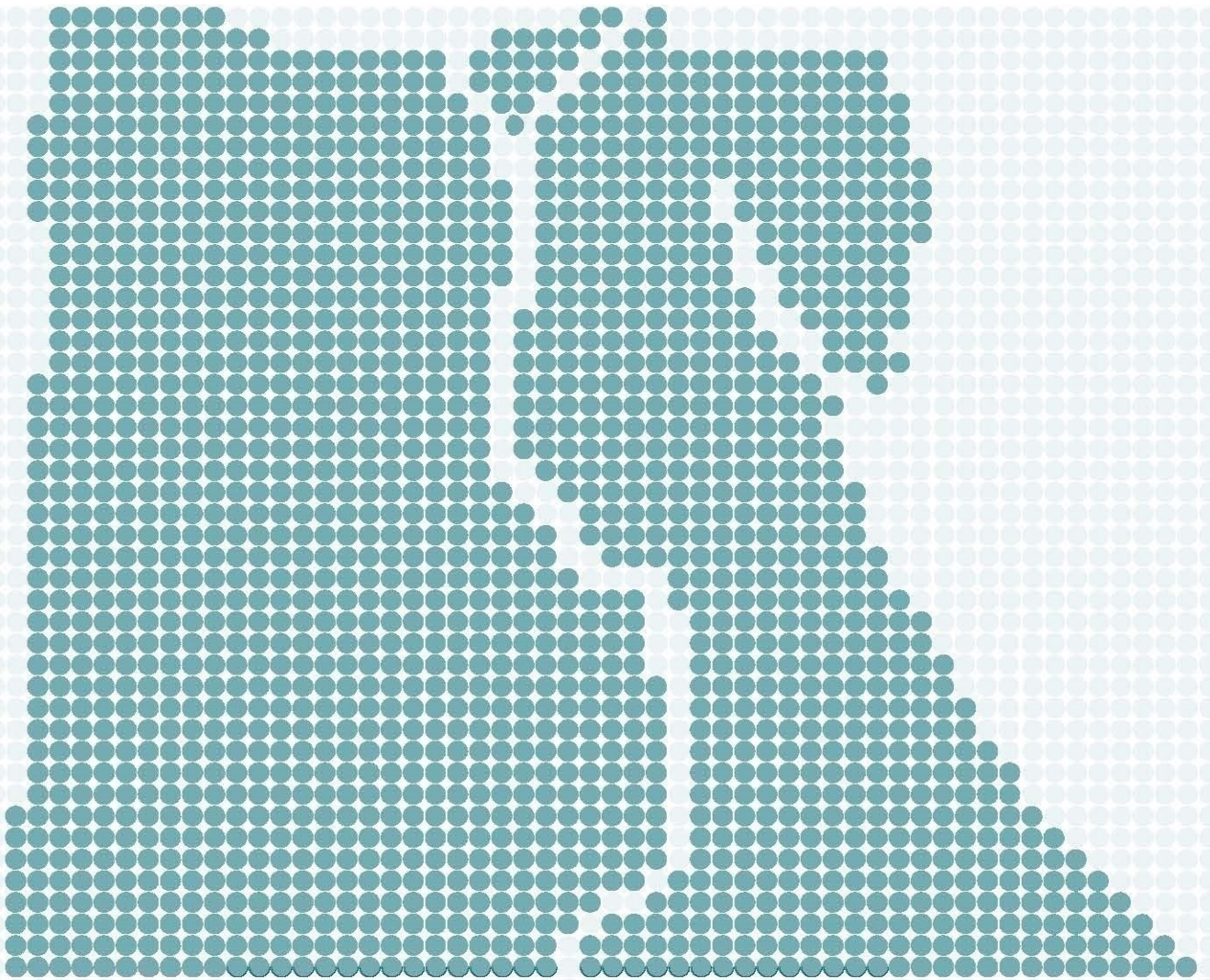


المركز المصري للدراسات الاقتصادية
The Egyptian Center for Economic Studies

Business Barometer

Issue 54 2020



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.

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Business Barometer

Issue No. 54 – 2020

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About the Business Barometer

The Egyptian Center for Economic Studies (ECES) publishes its Business Barometer (BB) quarterly to provide timely information about the developments of economic activity in Egypt based on a survey as well as an assessment of macroeconomic indicators produced by the relevant authorities. The survey covers an assessment by a sample of firms of economic growth and results of own operations in terms of production, domestic sales, exports, commodity inventories, capacity utilization, prices, wages, employment and investment during the quarter under review as well as their outlook for the same set of variables in the upcoming quarter.

ECES launched its first Business Barometer in 1998. The report analyzes the results of a sample survey of 121 private firms that cover manufacturing (50 percent), financial services (13 percent), construction (12 percent), transportation (10 percent), tourism (8 percent) and telecommunications (7 percent). The survey is conducted on a number of micro, small, medium and large firms as per the definition of the Central Bank of Egypt (CBE) announced on March 5, 2017.

This edition of BB provides an assessment of the performance of a sample of firms and results of their operations in the second quarter of FY2019/2020 (October-December 2019). It also summarizes their expectations for overall economic performance as well as own activities for the third quarter of the fiscal year (January-March 2020).

Methodology

The BB Index is a simple average of the sub-indices of surveyed variables (production, domestic sales, exports, inventory, capacity utilization, prices, wages, employment and investments). The Index is calculated once for large firms and once for SMEs, both for evaluation and expectations.

Index Value	Index Definition
50 points	Same (no change in firms' performance and expectations)
Above 50 points	Higher (improvement in firms' performance and expectations)
Below 50 points	Lower (decline in firms' performance and expectations)

The index is calculated for each variable using the following equation:

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

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 points 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 neutralized 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.

Overview

This section provides an overview of the main local and global developments of the second quarter of FY2019/2020 (October–December 2019), as well as an assessment of the performance of the main domestic macro indicators as per the latest available data.

The quarter under study has been characterized by the outbreak of several geopolitical incidents, regionally and globally. Early in October, and shortly after the pullback of US troops, Turkey launched a military operation to invade Syria's northern borders. The international community failed to condemn this act, putting the whole region under the risk of multi-lateral war. In addition, several populist movements broke out incited by economic austerity measures in Lebanon, Iraq, Iran and Chile. These events elevated the risk the global economy already encounters. Before these events, the [International Monetary Fund](#) revised downward its global growth forecast for 2019 to 3 percent, compared to 3.2 in July's projections. This new forecast is considered the lowest since 2008–09. Also, the 2020 growth forecast was revised downward by 0.1 percentage point.

On another front, the United Kingdom managed to resolve the political deadlock on Brexit as the Conservative Party managed to gain a parliamentary majority in the December elections. The German industrial output rebounded, as per November data, recording a growth rate of 1.1 percent beating a forecast of 0.8 and ending several months of contraction. The Federal Reserve kept its policy rate unchanged in [December](#), signaling its intention to keep the policy rate fixed for an

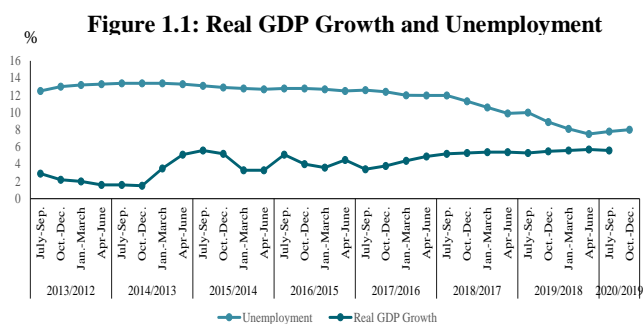
unspecified period of time. This decision came after three consecutive rate cuts, last recorded in October.

For Egypt, the quarter under review has seen the launch of an automatic fuel pricing mechanism. The new mechanism establishes a link between the price of fuel on the local market to its global price. In October 2019, the Committee on Automatic Pricing of Petroleum Products reduced fuel price by EGP 0.25 per liter.

The anticipated Cabinet reshuffle took place late December, with ten new ministers sworn in. Latest data available indicate a rise in GDP growth (at market price) during the first quarter of FY2019/2020, recording 5.6 percent compared to 5.3 percent in the corresponding quarter of the previous year (Figure 1.1). Government consumption and gross capital formation witnessed the highest annual growth rates at 4 and 22.2 percent compared to 2 and 16 percent in the corresponding quarter of FY2018/2019. However, it is worth noting that GDP growth at factor cost (representing the supply side of the economy) declined in Q1 FY 2019/2020 to record 4.5 percent compared to 5 percent during the same quarter last year. Sectors that witnessed the highest drop in their growth rates, albeit positive, are extraction industries, Suez Canal and tourism recording 2.5, 7 and 3 percent compared to 11.6, 12.3 and 43 percent, in Q1 FY 2018/2019, respectively (CBE, *Monthly Statistical Bulletin*, January 2020). Those sectors are highly vulnerable to the geopolitical risks facing the region.

Unemployment during Q2 FY 2019/2020 showed a slight increase compared to the previous quarter, yet lower than the rate of the corresponding quarter

last year, recording 8 percent (Figure 1.1). What is most alarming about this rate is that the labor market favors low-skilled labor. Sectors that absorbed labor were led by agriculture, trade and individual services. Unemployment rose significantly among university graduates compared to intermediate education graduates. For the age groups, the age category (15-24) witnessed a decrease in unemployment while the category (25-64) recorded higher levels of unemployment, all compared to the previous quarter (CAPMAS).

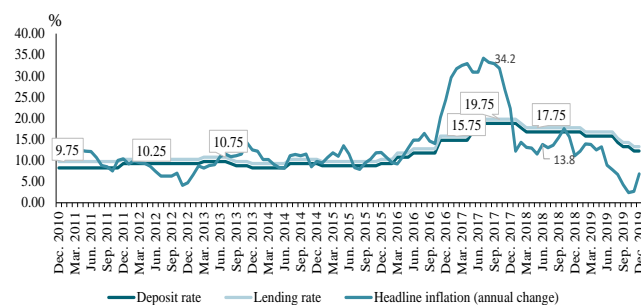


Sources: Ministry of Planning and Economic Development; Central Agency for Public Mobilization and Statistics (CAPMAS); Central Bank of Egypt, *Monthly Statistical Bulletin*,

On the monetary side, the cooling down of domestic inflation¹ as well as the uncertain global economic outlook pushed the Central Bank of Egypt to cut its policy rates by 100 basis points in [November](#). With this decision, deposit and lending rates became 12.25 percent and 13.25 percent, respectively—the lowest rates since exchange rate liberalization in November 2016 (Figure 1.2). Lower interest rate is expected to encourage the private sector’s appetite to credit to finance expansion operations. However, increased reliance by the Government on domestic credit to finance its budget deficit left the credit available to the

private sector at 21.9 percent of total credit as per November 2019 compared to 40.9 percent in November 2010 (CBE, *Monthly Statistical Bulletin*, several issues).

Figure 1.2: Inflation and the Policy Rate



Sources: Central Bank of Egypt (CBE); CAPMAS.

On the external front, the [balance of payment](#) (BoP) during Q1 FY2019/2020 recorded an overall deficit of \$227.3 mn. compared to a deficit of \$284.1 mn. in Q1 FY2018/2019. The trade balance recorded a lower deficit in Q1 FY2019/2020 of \$8.7 bn. compared to \$9.8 bn. in the corresponding quarter of the previous year. This is attributed to higher exports of non-petroleum products, namely gold, radio and TV transmitters and receivers, drugs, vaccines, pharmaceuticals, and organic and inorganic compounds. In addition to a drop in non-petroleum imports of cast iron, wheat, wood in the rough and densified wood, and spare parts of cars and tractors. The petroleum trade balance remained stable. For the service balance, a rise in the total payments outweighed increased travel receipts, causing the overall surplus to decline to \$4 bn. compared to \$4.3 bn. in the corresponding quarter. Net income deficit continued to widen and net portfolio investment reported lower net outflows.

¹ Starting September, a new Consumer Price Index (CPI) was established with 2018/2019 as base year and item weights derived from the Household Income and Expenditure Survey (HIECS) of year 2017/2018. The new

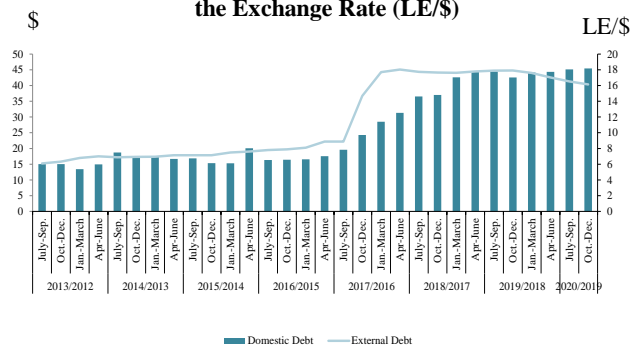
methodology could have contributed to the remarkable decline of inflation rate to 4.6, 2.4 and 2.7 in September, October and November, respectively.

On the other hand, worker remittances and foreign direct investment witnessed an increase during the period of comparison by \$700 mn. and \$900 mn., respectively.

Despite these challenges, net international reserves recorded \$45.42 bn. by the end of December compared to \$45.12 bn. by the end of September.

The EGP exchange rate appreciated slightly from 16.52 EGP/USD in Q1 2019/2020 to 16.14 EGP/USD during the quarter under study (Figure 1.3).

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

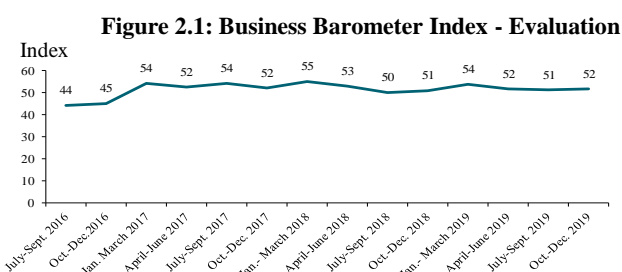


Source: Central Bank of Egypt (CBE).

Business Barometer Index (BBI)

Slightly improved evaluation and outlook indexes

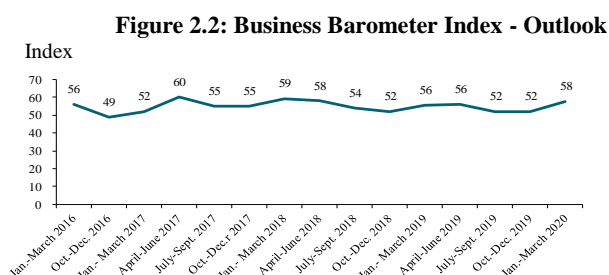
According to the survey results, the overall performance of sample firms improved slightly during the quarter under review (October-December 2019), with the evaluation index reaching 52 points, which is one point higher than the previous quarter and the corresponding quarter of the previous fiscal year (October-December 2018) (Figure 2.1).



Source: Survey results.

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

The outlook results are more positive than the previous two quarters, with survey results reflecting firms' optimism for the upcoming quarter (January-March 2020). The index value remained at 58 points (Figure 2.2).



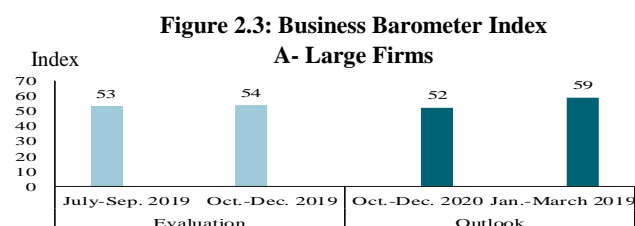
Source: Survey results.

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

The results also showed that more than half of the sample firms focused during the previous quarter on increasing domestic sales and about 40 percent of them focused on increasing exports. Noticeably, sample firms refrained from undertaking

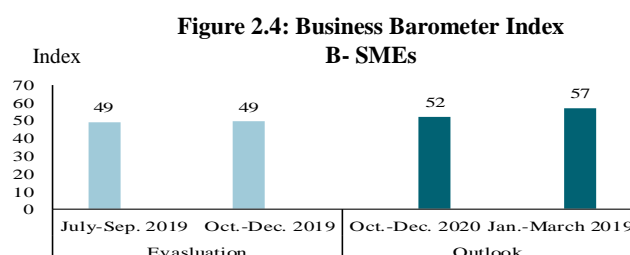
expansions by adding new production lines or introducing new products or using new technology, which requires more investment and entails more risks.

In terms of firm size, survey results for the quarter under review (October - December 2019) show a continued improvement in the performance of large firms by one point compared to the previous quarter. The outlook index for January-March 2020 also rose to 59 points (Figure 2.3).



Source: Survey results.

The results also show a continued decline in the performance of **small and medium enterprises** during the quarter under study (October - December 2019), to score 49 points. This can be attributed to the problems facing the sector, including increased tax burdens and financing problems despite reducing the interest rate during the relevant quarter, lack of skilled labor and lengthy customs clearance procedures for imported raw materials, as well as poor internal and external marketing. This stresses the need to support SMEs. However, in spite of their poor performance index, SMEs are optimistic about performance in the next quarter, which may be attributed to business confidence in the government's seriousness towards supporting SMEs (Figure 2.4.).

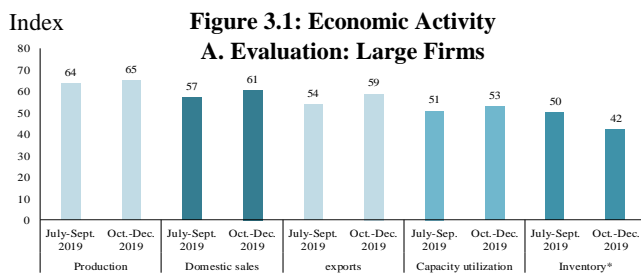


Source: Survey results.

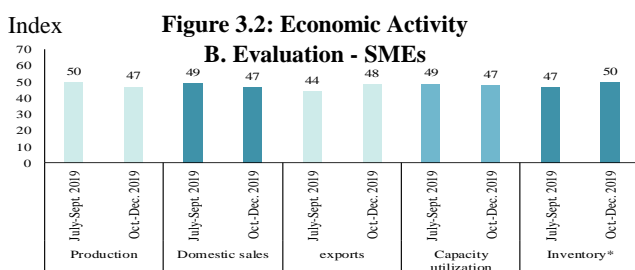
Past Performance of Businesses

Most economic indicators improved for large firms but declined for SMEs

On the level of economic activity, **large firms** reported positive perceptions regarding both domestic sales and exports during the quarter under review (October-December 2019), which was reflected in higher production and capacity utilization indicators, scoring 65 and 53 points respectively due to firms' previous contractual commitments. The inventory index has continued its rise despite increased capacity utilization, indicating that there is still room for more increase therein (Figure 3.1).



Overall, the evaluation results of SMEs is weak, in contrast to those of the large firms. SMEs reported a decline in domestic sales during the October-December 2019 quarter, and a continued drop in the export index of the sample firms, albeit at a lower rate than in the previous quarter. This was reflected in lower production and capacity



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.

utilization. The results also show stable inventory of the sample firms during the relevant quarter, following an increase since the previous quarter.

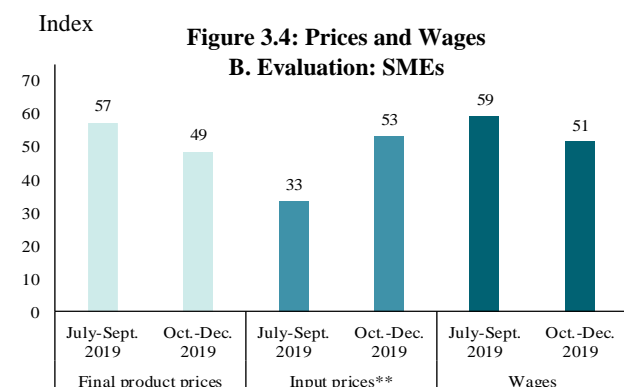
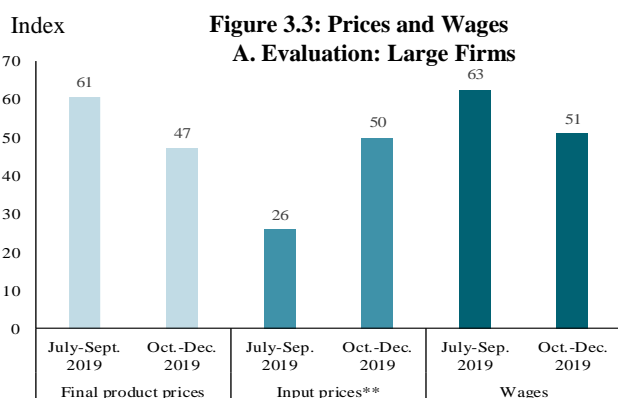
The results indicate that SMEs face challenges related to the production process and the marketing ability, stressing the need to provide them with more support (Figure 3.2).

Sectorally, the best perceptions came from the tourism sector. This may be attributed to higher reservations during the tourism season and new year celebrations, which is in line with the sector's official statistics and Egypt's improved ranking in the WEF's latest Travel & Tourism Competitiveness Report published in September 2019 (Table A1). The transportation sector came next in performance, followed by the telecommunications sector as a result of the Government's digitization efforts, increasing the volume of the sector's firms in the market. The results also showed an improvement in the performance of the manufacturing sector as a result of the state's efforts to support troubled factories through the initiative of the Central Bank of Egypt (CBE) to support the manufacturing sector.

Despite the CBE initiative for Real Estate Finance, the sector declined during the quarter under review. The financial services sector also declined for many reasons, including high financial burdens from many government bodies and institutions, lack of a timetable for government IPOs, and high cost of trading despite keeping the stamp tax unchanged at 1.5 per thousand of the trading value.

Lower final product prices, and slightly higher wages for all firm sizes

Evaluation results show steady input prices for large firms and a slight decrease in the same index for SMEs during the relevant quarter, albeit lower than the previous quarter. This resulted in a significant drop in the final products price index for large firms and a slight decrease for SMEs though less than the previous quarter. The results also show a slight increase in the wage index for all firm sizes (Figures 3.3 and 3.4).

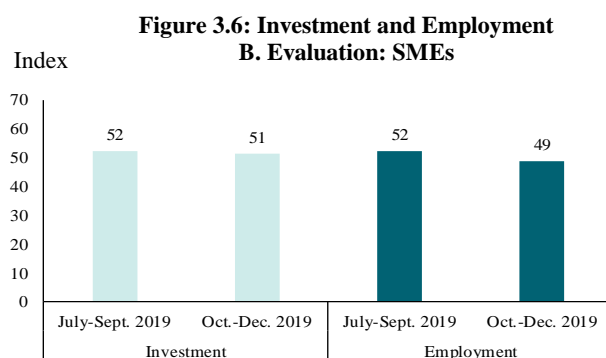
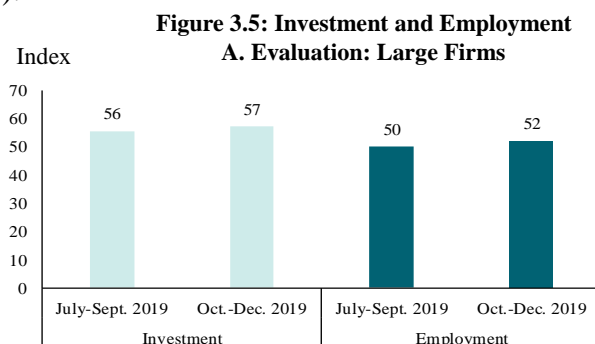


Source: Survey results.

** The input prices 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.

Improved investment and employment for large firms, and slightly improved investment and lower employment for SMEs

Survey results show continued improvement of investment by large firms scoring 57 points during the quarter under review, and slightly improved investment by SMEs, which can be attributed to Government's efforts to improve the investment climate, including reducing interest rate for the third consecutive time in the quarter under review, as well as the CBE initiative for financing industrial activities. The results show that the employment index improved for large firms, but declined for SMEs, which may be attributed to demand factors, including limited job creation ability of firms as evidenced by the decline in their production index, in addition to the supply factors, including lack of skilled labor (Figures 3.5 and 3.6).



Source: Survey results.

Business Strategy Going Forward

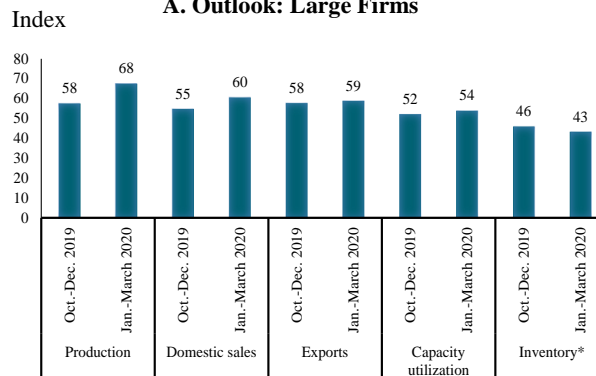
Positive economic activity outlook of large firms and SMEs

Large firms reported positive outlook regarding production, sales and exports during the quarter January-March 2020. The results also show a slight rise in capacity utilization, while the outlook is not optimistic for inventory during the period under study (Figure 4. 1.).

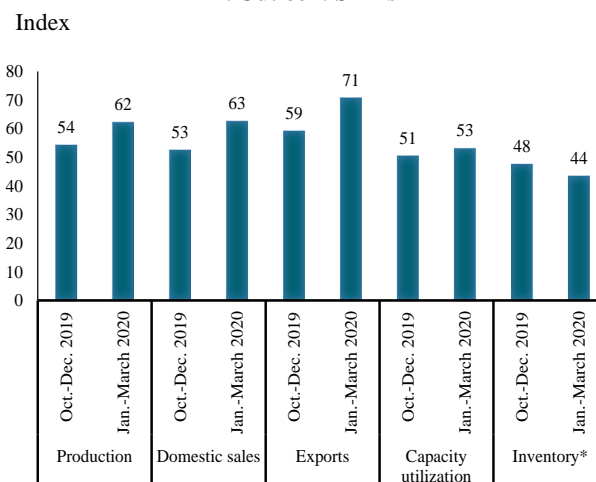
SMEs expect improved economic indicators during the upcoming quarter. As per the results, SMEs are mostly optimistic about exports, which may be ascribed to the Government's efforts to solve the problems related to delayed exporters' duty drawback with the Ministry of Finance (Figure 4. 2.)

Sectorally, Table A2 shows positive outlook for all sectors. For the upcoming quarter, construction firms reported the most optimistic views, followed by tourism, then transport, manufacturing and finally financial services.

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



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



Source: Survey results.

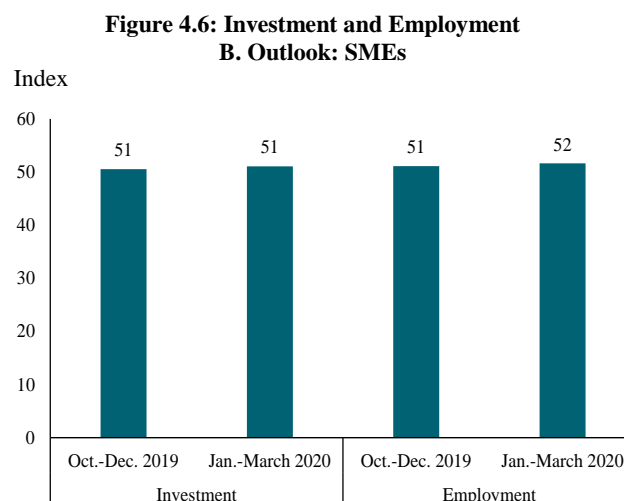
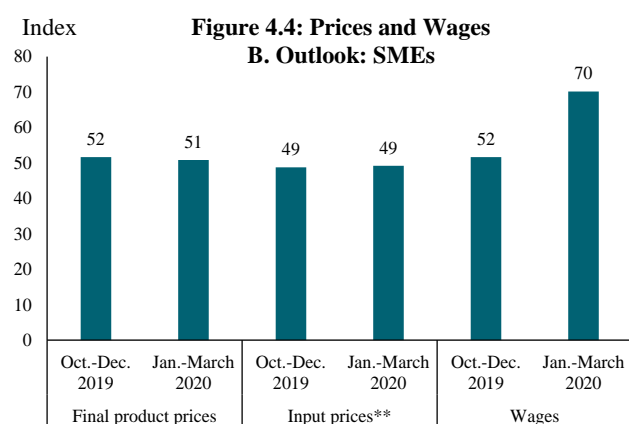
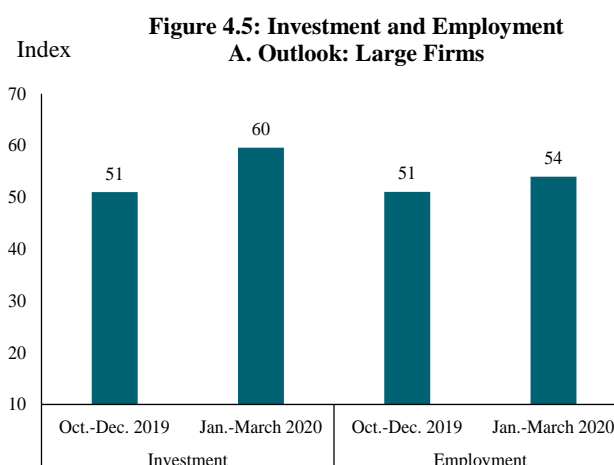
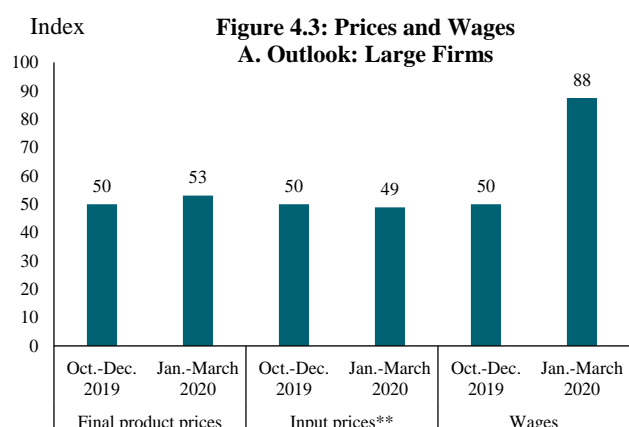
* The inventory index is inverted to reflect the negative impact of rising inventory on businesses. In other words, a higher index indicates lower inventory and vice versa.

Slight rise in input and final product prices, with a noticeable rise in wages in large firms and SMEs

As per the survey results, large firms and SMEs expect a rise in input prices in the upcoming quarter (January-March 2020). The sample firms also expect a noticeable rise in wages due to annual salary increases in January of every year (Figures 4. 3. and 4. 4.).

Improvement in investment and employment for large firms and slight improvement for SMEs

Large firms are optimistic about the upcoming quarter (January-March 2020). The SMEs outlook, however, is less optimistic. Large firms expect improved employment, while SMEs expect a slight improvement (Figures 4. 5. and 4. 6.).



Source: Survey results.

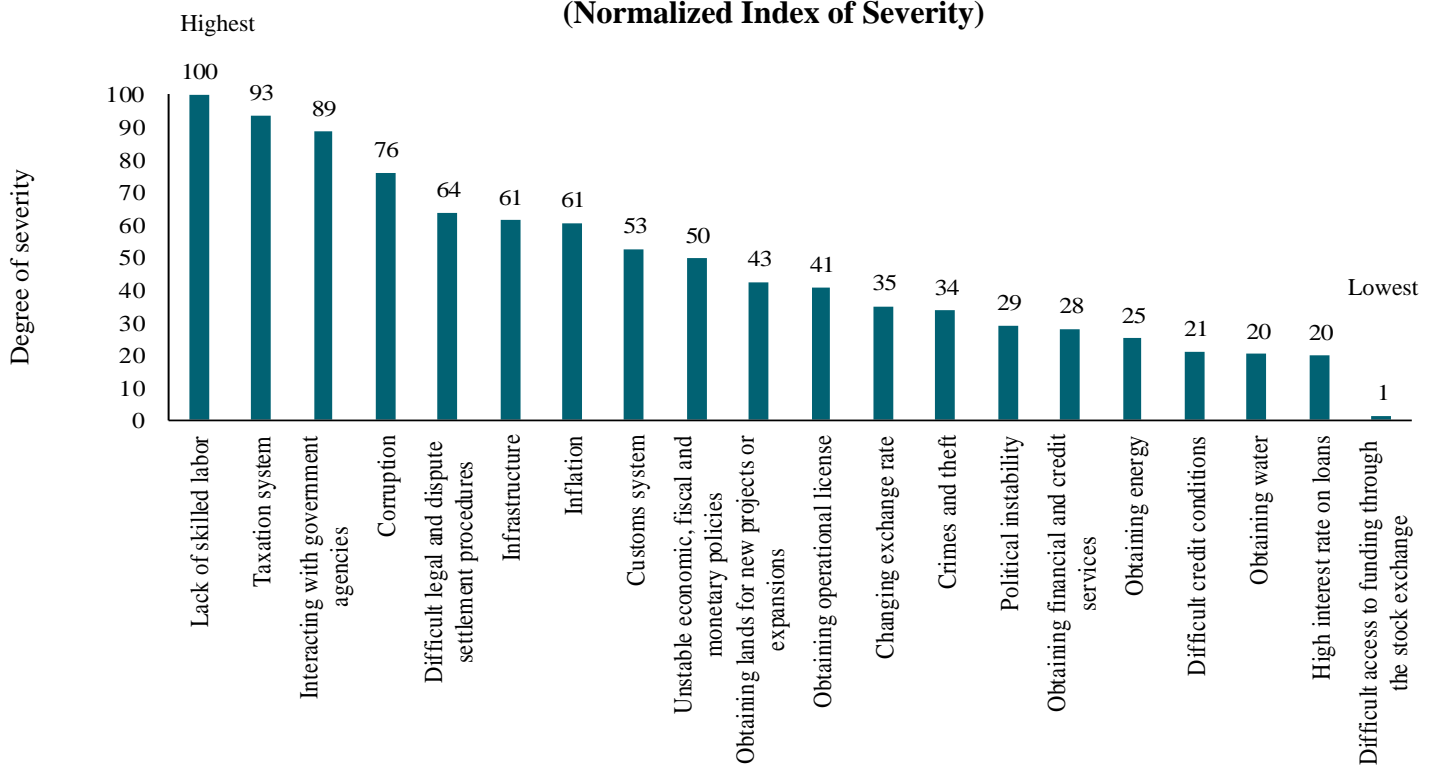
** The index for input prices is inverted to indicate the negative effect of the increase in input prices on businesses. Hence, a lower value of this index indicates higher input prices.

Business Constraints

Major constraints: Lack of skilled labor, complicated tax regime, difficulty in dealing with government authorities, and corruption

Figure 5 shows the major constraints facing businesses during the surveyed period, arranged in a descending order of severity, based on survey responses. Lack of skilled labor topped the list of major constraints, indicating a large gap between educational outcomes and labor market needs, which are structural problems facing the Egyptian economy or may be related to lower labor participation. Taxation came second on the list of constraints, highlighting the need for the government to develop a tight plan for reforming the tax regime, including reforming the legislative setup, such as the income tax and VAT laws. Among the major constraints reported by businesses are bureaucracy and corruption, indicating the need for the Government to adopt a comprehensive program for institutional and administrative reform and taking further measures to facilitate government services and combat corruption. Difficulty to obtain finance from the stock exchange came as the least constraint.

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

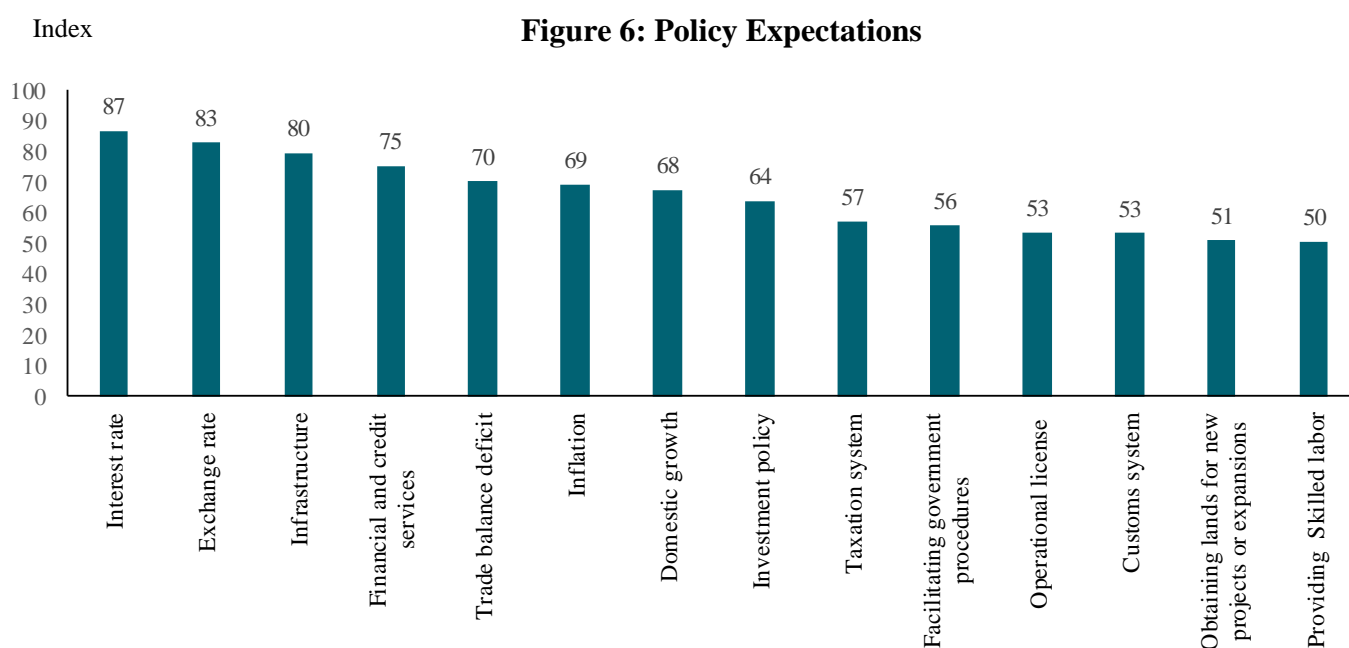


Source: Survey results.

Policy Expectations

Expected improvement in: interest rate, exchange rate, infrastructure, and financial and credit services

As shown in Figure 6, most firms were optimistic about the current trends of monetary policy due to the CBE decision to lower deposit and lending rates. Businesses also expect further improvement of the exchange rate of the pound against the US dollar due to increased foreign currency resources resulting from higher tourism revenues, foreigners' investment in Egyptian debt instruments and increased worker remittances. Further improvement in infrastructure is also expected due to the Government's implementation of national projects, including roads, bridges, and power and water plants. Firms also expect improved financial and credit services.



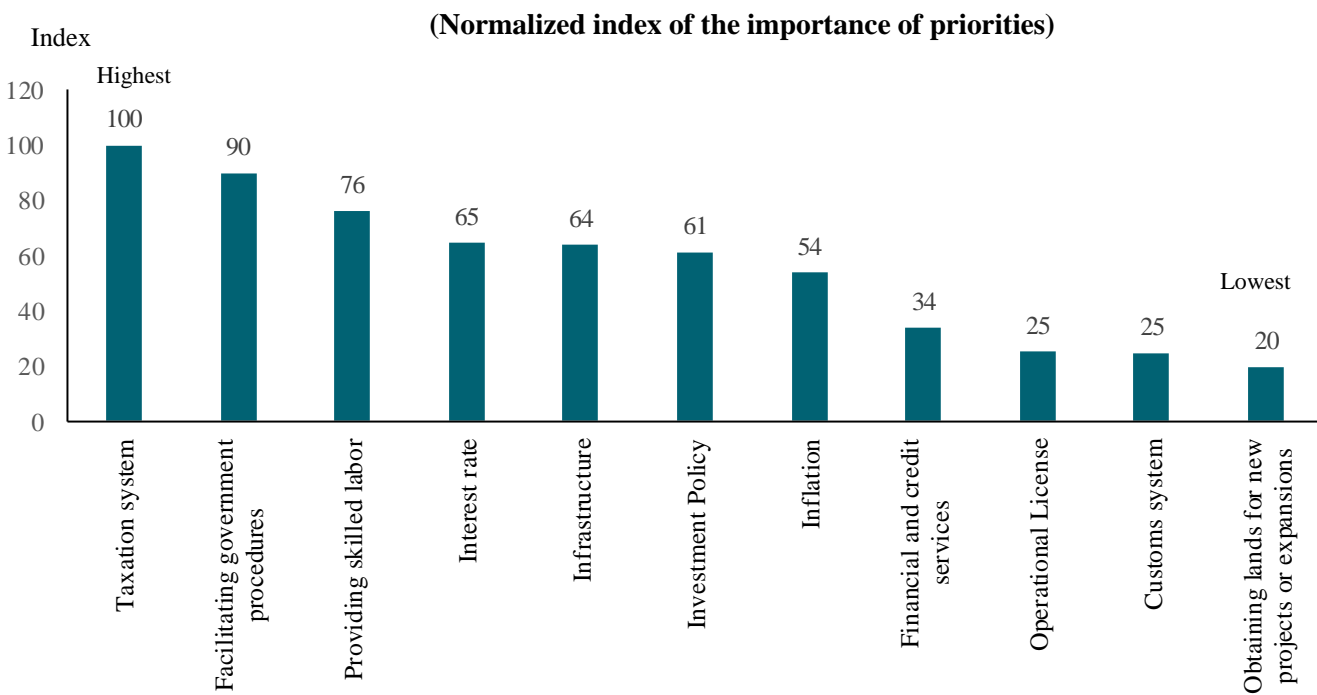
Source: Survey results.

Priorities for Improving the Business Climate (respondent views)

Simplifying tax regime, facilitating government procedures, providing skilled labor, lowering interest rate

According to Figure 7, firms reported the need for a comprehensive and effective plan for tax system reform. They also reported the need for effective efforts for institutional and administrative reform to end bureaucracy, facilitate government procedures, including the removal of the many obstacles facing businesses, which were mentioned earlier, such as complex customs system, difficulty of obtaining operating licenses, difficult litigation process, and the difficulty of obtaining lands, in order to increase investment. Also, finding unconventional solutions for the lack of skilled labor, which topped the list of constraints facing businesses as previously mentioned. Finally, results indicate that lowering interest rates will drive production in Egypt.

Figure 7: Priorities to Improve Egypt’s Business Ecosystem



Source: Survey results.

Table A1. Survey Results: Summary of Business Sector Past Performance of all Firms (October-November-December 2019)¹

Index	Manufacturing				Construction				Tourism				Transportation				Communications				Financial Intermediation			
	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²
	Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low	
				51				47				52				51				51				46
Business activity																								
Production	26	51	23	51	14	43	43	40	40	50	10	60	50	42	8	65	63	13	25	67	22	22	56	36
Domestic sales	28	43	28	50	14	43	43	40	40	50	10	60	42	42	17	59	63	13	25	67	22	22	56	36
Exports	27	69	4	57	0	100	0	50	17	67	17	50	0	67	33	40	50	0	50	50	-	-	-	-
Inventory	25	52	23	49	14	64	21	52	40	50	10	40	42	50	8	39	50	25	25	40	17	56	28	54
Level of capacity utilization	5	85	10	49	7	57	36	41	10	90	0	53	8	83	8	50	0	100	0	50	6	89	6	50
Prices																								
Final product prices	8	77	15	48	0	50	50	33	30	70	0	59	8	92	0	52	13	75	13	50	0	94	6	49
Intermediate input prices	21	52	26	52	14	43	43	60	0	100	0	50	0	100	0	50	50	25	25	40	-	-	-	-
Wage level	8	92	0	52	0	100	0	50	0	100	0	50	0	100	0	50	13	88	0	53	0	100	0	50
Primary inputs																								
Investment	7	93	0	52	21	79	0	56	0	100	0	50	25	75	0	57	25	63	13	54	0	100	0	50
Employment	0	98	2	50	14	79	7	52	10	90	0	53	8	92	0	52	13	50	38	42	0	83	17	45

Table A2. Survey Results: Summary of Business Sector Past Performance of all Firms (January-February-March 2020)¹

Index	Manufacturing				Construction				Tourism				Transportation				Communications				Financial Intermediation			
	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²	Percentage			Index ²
	Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low		Higher	same	Low	
				57				60				58				57				54				54
Business activity																								
Production	38	58	3	61	29	71	0	58	70	20	10	75	67	33	0	75	50	38	13	64	50	39	11	64
Domestic sales	36	61	3	60	29	64	7	57	50	50	0	67	58	42	0	71	63	25	13	70	50	39	11	64
Exports	40	60	0	63	100	0	0	100	67	17	17	71	33	67	0	60	50	0	50	50	-	-	-	-
Inventory	11	72	17	52	21	64	14	48	70	20	10	25	67	33	0	25	50	50	0	33	44	44	11	38
Level of capacity utilization	12	87	2	53	14	86	0	54	10	90	0	53	25	75	0	57	13	88	0	53	11	89	0	53
Prices																								
Final product prices	8	83	8	50	0	100	0	50	30	70	0	59	0	100	0	50	25	75	0	57	6	94	0	51
Intermediate input prices	8	87	5	49	0	93	7	52	0	100	0	50	0	100	0	50	50	50	0	33	-	-	-	-
Wage level	72	28	0	78	71	29	0	78	70	30	0	77	67	33	0	75	63	38	0	73	28	72	0	58
Primary inputs																								
Investment	10	90	0	53	7	93	0	52	10	90	0	53	25	75	0	57	25	75	0	57	0	100	0	50
Employment	10	90	0	53	7	93	0	52	10	90	0	53	8	92	0	52	13	75	13	50	6	94	0	51

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 Methodology.

Table A3. Survey Results: Summary of Past Performance of all Firms (by size) (October-November-December 2019)¹

Indicator	SMEs				Large firms			
	Percentage			Index ²	Percentage			Index ²
	Higher	Same	Lower		Higher	Same	Lower	
				49				54
Business activity								
Production	24	42	34	47	50	43	7	65
Domestic sales	26	38	36	47	44	41	15	61
Exports	16	63	21	48	30	70	0	59
Inventory	26	50	24	50	33	58	8	42
Level of capacity utilization	4	82	14	47	11	89	0	53
Prices								
Final product prices	9	76	15	49	4	82	14	47
Intermediate input prices	20	51	29	53	17	65	17	50
Wage level	5	95	0	51	4	96	0	51
Primary inputs								
Investment	5	94	1	51	25	75	0	57
Employment	2	91	7	49	11	85	4	52

Table A4. Survey Results: Summary of Outlook of all Firms (by size) (January-February-March 2020)¹

Indicator	SMEs				Large firms			
	Percentage			Index ²	Percentage			Index ²
	Higher	Same	Lower		Higher	Same	Lower	
				57				59
Business activity								
Production	43	52	5	62	54	43	4	68
Domestic sales	44	51	5	63	37	59	4	60
Exports	61	33	6	71	35	60	5	59
Inventory	32	56	12	44	33	54	13	43
Level of capacity utilization	13	86	1	53	14	86	0	54
Prices								
Final product prices	7	88	4	51	15	81	4	53
Intermediate input prices	8	88	5	49	9	87	4	49
Wage level	57	43	0	70	86	14	0	88
Primary inputs								
Investment	4	96	0	51	32	68	0	60
Employment	6	94	0	52	18	79	4	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 Methodology.