

**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 130 public and private firms. The survey covers their assessment of economic growth and the results of their operations over the second quarter of FY 2016/2017. It also summarizes their expectations for overall future economic performance as well as their own activities for the third quarter of FY 2016/2017.

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Business Barometer

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Overview

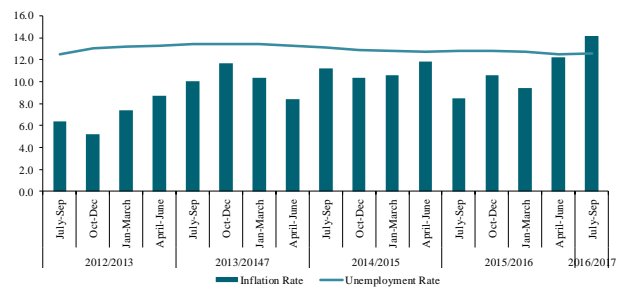
This edition of Business Barometer (BB) presents the survey results of a stratified panel of 130 firms regarding their perceptions about the performance of the Egyptian economy and own business for the second quarter of FY16/17 (October-December) and their outlook for the third quarter (January-March) of the same year, respectively. As for the outlook, the Business Barometer Index (BBI) witnessed a relative increase, reflecting uncertainty on the part of the business community.

Results of exchange rate liberalization combine negative and positive elements. The negative elements include rising operating costs and the effect thereof on prices. The positive elements include signs of a future desire to increase investment in order to replace imports or increase productivity, which requires controlling the negative elements.

On the fiscal side, transactions of the Egyptian economy with the outside world during FY2015/2016 resulted in a balance of payments surplus of US\$1.9 billion during the first quarter of the current fiscal year against an overall deficit of about US\$3.7 billion during the corresponding period of the previous fiscal year.

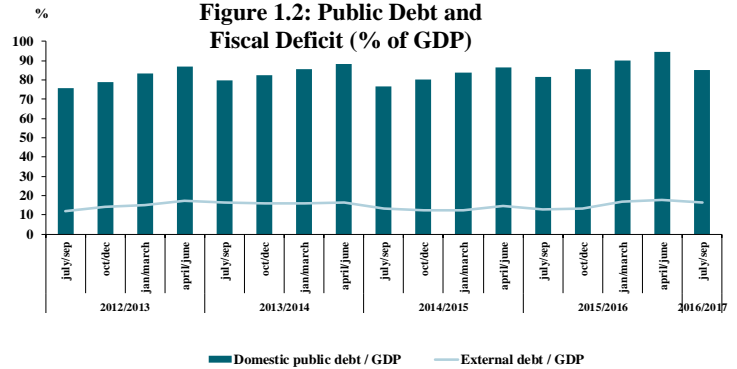
The trade deficit declined by about US\$1.3 billion (13.4 percent) to reach about US\$8.7 billion compared to about US\$10 billion. This is attributed to higher commodity export earnings by US\$530.3 million and lower import payments by US\$810.5 million.

Figure 1.1: Inflation and Unemployment Rates



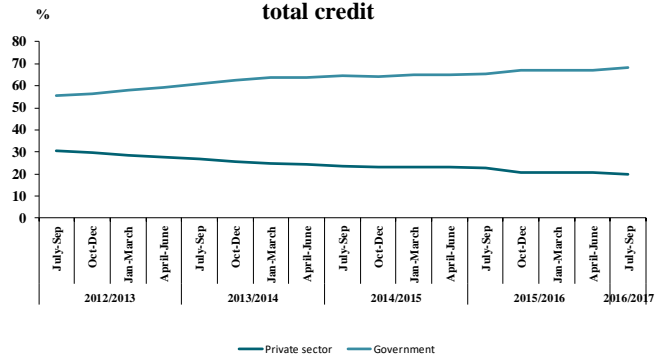
Sources: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

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



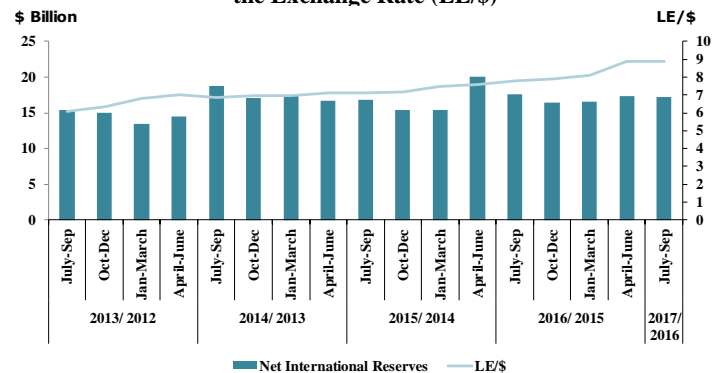
Sources: Central Bank of Egypt (CBE), *Monthly Statistical Bulletin*, various issues.

Figure 1.3: Domestic credit by sector as % of total credit



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

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



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

The services surplus narrowed by 50.2 percent, driven by the drop in tourism revenues by 56.1 percent, to only US\$758.2 million (from US\$1.7 billion). This is due to the decline in the number of tourist nights by 61.3 percent, to 9.2 million (against 23.7 million), notwithstanding the increase in the average spending per visitor/night from US\$72.7 to US\$82.5.

The budget deficit reached LE 144.4 billion (4.4 percent of GDP) during July-November 2016, compared to LE 138.5 billion (5 percent of GDP) during the corresponding period of the previous year.

As reported by the Ministry of Finance (MoF), total revenues increased to LE 174.3 billion during July-November 2016 compared to LE 160.1 billion during the corresponding period of the previous fiscal year. These developments could be explained mainly in light of the increase in tax revenue and non-tax revenue to LE 122.4 billion and LE 51.9 billion, respectively.

According to the MoF, total expenditures rose to LE 314.4 billion during July-November 2016 compared to LE 289.4 billion during the corresponding period in the previous fiscal year. The increase in expenditure is considered the lowest if compared to 29 percent representing the average over the last three fiscal years during the same period of time, driven by the reforms implemented by the Ministry of Finance to control the increase in expenditures. The MoF noted that wages and compensation of employees rose by 1.5 percent to LE 86.2 billion; purchase of goods and services increased to LE 12.3 billion; and interest payments rose to LE 113.7 billion.

Concerning public debt, the Central Bank of Egypt (CBE) reported that domestic public debt increased by 22 percent during the first quarter of the current fiscal year (on an annual basis). It further noted in its monthly report that domestic public debt amounted to LE 2.75 trillion in the three months ended in September,

compared to about LE 2.25 trillion by the end of the corresponding period of the previous year.

Domestic debt instruments accounted for LE 2.37 trillion out of the total amount, of which Treasury bills and bonds were auctioned at EGP 846.3 billion and LE 1.52 trillion, respectively.

The report noted that aggregate foreign investment in Treasury bills went down to LE 989 million by the end of October against LE 1.01 billion in last September. Public debt rose to LE 2.61 trillion in June 2016, from LE 2.49 trillion in March 2016.



Business Barometer Index (BBI)

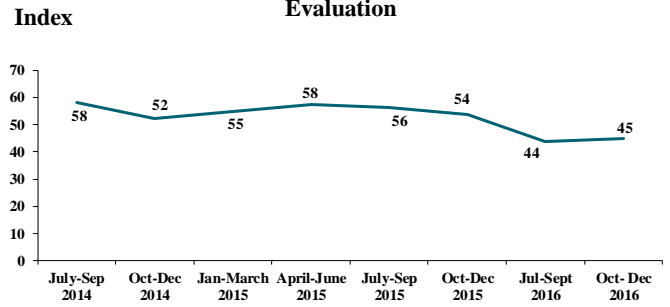
Business Barometer survey results during the quarter (October-December 2016) demonstrate a general rise in the BBI from 44 points in the quarter (July-September 2016) to 45 points in the last quarter of 2016. Despite slight improvement in the index, it is still near its lowest level in two years, reflecting overall uncertainty among the business community.

Regarding business expectations for the next quarter (January-March 2017), the BBI rose to 52 points compared to 49 points in the previous quarter, up from its lowest level in two years. However, it is still close to the level achieved in December 2014 amid uncertainty among the business community concerning new investments, employment and capacity utilization.

Survey results of the period October-December 2016 revealed that the BBI was affected by the decision to liberalize the exchange rate, the signing of the IMF loan agreement and economic moves on the monetary level. This led to a rise in the BBI for large companies from 49 points in the fourth quarter of 2015 to 51 points in the corresponding quarter of 2016. The outlook of large firms reflected a decline in expectations from 57 to 51 points due to continued uncertainty among the business community concerning developments in the economic reform agenda. This means that optimism about exchange rate liberalization is now overshadowed by the uncertainty about future developments, as businesses' exchange rate problems remain unresolved.

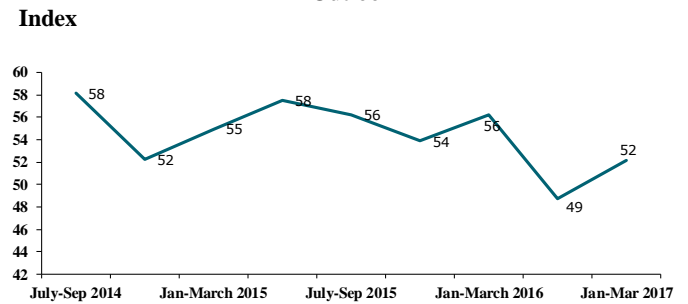
For small and medium-sized firms, the BBI decreased from 46 points in the fourth quarter of 2015 to 42 points in the corresponding quarter of 2016. The views of these firms reflect a decline in expectations from 55 to 53 points, due to continued uncertainty among the business community.

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

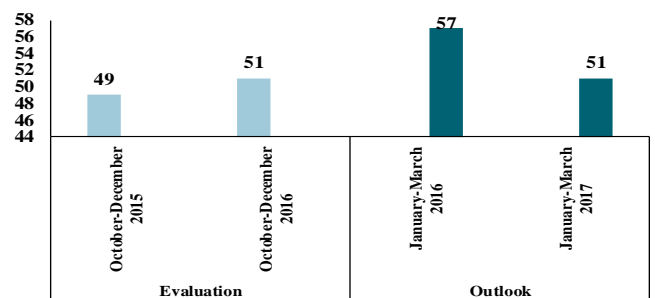
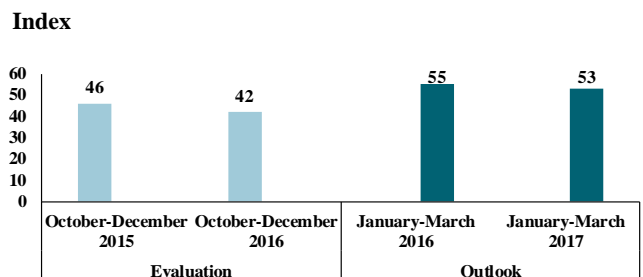


Figure 2.4: Business Barometer Index B-SMEs



Past Performance of Businesses

Economic Activity

It is worth noting that evaluation results reflect the views of large firms that inventory declined, with estimates of a slight decline in capacity utilization. The BBI also revealed a decline in domestic sales and production in light of the relative decline in economic growth rates.

Despite these indicators that reflect uncertainty among the business community, views about exports were particularly optimistic, recording 70 points in the last quarter of the year for large firms compared to 45.5 points in the preceding quarter of 2016 as a reflection of prospects of greater export opportunities due to exchange rate liberalization.

The assessment by small and medium firms of the second quarter of FY2016-2017 reflected estimates of increased economic growth as a result of the start of the economic reform program, despite an estimated decline in production, domestic sales and exports. However, firms noted a relative increase in capacity utilization and inventory, reflecting firm views that their role in import substitution has increased following the increase in exchange rates.

Figure 3.1: Economic Activity
A. Evaluation: Large Firms

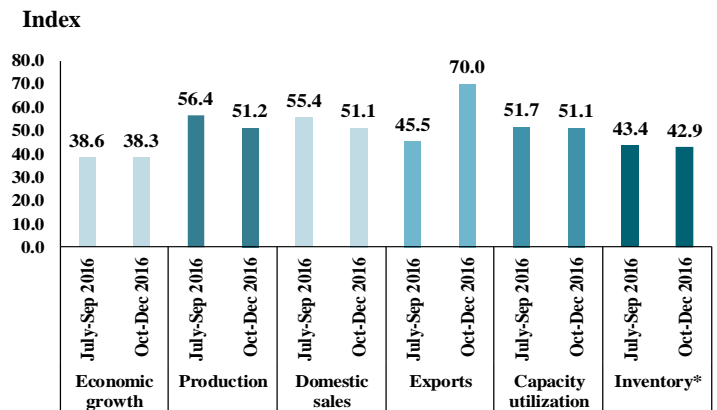
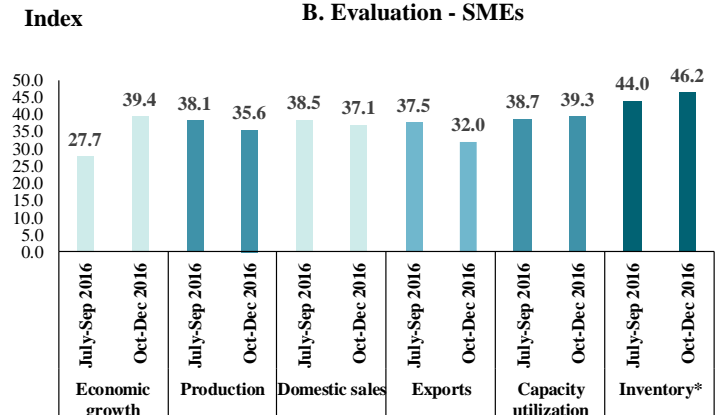


Figure 3.2: Economic Activity
B. Evaluation - SMEs



Source: Survey results.

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



Prices and Wages

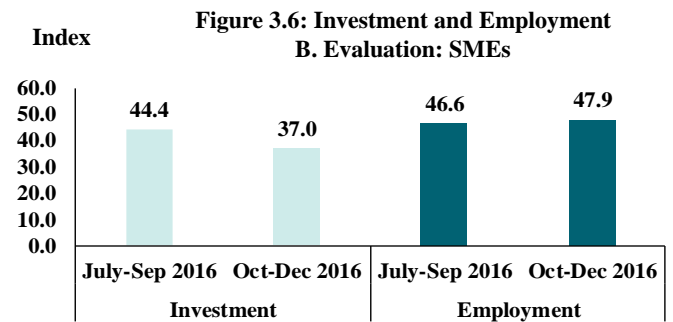
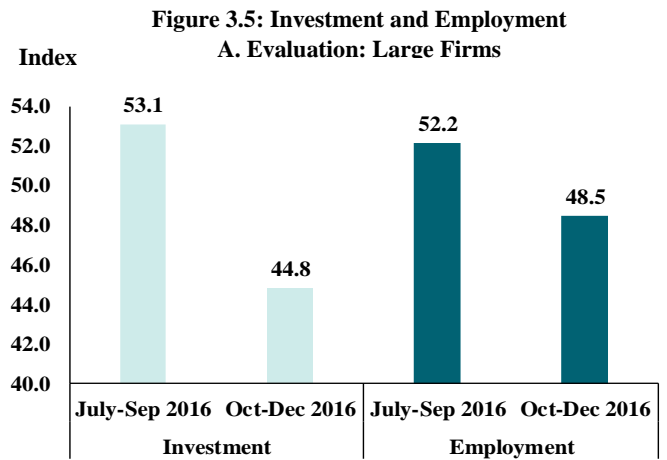
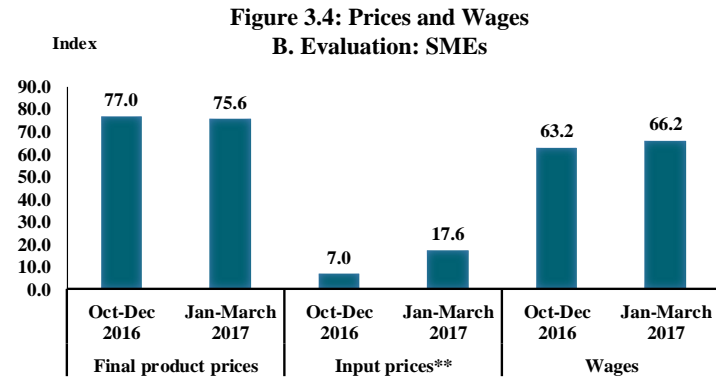
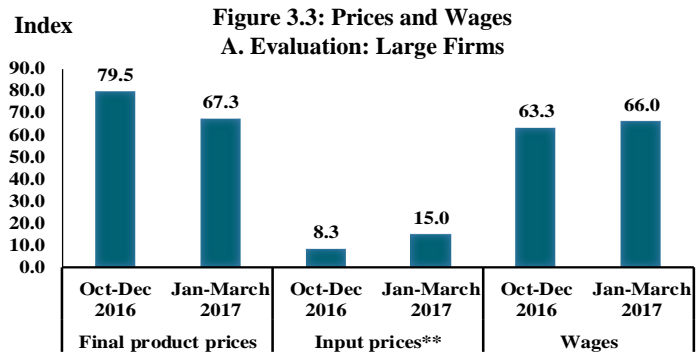
The assessment by large firms reflected the impact of rising inflation on increases in wages and final product prices.

Small and medium firms' assessment was no different, as they noted an increase in wages and final product prices, albeit with slower growth rate compared to large firms.

Investment and Employment

Contrary to the evaluation by large firms during the second quarter of FY2016-2017, estimates indicate a decline in employment and investment due to uncertainty about economic performance developments following the liberalization of the exchange rate.

The performance of small and medium firms, unlike large firms, reflected an increase in the employment index from 46.6 to 47.9 points, while the investment index declined due to higher cost, increased financing burdens along with future uncertainty.



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.

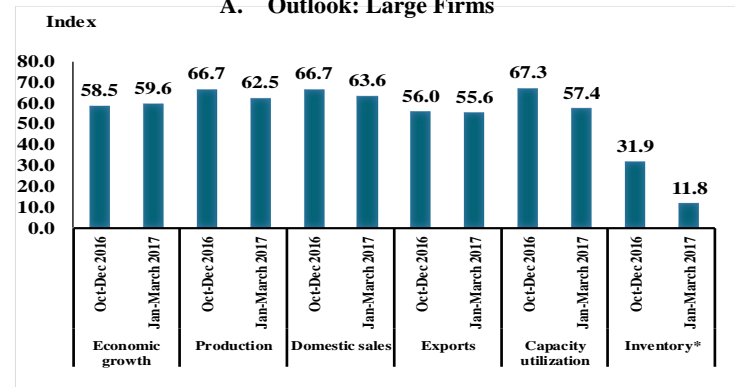
Business Strategy Going Forward

Firms’ outlook for the third quarter (January-March) of FY2016/2017 reflects uncertainty on the part of the business community in light of recent economic decisions and unpredictability regarding the time needed by the Egyptian economy to achieve balance in the short term. Accordingly, firms’ expectations for economic growth were cautious, especially that current government measures to stimulate the economy are still less than required to lift the economy out of its current slowdown.

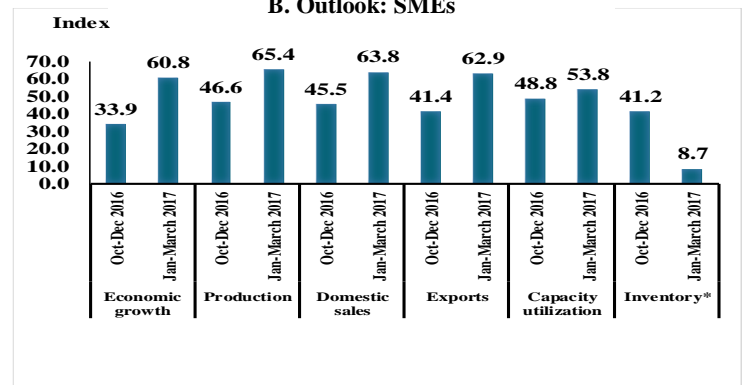
Expectations by large firms reflected the rise in economic growth during the period, despite the continued negative impact of high cost on production, domestic sales and exports. Views regarding capacity utilization and inventory continued to be weak during the period.

The outlook was more optimistic in the case of small and medium firms, especially with respect to economic growth, while the outlook for production was better in light of expectations of increased domestic sales and exports, which reflected positively on expectations of capacity utilization. However, this did not reflect positively on their expectations for inventory.

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



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



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



Prices and Wages

The outlook of large firms suggests the start of a decline in final product prices

during the third quarter of FY2016-2017, which reflects indirectly the relative decline in inflation since the beginning of 2017, while expectations of input price and wage increases continued during Period.

The outlook of small and medium firms was similar, with lower expected growth in the prices of final products, with higher expectations of continued increases in input prices and wages.

Investment and Employment

Survey results indicate an increase in expectations of large firms regarding employment during the third quarter of FY2016-2017, while expectations for investment continued to decline in light of uncertainty about the stability of the economy over the coming period.

The outlook of small and medium firms was more optimistic with respect to employment. But unlike large firms, they also expected growth in investment, reflecting views of future expansion in employment. This calls for the government to adopt more stimulus measures, on top of which amending the legislative system related to investment.

** 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.

Figure 4.3: Prices and Wages
A. Large Firms

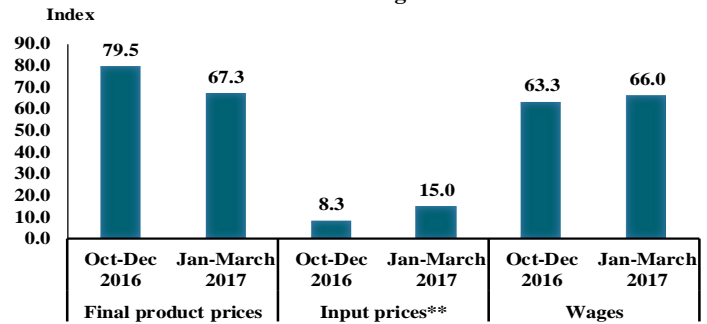


Figure 4.4: Prices and Wages
B. SMEs

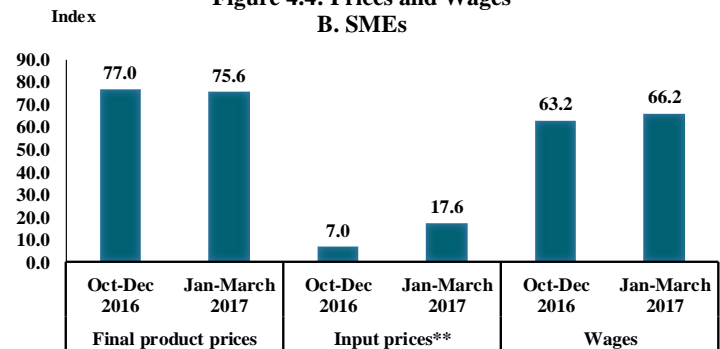


Figure 4.5: Investment and Employment
A. Outlook: Large Firms

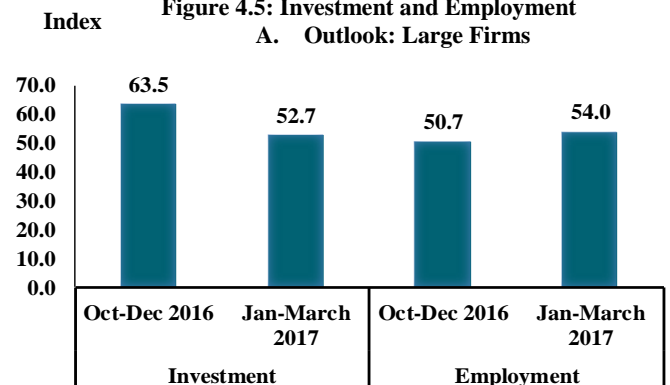


Figure 4.6: Investment and Employment
B. Outlook: SMEs



The Manufacturing Sector

The sector's indicators, compared to the other sectors of the economy for the whole sample of firms (October – November - December 2016), reflect a decline in growth and economic activity expectations, especially that it was the most affected sector by cost increases as a result of liberalization of exchange rate. This was reflected on estimates of decreased production in light of the increase in the marginal cost of products, with estimates of lower domestic sales and exports during the period as a result of uncertainty regarding economic policy developments.

The manufacturing sector expected the least increase in employment during the period in light of the high operating cost, slowdown in domestic consumption and the high foreign content in many industries, weakening export growth rates. Across sectors, the manufacturing sector expected the least investment due to the high cost of financing, production inputs, and machinery and equipment. Add to this the lack of provision of incentives to promote investment in the sector and failure to address the problems dogging the industry, including licensing, approvals, land allocation, and rising energy costs.

Compared to the whole sample of firms at the sectoral level (January - February - March 2017), the sector's expectations continued in the same direction, albeit with a relative expected improvement in investment and employment during the period.

Addressing the declining industry indicators requires the Ministry of Industry to identify idle production capacities in different sectors. It also requires launching an integrated program for employment and upgrading unutilized production capacities through entering into international agreements that facilitate the transfer of technology, particularly with China, Russia and the

European Union, with concessional credit drawn from these sources. It is also important to complete the investment plan of the state, which will help identify the sectors and industries that need to be incentivized over the coming period.

In addition, it is important to finalize the industrial licensing law, the unified land law, and the investment law as well as to encourage the banking sector to finance working capital and investments in this sector at a reasonable cost.



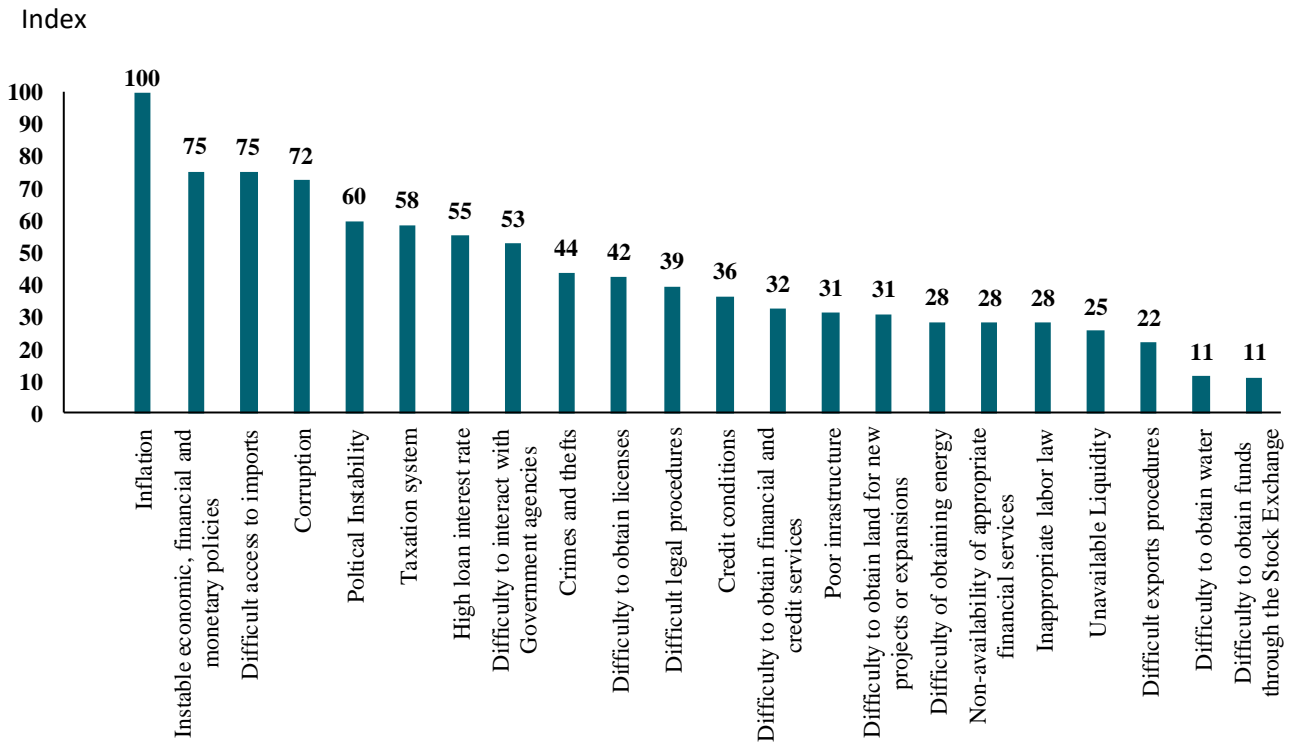
Business Constraints

Major Constraints: Inflationary pressures, trade stimulus policies, energy, and the exchange rate

The Figure shows the major constraints facing businesses in a descending order of severity from the perspective of surveyed firms.

Firms expressed 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. Trade stimulus policies and energy came next, followed by the exchange rate in light of successive liberalization measures by the Central Bank.

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



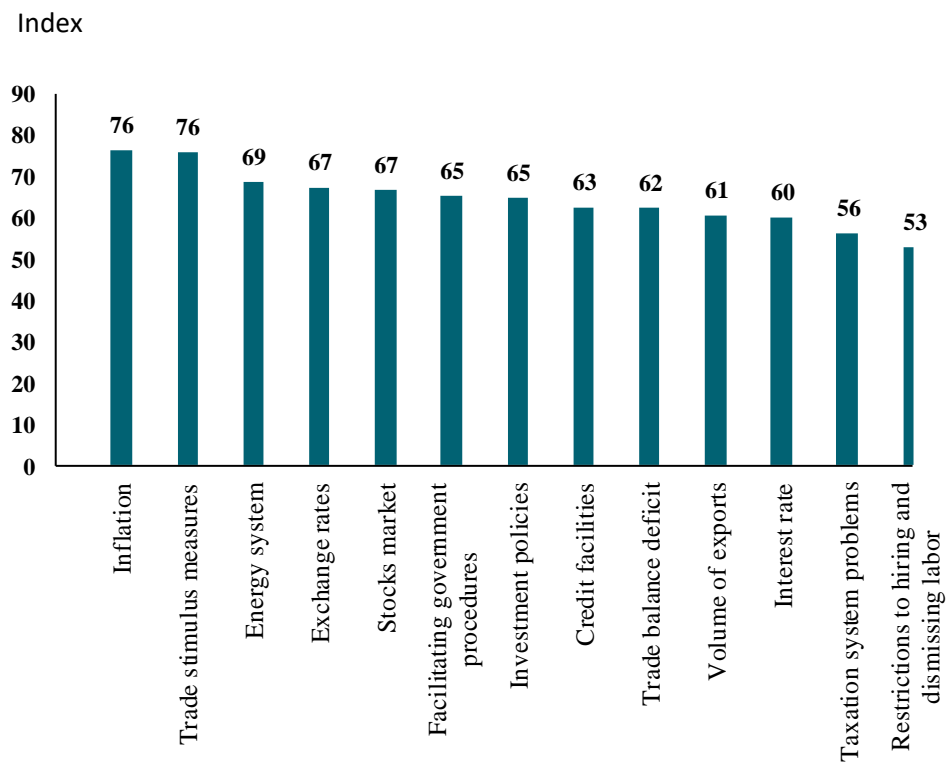
Source: Survey results.

Policy Expectations

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

In light of the higher exchange rates 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 intermediate inputs, while maintaining economic growth and taking social justice into account.

Figure 6: Policy Expectations



Source: Survey result.



Commentary on Survey Results

Despite the varying indicators, 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 still 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 fluctuations in foreign currency rates, which are expected to continue until the end of the third quarter of FY2016/2017. Stability in foreign currency rates is a prerequisite for achieving economic stability, especially that further inflationary pressures may lead to more government deflationary policies.

Also, improving the legislative infrastructure of the economic environment 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 requires substantive changes in the direction of both fiscal and monetary policies. It also needs redesigning fiscal policy to cope with the boom-bust cycles in a more systematic manner, and that monetary policy monitor those cycles in terms of overall risk with a view to maintaining financial balance.

Methodology

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 Environment 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 (October-November-December 2016)¹

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Services			
	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²
	Higher	Same	Lower	42	Higher	Same	Lower	45	Higher	Same	Lower	34	Higher	Same	Lower	42	Higher	Same	Lower	45	Higher	Same	Lower	44
Economic growth	10	34	56	33	28	44	28	50	6	53	41	38	20	20	60	33	0	0	100	0	47	40	13	62
Business activity																								
Production	17	17	66	29	28	50	22	52	33	17	50	43	0	40	60	29	0	25	75	20	73	20	7	78
Domestic sales	20	18	62	32	28	50	22	52	28	22	50	41	0	40	60	29	0	25	75	20	79	14	7	81
International sales	30	25	45	44	0	100	0	50	56	22	22	64	0	0	100	0	0	0	0	0	100	0	0	50
Inventory	35	32	32	49	22	72	6	45	44	25	31	45	25	75	0	43	25	50	25	50	64	29	7	28
Level of capacity Utilization	7	44	49	36	28	56	17	54	7	71	21	46	0	60	40	38	0	50	50	33	21	79	0	56
Prices																								
Final product prices	89	9	3	89	94	6	0	95	83	11	6	85	100	0	0	100	50	50	0	67	29	71	0	58
Intermediate input prices	99	1	0	1	100	0	0	0	100	0	0	0	100	0	0	100	75	25	0	20	86	14	0	13
Wage level	52	45	3	67	61	39	0	72	33	61	6	59	80	20	0	83	0	100	0	50	20	73	7	54
Primary inputs																								
Investment	11	34	55	34	11	67	22	47	0	61	39	38	0	60	40	38	0	75	25	43	13	80	7	52
Employment	6	77	17	47	11	72	17	48	0	89	11	47	0	100	0	50	0	75	25	43	20	80	0	56

Table 2: Survey Results: Summary of Business Sector Outlook (January- February- March)¹

Indicator	Manufacturing				Construction				Tourism				Transport				Communications				Financial Services			
	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	39	52	9	60	61	33	6	71	12	76	12	50	0	100	0	50	50	50	0	67	60	33	7	70
Business activity																								
Production	49	43	9	64	61	28	11	70	22	56	22	50	80	20	0	83	75	25	0	80	67	27	7	74
Domestic sales	48	38	14	62	61	28	11	70	22	56	22	50	80	20	0	83	75	25	0	80	71	21	7	76
International sales	45	36	18	60	50	0	50	50	30	60	10	56	0	0	0	0	0	0	0	0	75	25	0	80
Inventory	90	0	10	10	94	0	6	6	88	0	12	12	50	0	50	50	100	0	0	0	100	0	0	0
Level of capacity Utilization	16	75	9	52	44	44	11	62	31	63	6	58	20	60	20	50	0	100	0	50	38	62	0	62
Prices																								
Final product prices	74	26	0	79	78	17	6	81	44	56	0	64	60	40	0	71	25	75	0	57	36	64	0	61
Intermediate input prices	80	20	0	17	83	11	6	15	82	18	0	15	80	20	0	17	50	50	0	33	80	20	0	17
Wage level	48	51	1	65	56	44	0	69	35	65	0	61	80	20	0	83	0	100	0	50	67	33	0	75
Primary inputs																								
Investment	20	61	19	50	44	28	28	57	18	76	6	53	0	60	40	38	0	75	25	43	27	67	7	56
Employment	13	80	7	52	22	67	11	53	12	82	6	52	0	80	20	44	0	100	0	50	40	60	0	63

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) (October-November-December 2016)¹

Indicator	SMEs				Large Firms			
	Percentage			Index ² 46	Percentage			Index ² 49
	Higher	Same	Lower		Higher	Same	Lower	
Economic growth	17	37	46	39	15	38	47	38
Business activity								
Production	20	24	56	36	42	19	39	51
Domestic sales	22	23	54	37	39	25	36	51
International sales	11	32	58	32	60	33	7	70
Inventory	35	41	24	46	44	31	25	43
Level of capacity Utilization	5	56	39	39	28	47	25	51
Prices								
Final product prices	77	20	3	81	92	8	0	92
Intermediate input prices	97	3	0	3	97	3	0	3
Wage level	48	47	4	65	42	58	0	63
Primary inputs								
Investment	8	45	46	37	11	61	28	45
Employment	7	78	15	48	6	83	11	48

Table 4: Survey Results: Summary of Business sector outlook (by size) (January-February-March 2017)¹

Indicator	SMEs				Large Firms			
	Percentage			Index ² 53	Percentage			Index ² 51
	Higher	Same	Lower		Higher	Same	Lower	
Economic growth	40	54	6	61	40	49	11	60
Business activity								
Production	51	41	7	65	50	33	17	63
Domestic sales	49	40	11	64	54	26	20	64
International sales	43	52	4	63	47	20	33	56
Inventory	91	0	9	9	88	0	12	12
Level of capacity Utilization	22	70	9	54	30	64	6	57
Prices								
Final product prices	68	32	0	76	53	44	3	67
Intermediate input prices	79	20	1	18	82	18	0	15
Wage level	49	49	1	66	49	51	0	66
Primary inputs								
Investment	22	60	18	51	26	57	17	53
Employment	16	75	9	52	17	80	3	54

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.