Views On News

رأي في أزمة
VIEWS ON CRISIS

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Views on the Crisis

Egypt's External Position

Introduction

The objective of this report is to study the impact of the Covid-19 pandemic crisis on Egypt's external sector and the external financing gap. Egypt's continued reliance on portfolio inflows to finance the external funding gap meant the Covid-19 shock was bound to put further pressure on the balance of payments (BoP), which has been realized. A combination of a decline in tourism revenue due to the crisis and portfolio outflows from emerging markets has then led to a significant strain on Egypt's external accounts.

In reaction to the crisis and the induced pressure on the BoP, the government sought assistance from the International Monetary Fund (IMF). In May 2020, The IMF Executive Board approved funding of USD 2.8 billion in emergency support to address the Covid-19 pandemic. Furthermore, in June 2020, the IMF approved a 12-month stand-by arrangement, with total access of USD 5.2 billion to address the BoP financing needs.

In this report, we discuss likely trajectories for Egypt's external accounts as the crisis unfolds. We also present deeper-level analysis of the root causes of Egypt's external sector vulnerability in recent years. Viewing the current crisis as yet another opportunity to effect macroeconomic reforms, we propose policy measures to address vulnerabilities in Egypt's external sector.

"Egypt's high public debt and large financing needs remain a risk and create a vulnerability to changes in financial market conditions."

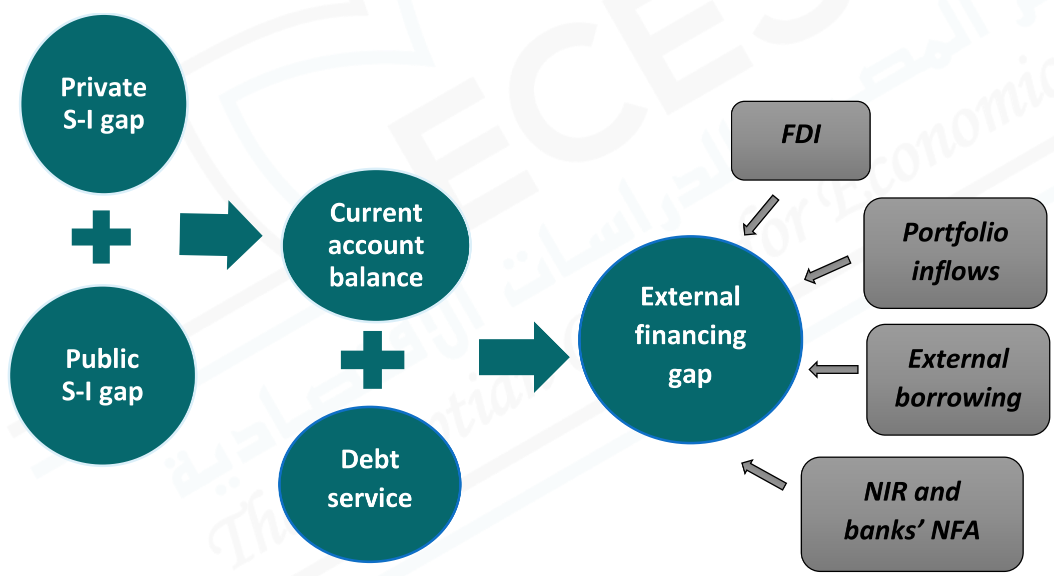
International Monetary Fund

First: Sources of Vulnerability in Egypt's External Position Prior the Crisis

Before assessing the impact of the crisis, it is instructive to analyze recent external sector developments in Egypt, and their interlinkages with the macroeconomic policy stance. Egypt has consistently run a current account (CA) deficit which averaged 4% of GDP during the period July 2014 to March 2020. This compares to a surplus of 0.1% in emerging and developing economies on average over the same period. In 2015/16, the CA deficit reached an alarming level of 6% of GDP in concurrence with a destabilizing currency crisis. The large devaluation of the exchange rate in November 2016 helped reduce the CA deficit; however, the root cause of the CA imbalance remained in place.

Egypt's CA deficit is best understood in terms of a basic macroeconomic identity stating that the savings-investment gap equals the CA balance. Therefore, the large and persistent CA deficit in recent years reflects the fact that the rate of investment in Egypt exceeds what can be financed by national savings. As a result, a CA deficit is realized which needs to be financed. One source of financing is foreign savings through foreign direct investment (FDI), portfolio inflows or external borrowing. The other source of financing entails using previously-accumulated savings of foreign currency, which results in the depletion of the Central Bank of Egypt (CBE) net international reserves (NIR), commercial banks' net foreign assets (NFA), or both. Noting that we can break down Egypt's SI gap into public and private savings gaps, and that debt service is a commitment that also has to be financed, we summarize these relationships in Figure 1.

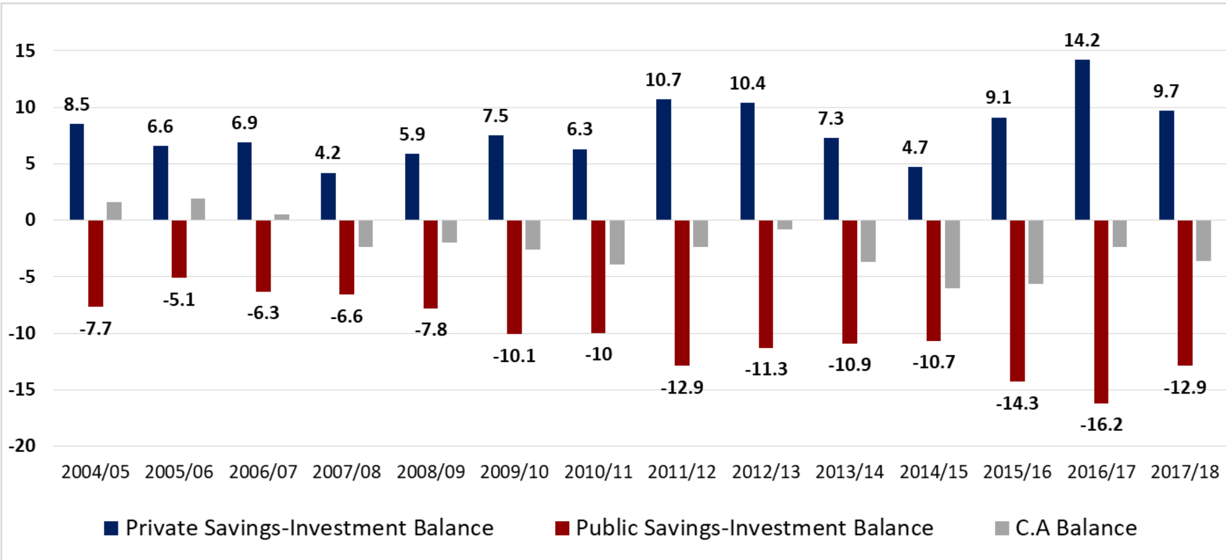
Figure 1: Sources of financing for the external financing gap



The next point in our analysis is to analyze developments in both the public and private savings-investment gaps over time. As shown in Figure 2, the reason behind the decline in the overall savings-investment gap in Egypt is the increase in the government budget deficit, which increased progressively from 7% of GDP in 2004/05 to 12.9% in 2018/19. The trends in Figure 2 indicate that Egypt is currently experiencing a twin-deficit situation with persistent government budget and CA deficits. As fiscal policy became increasingly expansionary in recent years, the CA deficit became persistent and of a large magnitude. To put things in perspective, it is important to note that every 1 percentage point increase in the government budget deficit requires about USD 3 billion of financing, which translates into large external financing needs to avoid running down NIR and the NFA of commercial banks.

The improvement in the government budget deficit since 2016/17 is due to the fiscal consolidation undertaken as part of the IMF Extended Fund Facility agreement for a total funding of USD 12 billion approved in November 2016. The agreement entailed targeting a primary budget surplus which was achieved in 2017/18. This is a noteworthy achievement as it represents the first time since 2006/07 that a primary budget surplus is attained. However, the overall budget deficit remains high in comparison to other emerging markets.

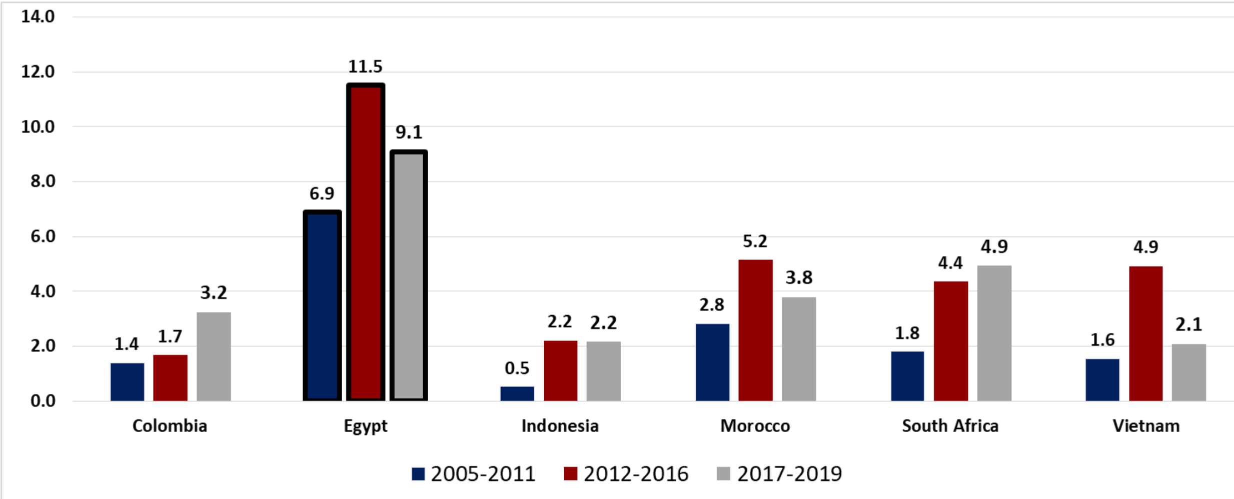
Figure 2: Public and private savings-investment balance and the current account (% of GDP)



Source: IMF Egypt Country Reports (09/25, 10/94, 15/33, 18/14, 19/311, 20/271). All variables are expressed as a percentage of GDP.

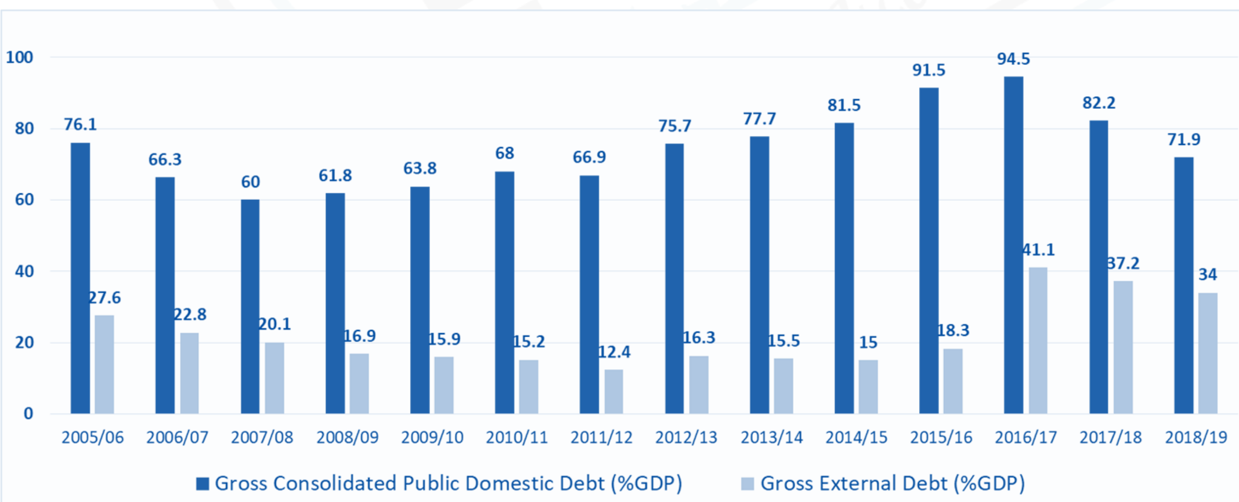
Despite the fiscal consolidation undertaken starting 2017/18, the overall budget deficit recorded an average of 9.1% of GDP in FYs 2017-2019 compared to an average of 3.2% of GDP in selected peer economies; see Figure 3. In addition to having a larger overall budget deficit, Egypt also has a high level of domestic public debt which recorded 71.9% of GDP in 2018/19. As for external debt, it reached a high of 41.1% of GDP in 2016/17, but declined thereafter to reach 34% of GDP in 2018/19; see Figure 4.

Figure 3: Overall budget deficit: Cross-country comparison



Source: IMF Fiscal Monitor database. The overall budget balance is defined as the difference between total revenue and total expenditure using the IMF's 2014 Government Finance Statistics Manual (GFSM 2014). All variables are expressed as a percentage of GDP.

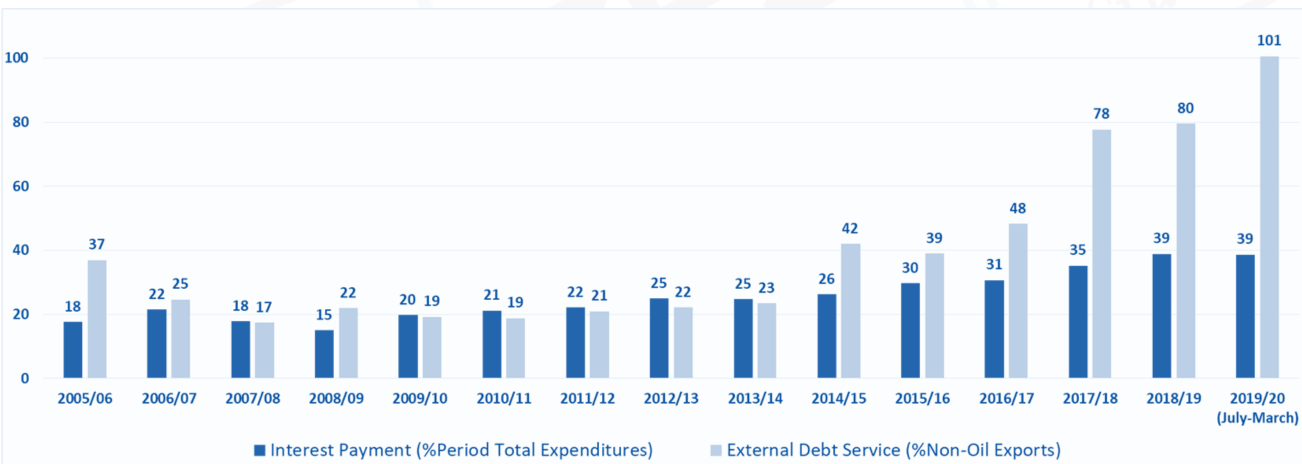
Figure 4: Domestic and External Debt (% of GDP):



Source: MoF Bulletins (vol.15 no.10, vol.15 no.2, vol.14 no.3, vol.12 no.2, vol.11 no.3, vol.10 no.2, Sep Bulletins for 2013, 2012, 2011, 2010), yearly figures calculated at the end of June, defined as consolidated domestic debt due on the general government and economic authorities, excluding outstanding debt of economic authorities to NIB as well as budget sector borrowing from economic authorities, gross external debt calculated using end of period exchange rate.

It is important to note that the debt-deficit spiral is becoming a challenge as seen in Figure 5. Interest expense on domestic debt has ballooned in recent years constituting around 40% of total government expenses in the Parliament-approved budget for 2019/2020. In addition, external debt service rose sharply to record 101% of Egypt's non-oil exports during the period July 2019 to March 2020.

Figure 5: Interest Payments on Domestic Debt and External Debt Service



Source: MoF Financial Monthly Bulletins (vol. 15 no.10, vol.14 no.3, vol.12 no. 2, vol.10 no. 2, Sep bulletins for 2012, 2013), CBE Monthly Bulletins (no. 165, 174, 190, 225, 250, 282), preliminary results for 2018/2019 and 2019/2020 (July-March), yearly figures calculated at end of June.

Before turning to the financing of the CA deficit, it is instructive to analyze the recent trends in Egypt's BoP. As shown in Table 1, there has been an improvement in the non-oil goods' trade balance, however, it is driven by a retrenchment of both exports and imports, with the latter retreating at a faster pace. At the same time, the services balance witnessed an improvement due to an increase in tourism revenue as the sector witnessed gradual recovery in the years prior to the Covid-19 crisis. Private remittances has also played a significant supporting role rising steadily since 2016/17. However, primary net income outflows (mostly interest payments on external debt) have somewhat limited these gains. Egypt's dependence on tourism revenue and private remittances as primary sources of CA receipts has increased in recent years; however, these sources are not immune to de-stabilizing shocks. Non-oil exports remain a modest contributor to CA receipts.

Table 1: Selected balance of payments indicators

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20 *(Jul-Mar)*
Current account	-3.7	-6.0	-5.6	-2.4	-3.6	-2.7
Trade balance	-11.8	-11.6	-14.5	-14.9	-12.6	-10.2
Oil and gas	-1.0	-1.1	-2.2	-1.5	0.0	-0.3

Other exports	-10.7	-10.5	-12.3	-13.4	-12.6	-9.9
Services balance	3.2	2.0	2.2	4.4	4.3	3.1
Services receipts	6.6	4.8	6.0	8.6	8.1	6.7
of which: Tourism receipts	2.2	1.1	1.7	3.9	4.2	3.5
Primary income (net)	-1.7	-1.3	-1.8	-2.5	-3.6	-3.3
Transfer	6.6	5.1	8.5	10.6	8.3	7.8
of which: Private remittances	5.8	5.0	8.5	10.5	8.2	7.7
Capital and financial account	5.4	6.4	6.0	5.2	1.4	1.5
Medium/long-term borrowing (net)	-0.1	0.4	1.1	0.4	0.4	0.5
FDI (net)	1.9	2.0	3.0	3.0	2.6	2.0
Portfolio investment (net)	-0.2	-0.3	6.3	4.8	1.4	-2.9
Commercial banks' NFA	2.4	2.5	-3.1	1.2	-0.6	2.9
Other items (inc. CBE deposits)	1.4	1.8	-1.1	-4.0	-2.4	-1.0
Overall balance	1.8	-0.8	-0.8	1.6	-2.3	-1.9
Memorandum items:						
Nominal GDP (EGP billion)	2,444	2,709	3,470	4,437	5,322	4,475
Nominal GDP (USD billion)	332	332	256	250	302	275
Exchange rate	7.4	8.1	14.7	17.7	17.6	16.1

Source: Central Bank of Egypt and the International Monetary Fund.

As a result of the chronic CA deficit, the economy has become increasingly reliant on two sources of financing: portfolio inflows in the form of "carry trade" in the local bond market, and external borrowing. As shown in Table 1, net portfolio investments rose from negligible values to a significant 6.3 of GDP (USD 16.1 billion) and 4.8% of GDP (USD 12 billion) in 2016/17 and 2017/18, respectively. As nominal interest rates were hiked in 2017 to contain the inflationary impact of the devaluation in November 2016, the increase in the interest rate differential on the Egyptian Pound attracted significant portfolio inflows. The stock of inflows into domestic government T-bills and bonds stood at USD 21.4 billion and increased further to USD 37.1 billion by the end of 2019.[1]

Increased reliance on portfolio inflows as a source of external financing, encouraged by high nominal interest rates, marked an unprecedented development for the Egyptian economy and made Egypt's external financing position vulnerable before the onset of the Covid-19 crisis. Furthermore, this dependence represents a conundrum in Egypt's macroeconomic policy framework. Dependence on portfolio inflows makes it difficult to disentangle the key monetary policy tool of the CBE, the short term interest rate, from

[1] Source: External balance assessment by the CBE for the year 2016/2017 (report no. 58), and for July/Sep 2019-2020 (report no. 67).

the needs of financing the CA deficit. Despite a 300 basis points cut in interest rates by the CBE in March 2020 in response to the Covid-19 crisis, nominal interest rates in Egypt remain high in comparison to peers. The level of nominal Interest rates seems to be intricately linked to keeping the carry trade in Egypt attractive for foreign investors.[2] In addition, real interest rates have risen significantly with inflation moderating since the early months of 2020, which has depressed domestic private investment and threatens the sustainability of Egypt's debt dynamics if growth remains subdued.

Second: The Covid-19 Crisis: A Stress Test for Egypt's External Position

The current pandemic crisis is the first in recent history to present a deep shock to demand and supply simultaneously, with a differential impact on the economy. Labor-intensive sectors such as hotels, restaurants and recreational activities have been hit particularly hard. Given the focus of this report, we focus on the flows in Egypt's BoP that are directly impacted by the crisis.

[2] Currently, Egypt offers one of the highest nominal yields making it one of the world's most attractive destinations for the carry trade.

Table 2 shows the change in the outlook for the Egyptian economy based on the revised IMF projections between October 2019 and September 2020. On the side of the CA, it is generally expected that the non-oil goods trade deficit will moderate as the drop in imports exceeds that in exports marking an improvement in the overall trade balance. However, the balance of services trade is likely to deteriorate driven primarily by lower receipts from tourism, and partly by lower remittances due to the decline in oil prices. Accordingly, the CA deficit is projected to deteriorate further to record 4.3% and 4.6% of GDP in 2019/20 and 2020/21, respectively.

Table 2: Balance of payments: Change in the outlook due to Covid-19

	Actual			**IMF Projections**						
	2017/18	**2018/19**		**2019/20**	**2020/21**	**2021/22**		**2019/20**	**2020/21**	**2021/22**
				(October 2019)				*(September 2020)*		
Current account	-2.4	-3.6		-2.5	-2.1	-1.9		-4.3	-4.6	-2.7
Trade balance	-14.9	-12.6		-11.7	-11.5	-11.6		-9.6	-8.0	-7.4
Oil and gas	-1.5	0.0		0.8	0.7	0.1		0.6	0.5	0.2

Other exports	-13.4	-12.6		-12.6	-12.2	-11.7		-10.2	-8.5	-7.7
Services balance	4.4	4.3		5.1	5.3	5.5		3.0	1.2	2.6
Services receipts	8.6	8.1		8.8	9.0	9.2		6.1	3.5	5.4
of which: Tourism receipts	3.9	4.2		4.7	4.9	5.0		2.9	0.9	2.4
Primary income (net)	-2.5	-3.6		-3.0	-2.9	-2.7		-4.1	-4.0	-4.0
Transfer	10.6	8.3		7.1	6.9	6.9		6.4	6.2	6.1
of which: Private remittances	10.5	8.2		7.0	6.8	6.8		6.3	6.1	6.0
Capital and financial account	5.2	1.4		1.8	2.4	2.2		-1.1	2.5	3.1
Medium/long-term borrowing (net)	0.4	0.4		0.2	0.1	0.1		0.3	0.2	0.2
FDI (net)	3.0	2.6		2.3	2.5	2.8		2.2	2.0	2.3
Portfolio investment (net)	4.8	1.4		1.5	1.6	1.0		-3.6	0.8	1.6
Commercial banks' NFA	1.2	-0.6		1.2	0.3	0.9		1.7	0.4	0.9

Other items (inc. CBE deposits)	-4.0	-2.4		-3.3	-2.1	-2.5		-1.8	-0.9	-1.9
Overall balance	1.6	-2.3		-0.6	0.3	0.3		-5.4	-2.1	0.4
Memorandum items:										
Nominal GDP (EGP billion)	4,437	5,322		--	--	--		--	--	--
Nominal GDP (USD billion)	250	302		--	--	--		--	--	--
Exchange rate	17.7	17.6		--	--	--		--	--	--

Source: Central Bank of Egypt and the International Monetary Fund.

With a large CA deficit, the BoP is projected to record a deficit of 5.4% of GDP in 2019/20 and 2.1% of GDP in 2020/21 before recording a surplus of 0.4% of GDP in 2021/22. Capital flows are subject to a reversal in 2019/20 (an outflow of 3.6% of GDP) followed by a resumption of inflows starting 2020/21. The approval of Covid-19 emergency support from the IMF amounting to USD 2.8 billion in addition to a stand-by arrangement equivalent to USD 5.2 billion were clearly needed to avoid a massive deterioration in NIRs.

The duration and magnitude of deterioration in the CA depends on the pace of recovery in the global economy from the pandemic crisis. Additionally, risks to the outlook revolve around two dimensions: (i) sudden stops or reversal in capital flows to emerging markets, and (ii) higher borrowing costs due to an increased risk premium for emerging market debt. In what follows we outline two scenarios to highlight possible trajectories.

2.1. Two Scenarios

In scenario formulation, our assumptions about global economic developments focus on two factors that currently have the largest impact on the Egyptian economy: the state of recovery in global demand, and the level of volatility of capital flows to emerging markets. While the Egyptian economy is not heavily integrated into the global economy given its low trade openness ratio, global economic conditions impact economic sectors with a direct link to the CA such as tourism and the Suez Canal revenue. In addition, a recovery in global demand is likely to increase oil prices which affects the flow of funds from the oil-rich MENA economies into Egypt in the form of remittances and FDI.

Table 3: Scenario assumptions

	Scenario 1	Scenario 2
Global demand	Slow, protracted recovery.	Quick recovery starting 2021H2.
International portfolio flows	Volatile portfolio flows, with recurring sudden stops.	Stable portfolio inflows into emerging markets.

The assumptions listed in Table 3 indicate that Scenario 1 foresees a slow and protracted recovery in global demand due to the long-term economic scarring from the pandemic shock and its impact on the economy's supply side. It also foresees that portfolio inflows into emerging markets will be characterized by volatility and recurring sudden stops. This is based on emerging evidence of an alarmingly intense second wave of the pandemic in Europe and the U.S., coupled with the uncertainty accompanying the upcoming U.S. presidential election. Scenario 2 foresees a steady recovery in economic activity in the major advanced economies starting the second half of 2021, and relatively stable capital flows into emerging markets with no sudden stops or reversals.

2.2. Expected outcomes under different scenarios for FY 2020/21

Under the Scenario 1, it is expected that CA deficit will record 4.5% of GDP in 2020/21 implying a large financing gap. The CA deficit is driven mainly by the decline in tourism revenue, and to a lesser extent, by a drop in Suez Canal revenues. The resulting external financing gap is partly financed by external borrowing since global capital inflows are assumed to remain volatile and subject to potential sudden stops/reversals under this scenario. Given the magnitude of the external financing gap, a large negative BoP position prevails (around 3.5% of GDP), and this results in a drawdown in NIR and possibly in commercial bank's NFA by the same magnitude.

Table 4: Macroeconomic outcomes for FY 2020/2021

	Scenario 1	Scenario 2
Current account balance	Further pressure on the CA deficit; deficit exceeding 4.5% of GDP; large external financing gap.	Maintaining CA deficit at slightly lower than recent levels to stabilize at 3.5% of GDP. This is driven mainly by

		higher tourism receipts.
Balance of payments	A large negative BoP position (around 3.5% of GDP) due to the inability of capital inflows to consistently close the external financing gap; reliance on external borrowing at higher cost due to higher risk profile for emerging market debt.	A negative BoP position around 1.5% to 2% of GDP. Steady capital inflows encouraged by high-interest rates help in partially closing the external financing gap. The mild negative BoP position improves as global recovery resumes.
CBE Net international reserves and commercial banks' net foreign assets.	A decline in NIR, and some volatility in the NFA position of the banking sector.	Stability in NIR and slight decline in NFA (as % of GDP) until global recovery begins. Stability in both NIR and NFA (as % of GDP) thereafter.

External debt	An increase in external debt from an already elevated level, and increased reliance on short-term debt.	Stability in external debt level (as % of GDP) if capital inflows are sufficient to close the gap, or a slow-paced increase if short-term debt is used in case of shortfalls in capital inflows.

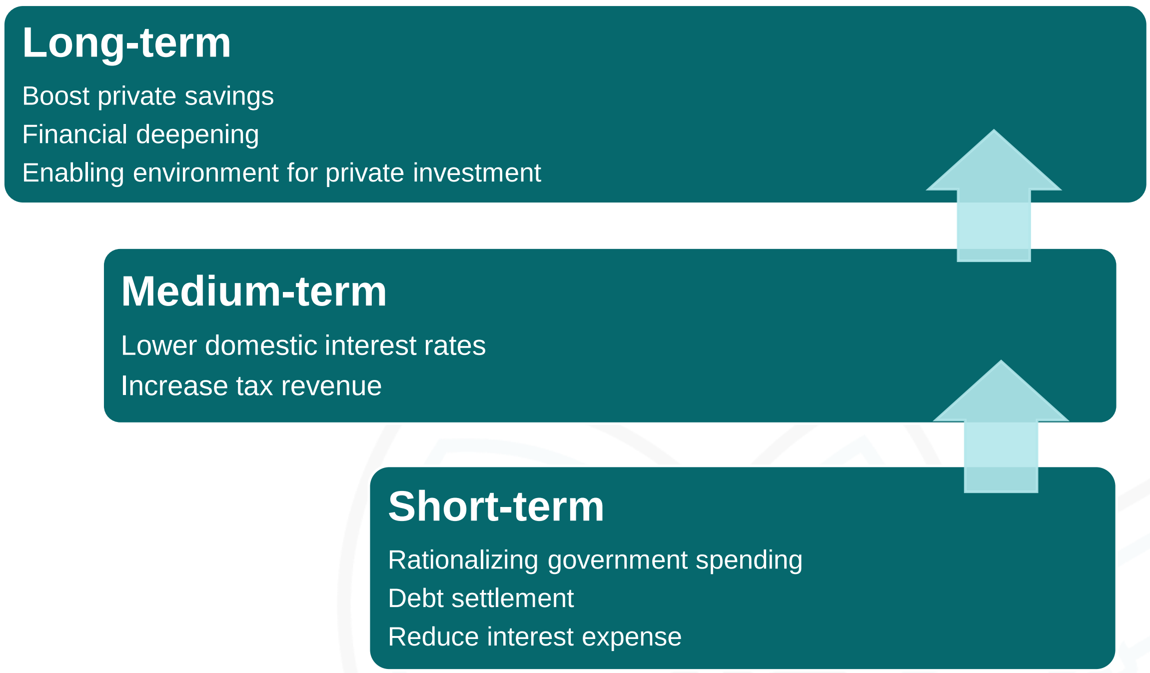
Under scenario 2 (optimistic scenario), with the assumption of a faster pace of recovery in global demand, we observe a milder CA deficit at around 3.5% of GDP. Stable capital inflows encouraged by the high interested rate differential help in partially closing the external financing gap. The resulting BoP deficit, around 1.5% to 2% of GDP, is mainly financed through the NFAs of commercial banks while NIR remain stable. Total external debt is either stable or subject to a small increase depending on any shortfalls in capital inflows.

Our scenario projections differ from those of the IMF latest projections in the following respects. Our baseline scenario projects the same CA deficit as the IMF projection, however, we project a wider BoP deficit (3.5% of GDP) compared to the IMF (2.1% of GDP) under our baseline scenario. This is due to our assumption of continued volatility in capital inflows which makes it an unreliable source of financing in an environment of heightened global uncertainty. On the other hand, our optimistic scenario projects a milder BoP deficit (1.5% to 2% of GDP), which is closer to the IMF projection (2.1% of GDP). Under the latter scenario, we are also projecting a milder account deficit compared to the IMF projection.

Third: Remedial Policy Measures

To reduce Egypt's external vulnerabilities, a multi-pronged approach is needed to achieve two simultaneous objectives: (i) reduce overall dependence on external financing, and (ii) change the balance of external financing sources in favor of stable, growth-enhancing sources. Figure 6 depicts the policy recommendations course, where policy recommendations are analysed in terms of duration needed for the implementation of policy changes, with more detailed descriptions of policies and policy outcomes presented below.

Figure 6: Policy recommendations sequencing:



Fiscal consolidation is the key starting point over the short term to break the cycle exacerbating external vulnerabilities. A reduction in the overall government budget deficit will reduce the CA deficit and mitigate pressure on the BoP. It also frees the short-term interest rate as a monetary policy tool to achieve its objective, which is delivering low and stable rates of inflation. Measures to raise domestic private savings are also needed to improve the CA balance further. Finally, creating an enabling business environment for the private sector is key to attract domestic and foreign direct investments.

The extent of fiscal consolidation needed in the short term should match the shortfall in the primary sources of CA receipts such as tourism revenues. If capital inflows into the carry trade witness a partial reversal as under Scenario 2, then further reduction in the budget deficit will be needed. It is also worth noting that fiscal consolidation is contractionary in general; however, the measures listed below are meant to minimize the contractionary impact of the consolidation effort.

The currently high real interest rates on the other hand are a direct threat to the sustainability of public debt. For government debt to remain steady or decline as a percentage of GDP, the real interest rate on debt should be less than or equal to real GDP growth. The reason behind high nominal interest rates despite the significant moderation of inflation in recent months is possibly linked to keeping the “carry trade” attractive and maintain steady capital inflows to finance the CA deficit.

It is therefore essential to ensure that such consolidation has little to no social impact, as well as to build a strategy for medium and long term sustainability. In light of this, we propose in what follows measures that do not impact spending on education, health and social safety nets, and that boost private sector savings and structural reforms. These are:

- **Rationalizing government spending *(fiscal policy)***: The key component that can be rationalized without significant negative socio-economic effects is capital spending on various investment projects. This can be replaced with effective public-private partnerships (PPPs), where the private sector can play its natural role. This measure is then expected to have a reduced contractionary impact since the total spending on infrastructure projects may be maintained but with a switching of the source of financing from public funds to private investments.

- **Bulk debt settlement *(fiscal policy)***: For financial adjustment to be successfully expansionary, it must be met with a decline in sovereign premium, which translates to reduced interest rates. Interest payments on debt currently constitute around 40% of total government spending, which is due to a high stock of debt as well as high interest rates. Aiming for bulk debt settlement will help reduce interest payments and achieve a reduction in the overall deficit. This can be targeted as a short-term policy measure with significant payoffs, and it can be achieved via different measures. First, the current pandemic crisis has opened the door for international calls for debt forgiveness and debt re-structuring for developing economies, which Egypt can capitalize on. Second, debt swaps can be arranged, especially in light of the increasing attractiveness of “debt-for-environment” swaps, in which debtors offer partial debt forgiveness in exchange for the forgiven debt payments being directed to projects with significant environmental benefits. Third, selling untilized state-owned assets is also a viable option with the proceeds directed entirely towards debt settlement.

- **Reduce interest expenses *(fiscal policy)***: The debt management strategy currently adopted by the government is a good vehicle to target a gradual reduction in interest expenses via a combination of measures including, but not limited to, improved maturity management and exploring the options of re-financing at lower borrowing costs given the currently favorable global environment with low interest rates. It is worth noting that this measure, combined with the debt settlement, has no contractionary impact since both measures relate to the management of the debt principle and its interest expense.

- **Lowering domestic interest rates *(monetary policy)*:** This is a measure that is made available by the financing of the C.A deficit and relieving BoP pressures, which achieves a number of important objectives. First, and foremost, it frees the short term interest rate as tool of monetary policy from subservience to fiscal considerations. Second, it lowers the real interest rate which is critical for debt sustainability. Third, it lowers the cost of borrowing which stimulates aggregate demand and counterbalances any contractionary effects due to fiscal consolidation. In a nutshell, lower domestic interest rates will effectively complement the fiscal consolidation effort.

- **Increasing tax revenue over the medium-term fiscal *(fiscal policy)***: A tax system that is predictable and progressive is needed for a successful and sustainable increase of tax revenue. Tax policy reform coupled with improved tax administration has proven to be the most effective way to sustain tax revenue. In order to facilitate such processes, tax code simplification and compliance to tax reporting is key, particularly in light of the large informal sector in Egypt. A simplified tax code will reduce barriers for smaller businesses to enter the formal sector, in addition to providing investors with a stable tax policy framework to confidently invest in projects without arbitrary costs. The digitization of economic transactions, which is currently a top priority for the government, is a step in the right direction. It is also necessary to revisit the current tax policy to assess of a more progressive taxation structure is needed over the medium term.

- **Boosting private savings in the long run *(financial development)*:** With regard to boosting private savings in Egypt, it is crucial to have a stable macroeconomic environment allowing for a sustainable high growth in per capita incomes. This also requires a general policy framework that promotes equitable growth. If inflation is kept in check and inflation expectations become firmly anchored, then financial planning is fundamentally improve which enables households and corporations to assess the viability of alternative savings and investment vehicles.

- **Financial deepening *(financial development)* :** Which is essential for increasing savings. Financial depending requires enhanced financial inclusion to tap into the savings of the informal sector and channel them for productive use. Moreover, Egypt needs to evolve from the current financial sector dominated by banks where deposits are the main savings vehicle. Developing domestic capital markets is essential. Introducing new financial instruments to the Egyptian market, such as inflation-indexed bonds and exchange-traded funds, as well as expanding the bond market to be more inclusive are crucial steps towards developing the capital market in a way that attracts private savings.

- **Enabling environment for private investments *(investment policy)*:** In parallel to fiscal consolidation and interest rate normalization, further institutional reforms are needed to create an enabling business environment for the private sector. In recent years, the government undertook massive infrastructure investments which positively impacts long-run productivity growth. However, this can only be realized if the private sector resumes its role as the engine for growth and employment generation. Reforms in the investment environment should aim at removing all sorts of hurdles for investors and creating a level-playing field in which the private sector can flourish. Well-tailored policies are needed to particularly boost private investment (both domestic and foreign) in manufacturing industries which have export potential. Over time, this will lead to growth in non-oil exports which could well become the driving force to achieve a stable CA surplus.

Fourth: Concluding remarks

The objective of this report is to present a diagnosis of Egypt's external sector vulnerabilities. The report shows how vulnerabilities in Egypt's external position persisted before the Covid-19 crisis hit the economy, mainly in relation to heavy reliance on portfolio inflows and external borrowing to finance the current account deficit. Through offering two scenarios for the evolution of the external sector during and in the aftermath of the Covid-19 crisis, we discuss projected trends for the current account and the balance of payments, and the implied developments in net international reserves, banks' net foreign assets and external debt.

The report concludes with a discussion of policy measures to mitigate the risks imposed by the current vulnerabilities. These measures focus primality on fiscal consolidation and boosting private savings, interest rate policy, and the creation of a hospitable environment for domestic and foreign investment.