

The Egyptian Center for Economic Studies



Industrial Barometer

January 2000

Expectations of the Egyptian Manufacturing Sector

The Egyptian Center for Economic Studies (ECES), an independent, nonprofit research institute, was founded in 1992 by members of Egypt's private sector. Its objective is to promote economic development in Egypt by assisting policy makers and the business community in identifying and implementing reform. By conducting and disseminating applied research and analysis of relevant issues, ECES is working to deepen understanding of the problems facing Egypt and to find solutions. Through its publications, lectures, conferences, and roundtable discussions, ECES strives to increase awareness and generate discussion of economic policy.

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Overview

In the last six months of 1999, Egypt's manufacturing sector showed an improvement in performance from the relatively stagnant years of 1998 and early 1999. Although industrial sales and production show a slight trend upwards, investment is not expected to rise in the next six months. This is due to the fact that producers must first deal with high inventories and excess capacity generated over the past year when sales were much lower than expected. Overall, the manufacturing sector's economic outlook for the first half of .2000 is for slow recovery in the rate of growth

Put in a broader perspective, it is worth noting that over the past year and a half, Egypt faced a growing current account deficit, which resulted in pressure on the exchange rate. The government's desire to keep the nominal exchange rate stable meant that policy makers had to follow tight monetary policy to avoid further deterioration of the exchange rate. Moreover, real interest rates have been kept high and the rate of growth of money supply (M1) has decreased, resulting in the often talked about liquidity problem. Tight monetary policy seems to have caused the economy to slow down and inflation to fall. Not surprisingly, manufacturers have reported stable or declining final and intermediate product prices .(over the past year and a half (See chart 1

The remainder of this edition of the *Industrial Barometer* is divided into three sections covering firms' assessment of economic growth, sales and production; prices of both final output and intermediate .products; and investment and employment

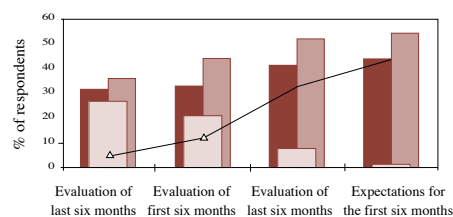
Levels of Activity

Manufacturers' Assessment of Growth

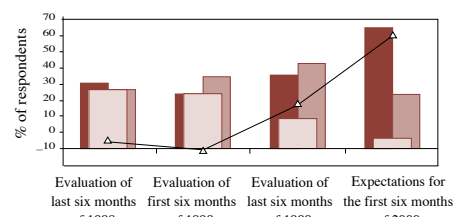
Our survey results for the past year show that manufacturers expected the economic downturn in 1998/99 to be brief. This is indicated by the percentage of firms that expected economic growth to accelerate in our last two surveys (41 percent and 52 percent, respectively). Furthermore, the results from our last two surveys show that firms did not cut production and continued to have plans to expand investment despite stagnant sales (See table 1). The figures for industrial consumption of electricity for 1999 corroborate our survey results, showing a steady increase in electricity consumption of about 8 percent, which implies a .(continued increase in industrial production (See chart 3

Chart 1. Trends in Manufacturing Indicators
(July 1998 - July 2000)

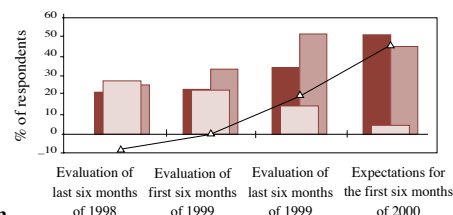
Economic Growth



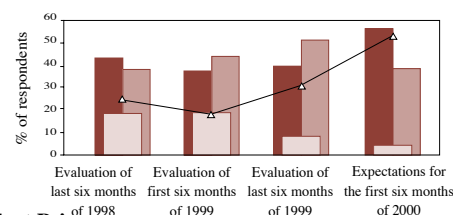
Domestic Sales



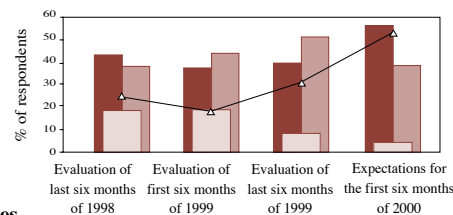
International Sales



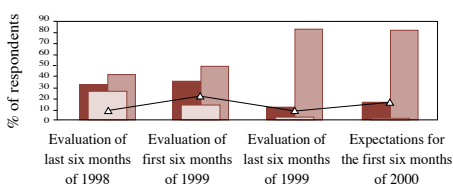
Production



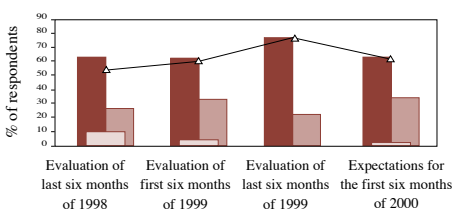
Final Product Prices



Input Prices

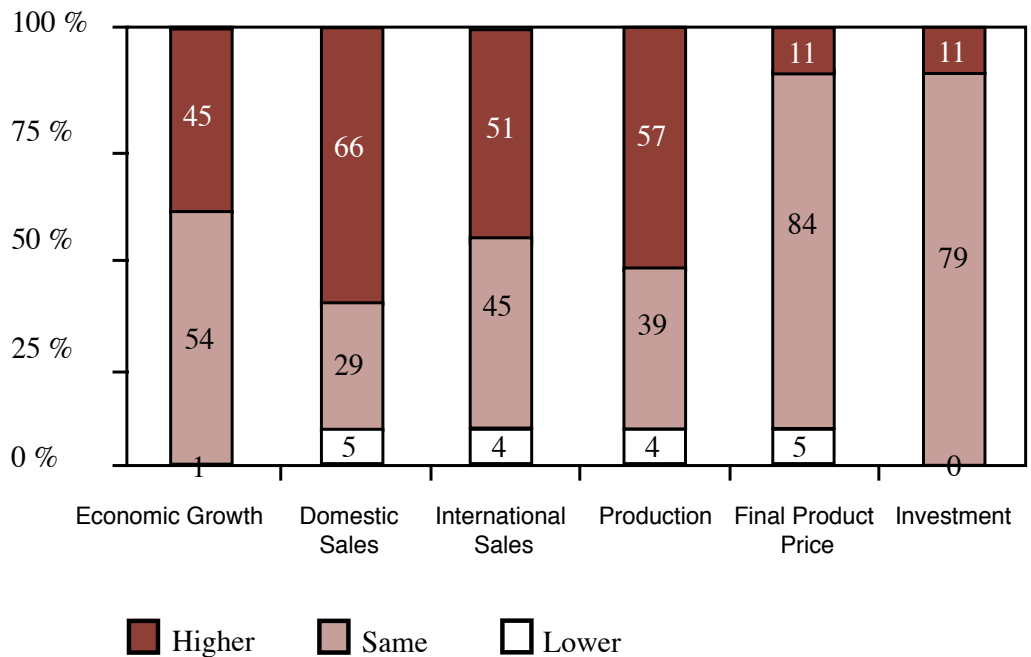


Wage Bill



■ Higher ■ Same ■ Lower △ Net balance

Chart 2. Firms' Expectations for January - June 2000



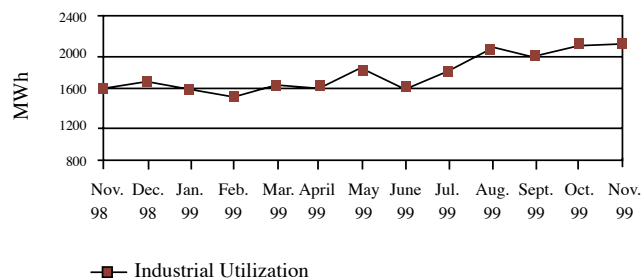
In the second half of 1999, firms are finally reporting that they can see an improvement in economic growth. In fact, more than 40 percent of firms judged economic growth in the second half of 1999 to be higher than growth in the first half, and only 8 percent thought that it was lower. While these results are still lower than their initial expectations, they are much closer to reality than previous forecasts. Only 12 percent of firms who expected growth would be higher actually reported it to be the same, while the firms that expected economic growth would be lower (9 percent) were almost equivalent to the number that actually reported a slowdown (8 percent).

Although the liquidity problem, the exchange rate shortage and tight monetary policy continue to constrain economic growth, firms are optimistic that growth in the first half of 2000 will be higher. Close to 45 percent of the firms surveyed expect the rate of growth to increase, and only 1 percent expect slower growth. This result is similar to previous surveys, indicating a moderate level of business confidence, despite disappointing performance in 1998/1999 as indicated by companies' sales performance (See table 1).

Improving Sales

In the last half of 1999, manufacturers' previous expectations that sales would recover finally began to materialize. Sales to both domestic and international markets were higher for the last half of 1999. The net balance for domestic sales was 24 percent (39 percent reporting higher sales and 15 percent reporting lower sales), and 19 percent for international sales (34 percent reporting higher sales and 15 percent reporting lower sales). This is a marked improvement from the first six months of the year when sales were stagnant, with a net balance for domestic and international sales of -1 and zero percent, respectively (See chart 1).

Chart 3. Industrial Utilization of Electricity



In both internal and external markets, a higher number of public firms report improvement in their sales. This, however, does not imply that public firms are doing better than private firms across the board, only that they have seen greater improvement in their sales with respect to the past six months

Looking at sales performance at the sub-sector level, the processed food and chemicals sectors were the only two sectors showing strong positive results for both public and private firms. The net balance for domestic sales for food processing firms was 32 percent (37 percent reporting increased sales and 5 percent reporting lower sales) and 31 percent for international sales (36 percent reporting increased sales and 6 percent reporting lower sales). Both private and public sector chemical firms also did well with a net balance for domestic sales of 66 percent (72 percent reported higher sales and 6 percent reported lower sales) and a net balance of 56 percent for international sales with 62 percent of the companies reporting higher export sales. The private sector's ready made garments industry also reported impressive results with a net balance of 33 percent for domestic sales and 50 percent for international sales

Expectations for sales continue to be optimistic with 66 percent of firms expecting domestic sales to increase and 51 percent expecting international sales to increase over the next six months (See chart 2). This is very similar to sales expectations in our previous survey

Modest Increase in Production

Over the past six months, production showed a modest net gain, with 40 percent of the surveyed companies reporting higher production, 51 percent reporting stagnant production, and 9 percent reporting lower levels of production. These figures are more positive than those reported in the last survey, and indicate that production continues to grow faster than sales (See chart 1 and table 1)

Firms continue to expect an improvement in sales, and therefore, have not cut production and do not anticipate cutting production in the coming six months. In fact, 57 percent of the companies surveyed say they intend to raise production over the coming months (See chart 2). While these numbers are relatively optimistic, they are lower than expectations from our previous survey by more than 8 percent. These lowered expectations imply that rising inventory levels as well as low capacity utilization are finally

beginning to have a dampening effect on production expectations. The excess capacity created by higher investment over the past year and lower than expected sales is also reflected in plans of capital investment. While 30 percent of firms reported plans for increased investment in the last *Industrial Barometer*, only 11 percent, report having plans for increased capital investment for the first half of 2000

Inventories and Excess Capacity Increased

Since the economic downturn was expected to be short lived, firms expected that their sales would quickly recover. These expectations were translated into higher capital investment and an expansion of production, which were not matched by an increase in domestic or international sales. Since this trend of production and expected production rising faster than sales is a continuing one, inventories are rising. Approximately 19 percent of firms report rising inventories and only 11 percent of firms report declining inventories. Furthermore, 31 percent of firms report operating below normal capacity, and only 10 percent report operating close to full capacity (See table 1). This is a result of the increase in capital investment over the past year, which was based on the erroneous assumption that sales would soon recover

Prices

Lower Prices for Final Goods

The general picture for prices is of a slowly declining rate of inflation. This is a direct result of the tight monetary policies followed over the past year. Our survey results corroborate the continuation of a declining rate of inflation, albeit at a slower rate of decline than that indicated over the past year and a half. The vast majority of firms (85 percent) held their prices constant for the second half of 1999, with only 11 percent reporting lower prices. This is a marked improvement over the past year and a half, where between 22 and 30 percent reported lower final product prices. Firms' expectations for the next six months closely mirror what happened in the last six months of 1999, with 83 percent of firms expecting to hold the prices for their products constant (See chart 2, Tables 1, 2 & 3)

Input prices continued to rise, but at a slower pace than in the last survey, and at a slower rate than firms expected. Only 14 percent of firms report rising input prices relative to 37 percent of companies during the first half of the year, and the 30 percent who expected they would rise (See table 1). Wages likewise continued

to increase with close to 77 percent of firms saying that their wage bill has increased relative to the past six months. The increase in wages is mostly due to regular pay raises, which firms report to be between 7 and 10 percent. These increases are well above the rate of inflation, indicating an increase of real wages of between 4 and 7 percent. Given that actual sales performance continually fails to meet expectations, rising input and wage prices in combination with falling final goods prices implies that firms' profits continued to be squeezed during the second half of 1999

Investment and Employment

Stagnant Investment and an Increase in Private Sector Employment

For the first time since ECES started the *Industrial Barometer* survey, the number of firms expecting to increase employment (12 percent) exceeded the number of firms planning to lower employment (7 percent). The overall balance for the public sector is still negative (-9 percent), but the balance for the private sector is positive, with almost a quarter of firms expecting to hire more workers and only 3 percent expecting to employ less workers (See tables 2 & 3). This is a continuation of the trend over the past year. However, with a slowing down of the public sector early retirement schemes, the overall picture for employment in the manufacturing sector finally looks positive

More than half of the expected increase in employment in the private sector is expected to come from the textile industry. The textile sector's expectations for domestic and international sales for the first half of 2000 are very high, despite continuing to have excess capacity. Furthermore, although the ready made garment industry performed well in the last half of 1999, the spinning and weaving sub-sector did not perform well, and in fact showed a decline in sales to international markets

Investment in fixed capital is projected to increase slightly, with 11 percent of firms saying they plan to increase capital investment during the first six months of 2000. This is much lower than the near 30 percent that planned to increase investment over the past year. The slow down in investment is due to the excess capacity that is reported. More private sector companies than public sector companies are planning increases in capital investment (16 percent and 7 percent, respectively), which is in line with the private sector's expectations of higher employment over the next six months (See chart 4

Chart 4. Firms' Expected Investment

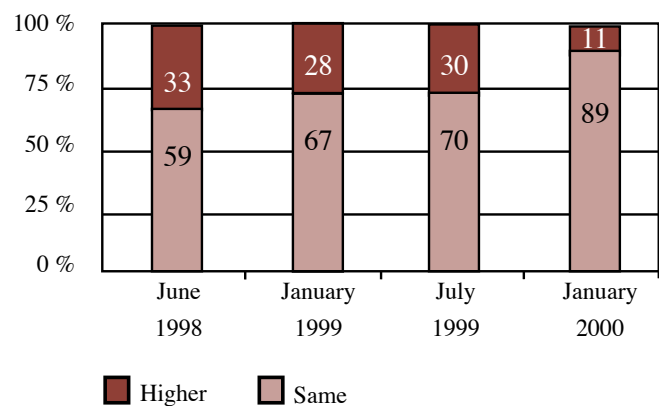


Table 1. Summary of Survey Results for Private and Public Firms¹

Activity	Evaluation Jul-Dec 1998			Evaluation Jan-Jun 1999			Evaluation July-Dec 1999			Expectations Jan - June 2000		
	Higher	Same	Lower	Higher	Same	Lower	Higher	Same	Lower	Higher	Same	Lower
Economic growth	31.8	36.2	26.8	32.7	44.2	21.2	40.8	51.2	7.9	44.8	53.9	1.2
			Net Balance²			Net Balance²			Net Balance²			Net Balance²
			5.1			11.5			32.9			43.6
Output												
Domestic sales	34.7	31.1	31.2	28.5	38.2	29.7	39	45.7	15.2	65.8	29.2	4.8
International sales	21	25.3	27.5	22.4	33.3	22.4	33.8	51.4	14.7	50.7	44.9	4.3
Production	43.4	37.6	18.1	37.0	44.2	18.8	40.0	50.9	9.0	56.9	38.7	4.2
Size of Inventory	31.2	31.2	35.5	24.8	36.4	37.0	18.7	70.3	10.9	n/a	n/a	n/a
Level of capacity utilization ³	27.5	48.6	22.5	17.6	57.0	24.8	9.7	59.1	31.1	n/a	n/a	n/a
			Net Balance²			Net Balance²			Net Balance²			Net Balance²
			3.6			-1.2			23.7			60.9
			-6.5			0.0			19.1			46.3
			25.4			18.2			30.9			52.7
			-4.3			-12.1			7.7			n/a
			5.1			-7.3			-21.3			n/a
Prices												
Final product prices	4.3	65.2	29.7	16.4	58.8	24.8	4.24	84.8	10.9	10.9	83.6	5.4
Input prices	33.3	41.3	25.4	36.4	48.5	13.9	13.9	82.4	3.6	17.0	81.7	1.2
Wage bill	63.7	26.0	10.1	63.0	32.7	3.6	76.9	22.4	0.6	64.0	34.7	1.2
			Net Balance²			Net Balance²			Net Balance²			Net Balance²
			-25.4			-8.5			-6.6			5.4
			8.0			22.4			10.3			15.8
			53.6			59.4			76.3			62.8
Inputs												
Employment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	12.1	80.6	7.2
Investment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	10.9	89.0	0
			Net Balance²			Net Balance²			Net Balance²			Net Balance²
			n/a			n/a			n/a			4.8
			n/a			n/a			n/a			10.9

¹ Numbers represent percent of total responses. Items may not add up to 100 percent due to omission by respondents.

² 'Net Balance' represents the percentage of respondents indicating an increase minus the percentage of respondents indicating a decrease.

³ Higher = approaching full capacity utilization; Same = normal capacity utilization; Lower = below capacity utilization.

Table 2. Summary of Survey Results for Public Firms¹

Activity	Evaluation Jul-Dec 1998				Evaluation Jan-Jun 1999				Evaluation July-Dec1999				Expectations Jan - June 2000			
	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²
Economic growth	28.4	43.3	22.4	6.0	38.5	46.2	15.4	23.1	44.0	49.0	7.0	37.0	47.0	53.0	0.0	47.0
Output																
Domestic sales	26.9	37.3	35.8	-9.0	29.2	39.3	31.5	-2.2	40.0	47.0	13.0	27.0	69.0	31.0	0.0	69.0
International sales	17.9	23.9	25.4	-7.5	24.3	45.7	30.0	-5.7	36.0	53.0	11.0	25.0	53.0	47.0	0.0	53.0
Production	32.8	46.3	19.4	13.4	37.4	38.5	24.2	13.2	43.0	48.0	9.0	34.0	64.0	36.0	0.0	64.0
Size of inventory	29.9	22.4	47.8	-17.9	21.1	35.6	43.3	-22.2	14.0	72.0	15.0	-1.0	n/a	n/a	n/a	n/a
Level of capacity utilization ³	29.9	47.8	20.9	9.0	15.4	62.6	22.0	-6.6	11.0	57.0	32.0	-21.0	n/a	n/a	n/a	n/a
Prices																
Final product prices	3.0	61.2	35.8	-32.8	20.9	51.6	27.5	-6.6	7.0	85.0	9.0	-2.0	12.0	86.0	2.0	10.0
Input prices	31.3	41.8	26.9	4.5	40.0	44.4	15.6	24.4	10.0	87.0	3.0	7.0	16.0	84.0	0.0	16.0
Wage bill	59.7	19.4	20.9	38.8	54.9	38.5	6.6	48.4	84.0	15.0	1.0	83.0	62.0	37.0	1.0	61.0
Inputs																
Employment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	3.0	86.0	11.0	-8.0
Investment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	7.0	93.0	0.0	7.0

¹ Numbers represent percent of total responses. Items may not add up to 100 percent due to omission by respondents.

² 'Net Balance' represents the percentage of respondents indicating an increase minus the percentage of respondents indicating a decrease.

³ Higher = approaching full capacity utilization; Same = normal capacity utilization; Lower = below capacity utilization.

Table 3. Summary of Survey Results for Private Firms¹

Activity	Evaluation Jul-Dec 1998				Evaluation Jan-Jun 1999				Evaluation July-Dec1999				Expectations Jan - June 2000			
	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²	Higher	Same	Lower	Net Balance ²
Economic growth	35.2	29.6	31.0	4.2	26.4	43.1	29.2	-2.8	37.0	53.0	10.0	27.0	42.0	55.0	3.0	39.0
Output																
Domestic sales	42.3	25.4	26.8	15.5	30.0	40.0	30.0	0.0	38.0	44.0	18.0	20.0	62.0	27.0	11.0	51.0
International sales	23.9	26.8	29.6	-5.6	33.9	39.0	27.1	6.8	31.0	49.0	20.0	11.0	48.0	43.0	10.0	38.0
Production	53.5	29.6	16.9	36.6	36.5	51.4	12.2	24.3	36.0	54.0	9.0	27.0	49.0	42.0	9.0	40.0
Size of inventory	32.4	39.4	23.9	8.5	30.1	38.4	30.1	0.0	25.0	69.0	6.0	19.0	n/a	n/a	n/a	n/a
Level of capacity utilization ³	25.4	49.3	23.9	1.4	20.3	50.0	28.4	-8.1	8.0	62.0	30.0	-22.0	n/a	n/a	n/a	n/a
Prices																
Final product prices	5.6	69.0	23.9	-18.3	10.8	67.6	21.6	-10.8	1.0	85.0	14.0	-13.0	9.0	81.0	9.0	0.0
Input prices	35.2	40.8	23.9	11.3	32.9	54.8	12.3	20.5	19.0	77.0	4.0	15.0	19.0	78.0	3.0	16.0
Wage bill	67.6	32.4	0.0	67.6	74.0	26.0	0.0	74.0	69.0	31.0	0.0	69.0	66.0	32.0	1.0	65.0
Inputs																
Employment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Investment	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	84.0	0.0	16.0

¹ Numbers represent percent of total responses. Items may not add up to 100 percent due to omission by respondents.

² 'Net Balance' represents the percentage of respondents indicating an increase minus the percentage of respondents indicating a decrease.

³ Higher = approaching full capacity utilization; Same = normal capacity utilization; Lower = below capacity utilization.

Appendix

Methodology

While tracking and monitoring trends in the Egyptian economy, ECES discovered that data on the financial side of the economy was widely available and its timeliness and accuracy had improved dramatically over the last few years. There was, however, a lack of timely, real-side data reflecting trends in individual sectors. In order to gather data on entrepreneurs' perspectives of industrial trends, ECES created and conducted a survey targeted at certain sectors/industries. Aside from providing a useful biannual report, ECES also ultimately intends that the information gathered on a number of sectors about past and present demand and supply elements, expectations about future orders, prices, and so on will .be developed into more sophisticated output indices

The survey concentrates on the industrial sector, mainly manufacturing, and excludes construction, petroleum, agriculture, and service activities, which can be monitored by other means. Selecting the sample was done in three stages. First, the value-added contribution of each major sub-sector to manufacturing was calculated, including the relevant public/private split within each sub-sector. Second, the number of public and private firms needed from each sub-sector was calculated, based on the sample size. Finally, large firms were chosen on the assumption that they contribute the most value added to the industrial sector as a whole .across different sub-sectors

In the current survey, out of a sample of 200 firms distributed among 11 industrial sectors, 165 responded between November and December 1999. Using the classification categories of the Ministry of Planning, the manufacturing sectors surveyed were: food (41); beverages and tobacco (9); spinning and weaving (24); ready-made clothes (8); printing (2); shoes (2); leather and leather products (4); rubber products (2); chemicals and chemical-related products (18); non-metal mining products (14); basic metal products (28); and transportation equipment (4). The survey elicited responses on current levels of activity, prices, inventories, and capacity utilization relative to the previous six months, and

expectations about output and input prices, final product demand, wage and employment trends, the changing nature of constraints on business, as well as overall economic growth. Firms were requested to indicate an increased, decreased or unchanged level of activity for each indicator. The data supplied by participating firms is complete in most cases, with the exception of the surveys submitted by those firms who do not engage in external trade and .accordingly, do not comment on international sales

The ECES *Industrial Barometer* is conducted as a means of gaining information to make short-term assessments and predictions about the Egyptian economy. As an industrial survey of input and output expectations in Egypt, it has certain methodological weaknesses. The survey focuses on constraints to production and does not address general constraints to business (See survey). The purpose of this focus is to determine if certain factors of production are causing bottlenecks, and thereby help in the process of anticipating .changes in price levels and employment

Additionally, the ECES survey relies on the largest firms in each industry, in terms of employment, in order to capture as much of the production trends as possible. Since large firms tend to have fewer constraints than small firms, the sample is biased. Furthermore, the incidence and severity of constraints are not uniform across sectors .and do not mirror results of other formal and informal surveys

ECES is committed to improving the rigor of the overall approach and increasing the sample size in each subsequent survey to ensure greater coverage of the manufacturing sector and industrial sector. The next *Industrial Barometer* survey will take place in the months of May and June 2000 with the results due to be published in July 2000. ECES would like to thank all the companies that participated and those readers who sent their comments and suggestions. ECES has tried to incorporate their feedback into this survey and would .welcome any further comments or suggestions