32	59	9	**57**
Economic activity								
Production	50	33	17	**62**	45	32	23	**59**
Domestic sales	50	30	20	**62**	41	32	27	**55**
Exports	54	39	7	**67**	46	31	23	**59**
Inventory	35	65	0	**39**	9	91	0	**48**
Level of capacity utilization	23	65	12	**53**	18	77	5	**54**
Prices								
Final product prices	34	62	4	**59**	41	55	5	**62**
Intermediate input prices	46	54	0	**35**	30	70	0	**41**
Wage level	17	82	1	**54**	9	91	0	**52**
Primary inputs								
Investment	18	79	3	**54**	32	68	0	**59**
Employment	14	84	2	**53**	18	82	0	**55**

[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.