Views On News
رأي في أزمة
VIEWS ON CRISIS
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Views on the Crisis

Projected Impact of the COVID-19 Pandemic on Egypt's GDP Growth

Introduction

While the whole world shares the broad outlines of the economic and social repercussions of the Coronavirus (COVID-19), which are unprecedented in its recent history, the implications thereof for each country are linked to the nature of each country's economic system, its ability to withstand the entailed repercussions and the speed of its recovery.

In light of the need to study the sectoral implications of these repercussions in order to address the crisis properly, the Egyptian Center for Economic

Studies (ECES), in its initiative, is producing a set of daily reports entitled "Views on Crisis". The reports aim to analyze the implications of the coronavirus crisis for Egypt in relation to a number of vital production and service sectors and to key macroeconomic variables. This ECES initiative comes from the belief that the current critical conditions require directing state’s efforts towards achieving two main goals: providing a decent life for Egyptians during the crisis and in the recovery phase, preserving the existing investments-especially domestic investments- and helping to overcome the crisis and prepare for a rapid launch with the gradual decline of the crisis and recovery of the global economy.

The methodology used in these reports is based on an analysis of the supply and demand shocks associated with the crisis cycle in its various stages. Given the lack of detailed data on the sectoral impact of the crisis, the sectoral analysis is based on logical assumptions related to the nature of each sector and the degree of sector vulnerability to previous sever crises that were certainly less severe than the current crisis and different in nature. However, it is a starting point for the urgently required scientific diligence at this stage.

The reports attempt to provide a detailed perception of the magnitude and direction of crisis impact on each sector at present and until the end of the crisis. They aim to propose quick solutions to reduce the adverse impacts of the crisis in a balanced and integrated means that complement the serious efforts made by the state in this regard, and to offer other longer-term solutions to the existing institutional flaws, clearly revealed by the crisis. It is high time that these flaws are radically removed, which will improve post-crisis development efforts.

“when written in Chinese, the word ‘crisis’ is composed of two characters. One represents danger and the other represents opportunity.”

John f. Kennedy

* Reports will be issued in Arabic on a daily basis. An English translation of each report will be sent on the day following its issuance.

Overview

This report aims to provide preliminary estimates of the macroeconomic impact of the crisis and chart a course of policy action. It is important to note that we acknowledge the difficulty of this exercise. On the one hand, the information set, which is used to make the projections, is changing rapidly and significantly; on the other hand, we do not have precedents of shocks of comparable magnitude in Egypt's recent history to guide us. However, there are two recent shocks, which provide some guidance in this respect. The first shock is the global financial crisis of 2008, which bears similarities with the current crisis given the expected sharp decline in global economic growth. This was a global demand shock which also led to a significant dislocation in global supply-side capacity. Prior to this shock, Egypt had enjoyed some of its highest growth rates in recent history, and the shock led to a reduction in domestic growth rates due to the negative impact of the crisis on domestic private investment, as well as Egypt's international trade. Second, the aftermath of the January 2011 uprising in Egypt was a domestic shock, which destabilized both demand and supply channels in the Egyptian economy, and offers particular insights into the impact of a sudden and significant drop in investment and exports, with the impact felt mostly in the manufacturing sector, wholesale and trade, and tourism.

Impact of the Two Previous Shocks

As shown in Table 1, the Egyptian economy witnessed a prolonged period of high growth, which was balanced across the components of aggregate demand: household consumption, investment and export growth. At the peak of the crisis, world GDP growth declined drastically to 0.7 percent dragging with it GDP growth in Egypt from

6.6 percent to 4.3 percent. This decline was driven by a significant decrease in private investment and exports. Prior to the January 2011 uprising, the Egyptian economy was starting to show signs of recovery from the slowdown that followed the 2008 global financial crisis. During the period 2009Q4-2010Q4, growth increased to 5.3 percent supported by the rebound in world GDP and the fiscal stimulus package of EGP 15.5 billion (1.5 percent of GDP) introduced by the government to boost domestic demand at the time. During the January 2011 uprising, GDP growth witnessed a large drop to an average of -0.9 percent during 2011, largely driven by a significant decline in private investments and exports. However, household consumption remained resilient during this period, and this played a significant role in supporting economic growth. An increase in government consumption starting 2012Q1 helped revive overall growth to 3.4 percent.

Table 1. Impact of the two recent shocks on the Egyptian economy (average quarterly rates of growth)

Time period	World GDP	Egypt's GDP	Household consumption	Government consumption	Investment	Exports	Imports
2007Q3-2008Q3	4.0	6.6	5.7	2.6	12.0	23.0	20.9
2008Q4-2009Q3	0.7	4.3	5.0	5.4	-6.9	-24.7	-28.4
2009Q4-2010Q4	4.3	5.3	4.5	4.0	8.5	6.3	6.3
2011Q1-2011Q4	4.3	-0.9	5.7	3.3	-10.0	-6.5	5.8
2012Q1-2012Q4	3.3	3.4	5.8	7.1	5.6	-5.4	7.2
⋮	⋮	⋮	⋮	⋮	⋮	⋮	⋮
2018Q1-2019Q3	3.3	5.4	0.9	2.6	14.9	-1.5	-7.8

Source: ECES calculations based on data from the Ministry of Planning and Economic Development, Central Bank of Egypt and the IMF's International Financial Statistics Database.

It is important to note that right before the COVID-19 pandemic shock, the Egyptian economy grew at 5.4 percent during the period 2018Q1-2019Q3; however, the sources of growth were fundamentally different from previous expansions. During this period, household consumption was weak (growing at only 0.9 percent), and all of the heavy lifting in the economy was due to a surge in investments, where public investments took an increasingly important role.

Global Projections

The world growth outlook was already weak before the COVID-19 outbreak. This was in large part due to growing trade tensions and protectionist measures in the US. World growth was projected to slip below 3 percent in 2020, and recent data showed that new business orders (all goods, manufacturing goods and services) in advanced economies were on the decline. Also, global merchandise trade, and air and container freight traffic were contracting.[1] In line with emerging forecasts from many institutions, the global impact of the pandemic is looking rather dire with many forecasts predicting a contraction similar or even stronger than the financial crisis of 2008 in most advanced economies.

[1] Source: OECD Interim Economic Assessment "Coronavirus: The world economy at risk".

Growth Outlook for the Egyptian Economy under three Different scenarios: 2020 and 2021

As indicated earlier, Egypt's growth was not severely affected in the aftermath of the 2008 crisis given its limited integration in international financial markets, and its solid domestic economic fundamentals at the time. However, the current shock is expected to have a larger effect since the Egyptian economy is currently reliant on external financing, and given vulnerable growth dynamics in the components of aggregate demand, in particular household consumption, private investment, and exports.

The recovery path is dependent on various factors, some of which are non-economic and are highly uncertain at the moment. Figure 1 shows the likely trajectory for the pandemic during the crisis cycle.

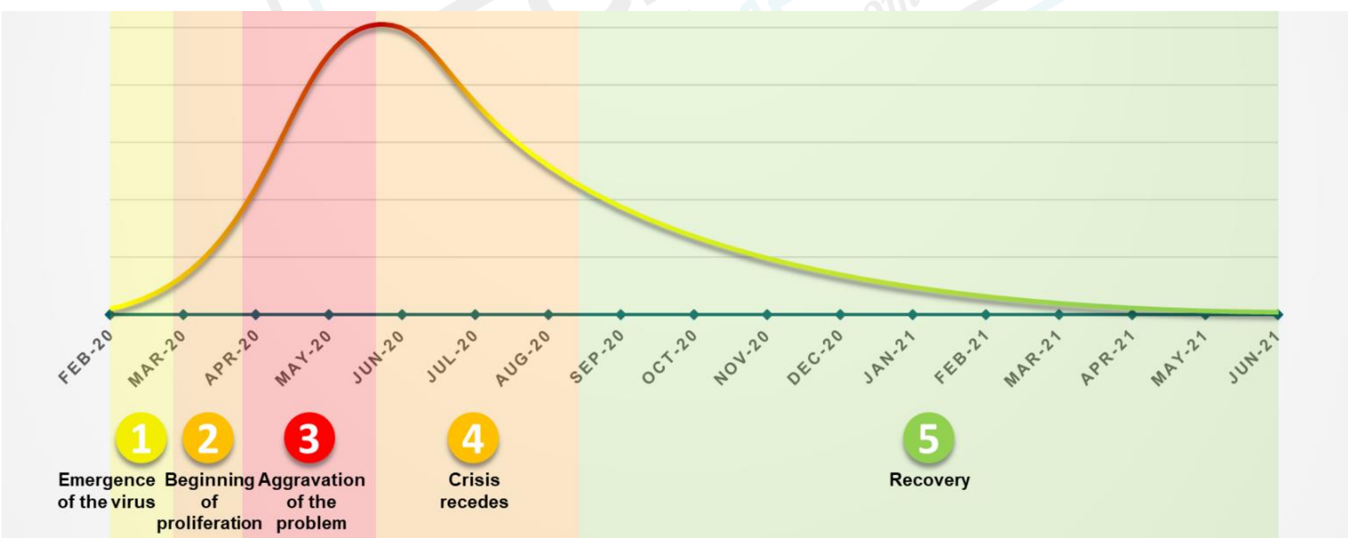

Figure 1. Crisis Cycle

In Table 2, we present three scenarios for the growth prospects in 2020 and 2021 based on differential speeds of virus containment.

Table 2. Projected impact of the crisis on GDP growth

Stage	Scenarios	Assumptions	Impact on GDP growth
Stage 1. December 2019-January 2020		No significant supply disruptions or changes in consumer and investor sentiment. No known cases of COVID-19 appeared in Egypt at this time.	Estimated growth rate for 2019Q4 is 5.6%.
Stage 2. February 2020-mid March 2020		Escalating supply disruptions with growing uncertainties among households and businesses.	Real GDP growth in 2020Q1 is projected to be 4.9% compared to 5.6% in 2019Q4.
Stages 3 to 5 (interlinked).* Mid-March 2020-end of 2021	Scenario 1: Quick Containment (Optimistic)	In this scenario, we assume (a) containment of the virus by end of 2020Q2; (b) quick upturn in economic activity starting 2020Q3 (V-shaped recovery) where the growth momentum continues, driven mainly by an increase in investment and a contraction in imports; (c) unlike its resilient response in the previous two crises and given relatively weak growth during the last two years, household	Under this scenario of a short-lived shock, the recovery pace is expected to be higher than that of the other two scenarios. This scenario projects that real GDP growth will slow down to 3.5% in 2020 (down from an estimate of 5.5% in 2019) and continue

Stage	Scenarios	Assumptions	Impact on GDP growth
		consumption is assumed to contract during the second and third quarters of 2020 and resume its growth momentum gradually starting 2020Q4, (d) government spending remains resilient, supporting economic growth throughout the forecasting period, (e) investments, mainly by the private sector, will be severely affected by the shock in 2020Q3, however, with quick containment of the virus, the business sentiment will be slightly affected and initial investment plans will resume in 2020Q4, (f) exports start to pick up gradually in 2020Q4 assuming a contemporaneous recovery in global demand.	recovering to 4.7% in 2021.
	Scenario 2: Mild Containment (Baseline):	In this scenario, we assume (a) virus containment to be slower than in the first scenario, lasting till	We project growth to dip to 2.3% in 2020 and pick up to 3.1% in 2021. To date,

Stage	Scenarios	Assumptions	Impact on GDP growth
		2020Q3; (b) economic disruptions last for the second and third quarters of 2020 and the economy begins to pick up only in 2020Q4 (U-shaped recovery); (c) recovery is projected to be sluggish as the impact of prolonged supply chain disruptions, employee layoffs and suspended production due to imposed quarantine measures and lockdowns will be more profound.	this scenario seems to be the most likely one.
	Scenario 3: Very Slow Containment (Pessimistic):	In this scenario, we assume (a) virus containment does not occur before the end of 2020; (b) a longer economic activity disruption, which lasts for four quarters: 2020Q1 through 2020Q4; (c) due to the accumulation of negative effects of the prolonged economic disruptions described above, this scenario suggests a similar	Real GDP growth is projected to drop to 0.8% in 2020 and increase to around 1.1% in 2021 as disruptions in economic activities lessen.

Stage	Scenarios	Assumptions	Impact on GDP growth
		outcome to the second scenario but with a more protracted dip in economic activity.	

Source: ECES projections based on different growth trajectories for the components of GDP guided by the previous two shocks and subsequent recovery paths. * Stages 3, 4 and 5 are interlinked in this analysis since the path of recovery depends on the speed of containment under each scenario.

The preliminary growth projections presented in this note show that the speed of recovery is expected to vary across the three scenarios. While growth is expected to witness a quick recovery under the optimistic scenario, the rebound in economic activity in the pessimistic scenario is expected to be much more modest. However, these projections are also subject to downside risks. This concerns the deepening and widening of the economic effects of the pandemic for the global economy. Hence, it is important to note that the current situation remains fragile with high uncertainty surrounding the global growth outlook. Accordingly, quick and targeted policy responses are needed to limit the adverse effect of those risks and ensure faster recovery. In what follows, suggested policy responses to the ongoing crisis will be discussed.

Institutional weaknesses revealed by the crisis:

1. GDP measurement in Egypt suffers from known inaccuracies, particularly when it comes to measuring household consumption (around 80% of GDP). The official national accounts also do not capture the large informal economy, which makes it difficult to measure GDP and its sources of growth in a reliable manner.

Addressing this issue require availing more resources to the Ministry of Planning to improve the way national accounts are prepared in Egypt.

2. Apart for measurement issues, data availability is also subject to significant delays. This prohibits the ability of the government and economic agents to have access to reliable data with a short lag. In this regard, it is suggested that the Ministry of Planning works on speeding up the process of collecting and disseminating the data.
3. It is important to align the efforts between the Ministry of Planning and CAPMAS to obtain consistent time series data on price developments for important series such as the GDP deflator, the producer price index, and export and import prices. Improving the measurement of these prices will enable more accurate analysis of real versus nominal changes in the components of GDP.
4. It is also important to develop local capacity at the relevant ministries to provide short- and medium-term projections for the components of GDP rather than rely entirely on those produced by international institutions.

Needed policy interventions to mitigate the crisis impact

The macroeconomic policy response has so far been proactive rather than reactive with significant measures announced by various governmental bodies, including the Central Bank of Egypt (CBE) and the Ministry of Finance. This includes the reduction of the CBE policy rate by 3 percent, the announcement of a fiscal stimulus package of EGP 100 billion (around 1.9 percent of GDP level in FY 2018-2019) and various other announcements aimed at ensuring the solvency of individuals and businesses as business activity becomes increasingly disrupted.

While it is still early to provide a detailed assessment of the policy response, in what follows we suggest some important points to be considered.

On the fiscal policy front:

1. Fiscal policy is expected to play a prominent role in steering the economy during this crisis. The role of monetary policy should be supportive and accommodative.
2. While fiscal space is limited due to an elevated debt-to-GDP ratio, this is likely to be a time where debt levels are bound to increase for many nations. Egypt's fiscal stimulus package should be both sizable and immediate. A quick response is needed to provide immediate support to businesses to minimize job losses, and also to provide a safety net to individuals already out of job.
3. The primary and immediate candidate for increased spending should be the health sector and the containment effort.
4. In line with proposals in other countries, an increase in the coverage of cash transfers is required to counter the impact of lost jobs and incomes. This is of paramount importance for two reasons: First, to ensure that any lockdown measures will be feasible and will not result in unnecessary suffering by those without secured means of income. Second, cash transfers will help support household consumption, which is the dominant component of aggregate demand, and thus will lessen the impact of the shock on economic growth.
5. As the crisis is likely to hit private investment, and with public investment continuing to support growth under our scenarios,

this is an opportune moment to redirect public spending away from housing and real estate to more critical investments in the health care sector, the digital infrastructure for key services (e.g., education, commerce and financial services), and launch public-private partnerships to increase investment in the manufacturing sector for export-oriented industries or to allow for import substitution.

On the monetary policy front:

1. Given the dual nature of the shock to both demand and supply, it is important for the CBE to keep a close eye on disruptions in the supply side via continuous gathering of information from business associations. This is important not only for targeted interventions at the sectoral level, but crucially to avoid excessive liquidity expansion at a time of supply-side contraction, which will result in a surge in inflation.
2. The interest rate policy instrument may not be effective at this time of heightened uncertainty for consumers and investors. The use of macro prudential policies and non-traditional instruments (e.g., the reserve requirement ratio) may prove more effective during this crisis, and requires close coordination with the banking sector. For instance, the reserve requirement ratio was lowered from 14 percent to 10 percent in 2011 to increase liquidity.
3. The CBE has taken welcome steps to ensure short-term relief from debt payments for individuals. Similar initiatives have also been introduced to alleviate the burden of the crisis on selected sectors (e.g., tourism). However, it is necessary to quickly scale

up these measures and work out how to target businesses in dire need.

4. The objective of monetary policy during the containment and recovery phase should not be blanket provision of cheap credit. Rather, it should be targeted to those sectors that are crucial for speeding up the pace of recovery, and also sectors where productivity growth is likely to be highest.
5. The management of the exchange rate is likely to be a contentious issue. The key to successful policy here is enhanced transparency. With a likely hit to both the sources and usage of foreign exchange, it is rather difficult to predict the intensity and direction of pressure on the Egyptian pound. However, and as learned from the currency crisis of 2016, if the currency comes under significant pressure, then it is best to allow some controlled depreciation rather than allow a currency black market to appear or dollarization to increase.

In future reports, a detailed assessment of the fiscal and monetary measures for the different sectors will be analysed in further detail in the context of sectoral assessments of the impact of the crisis.