



# The Egyptian Economy: Short and Medium Term Prospects

September 13, 2011

# Introduction

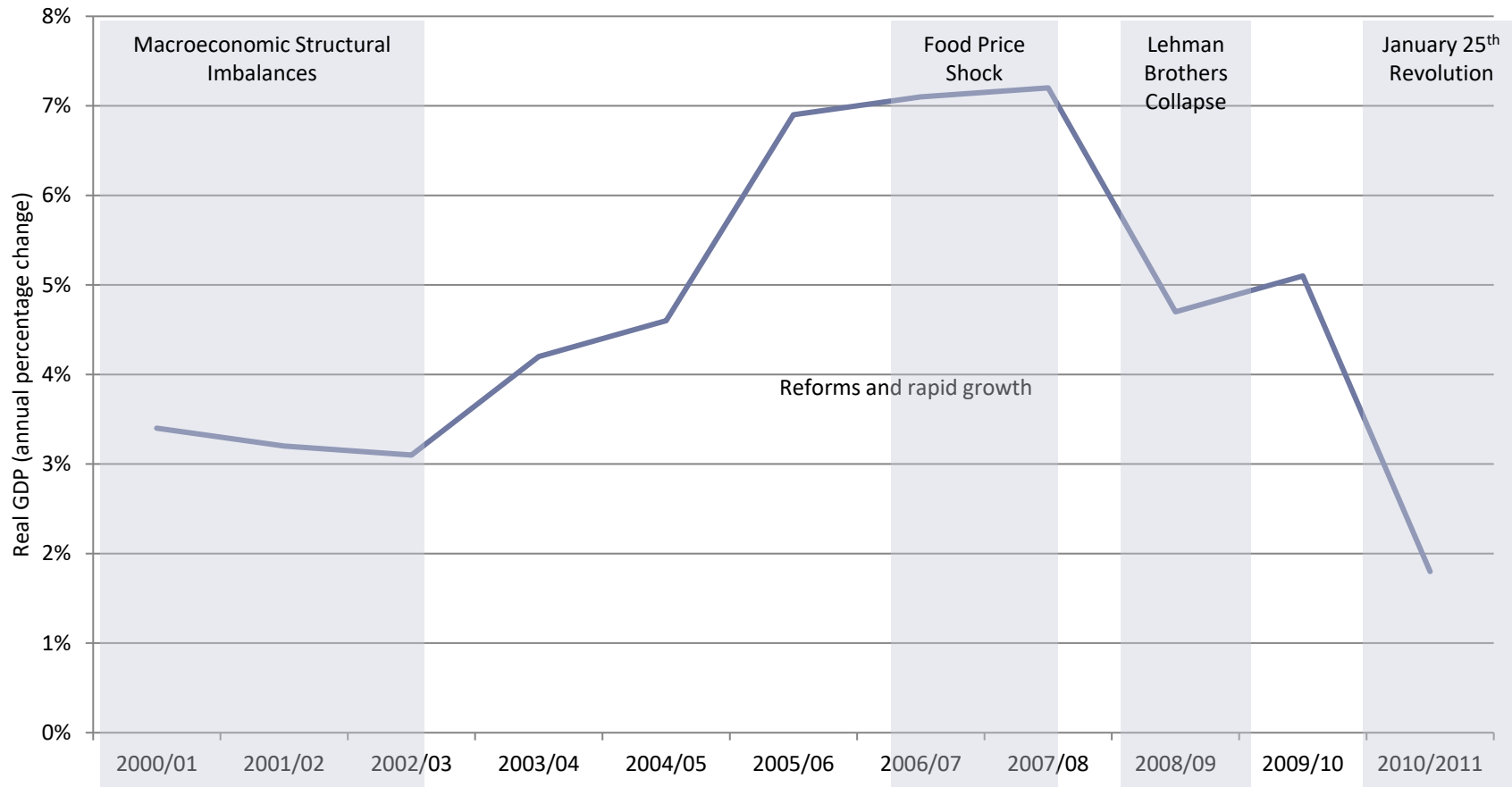
---

- ▶ We aim to look backward into developments in the Egyptian economy leading to the crisis and the shortcomings that may have contributed to the social unrest.
- ▶ Further, we aim to evaluate recent and potential economic losses due to the political upheaval and offer a forward looking strategy to capitalize on ongoing reforms towards securing a better future for the Egyptian economy.

# A quick view on the economy before January 25th

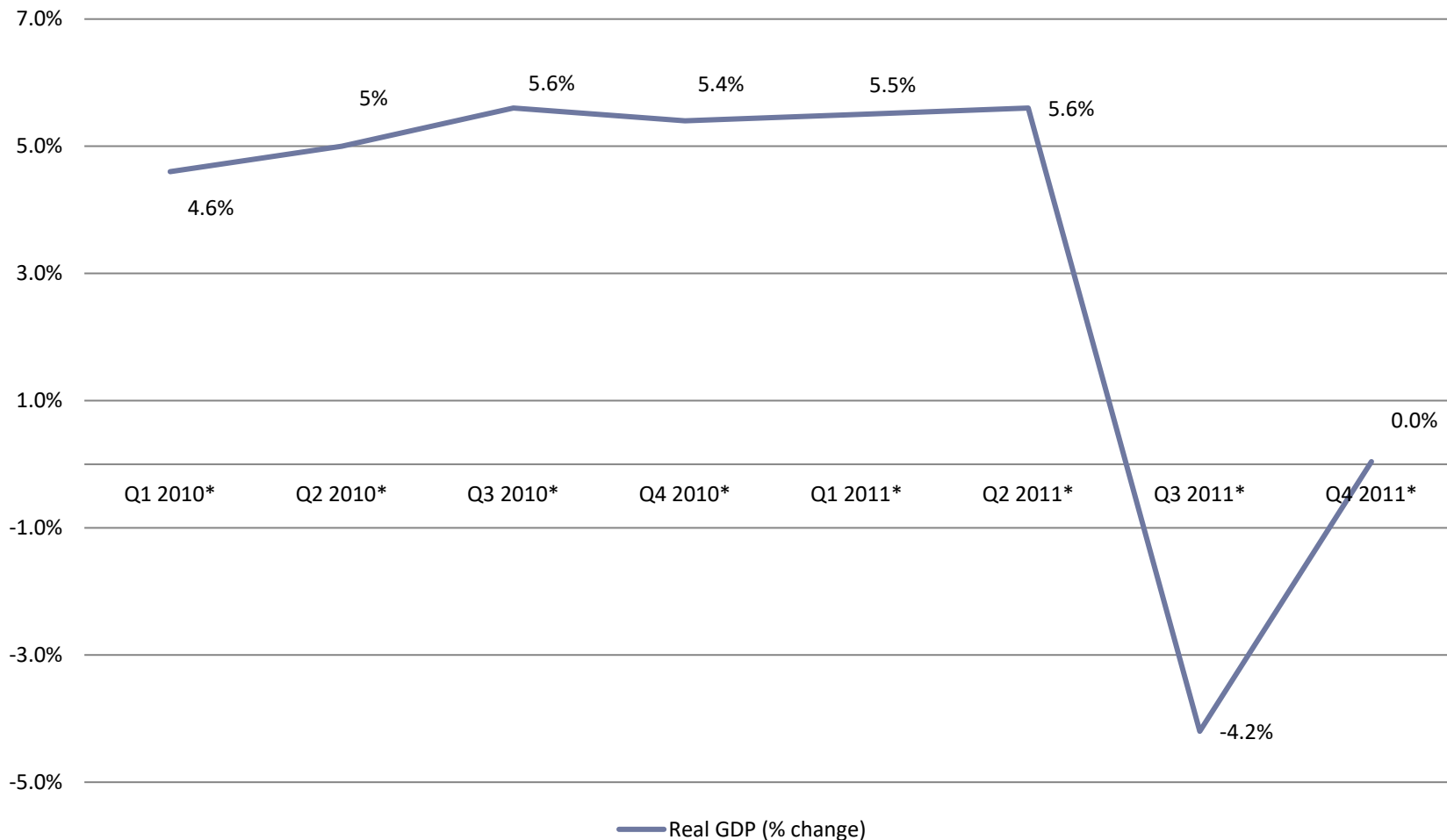
- Economic reforms have paid off to energize growth and provided space for policy stimulus during the global crisis

## Real GDP Growth



• In 2010, the economy was rebounding well... up till the outbreak of the revolution in Jan 2011

Real GDP Growth

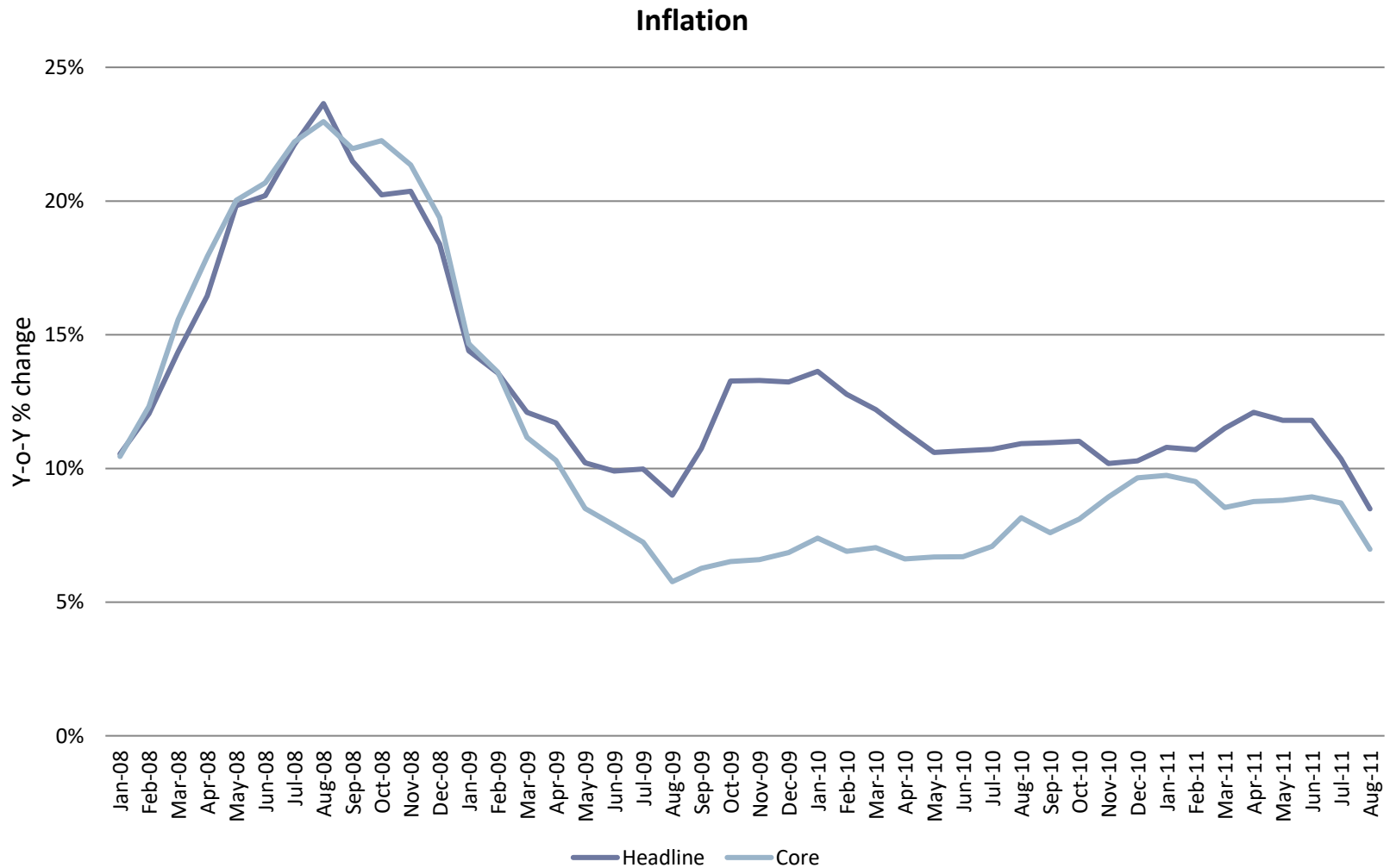


# Inflation

---

- ▶ In 2010/11, inflation rate averaged 11.1 percent (year-on-year), against 11.7 percent in 2009/10
- ▶ The gap between core and headline inflation has been narrowing, although the convergence rate is somewhat unstable
- ▶ The monthly core inflation had an average of 8.6 percent in 2010/11, against 6.7 percent in 2009/10, driven by the rising prices of rice, poultry, edible oils and fats.

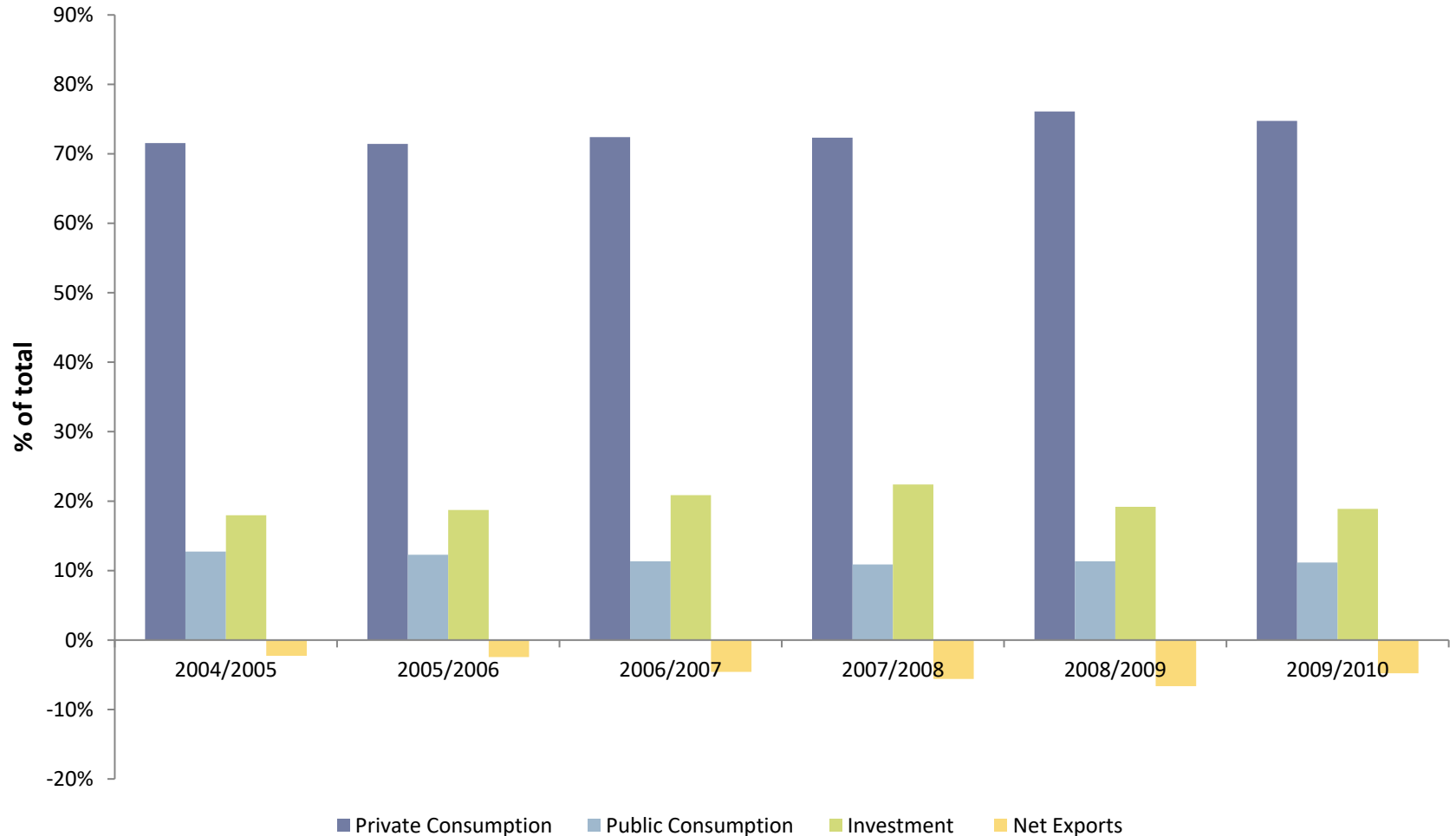
- Core inflation accelerated in 2010/11, owing to rising prices of rice, poultry, edible oils and fats



# Sources of Growth

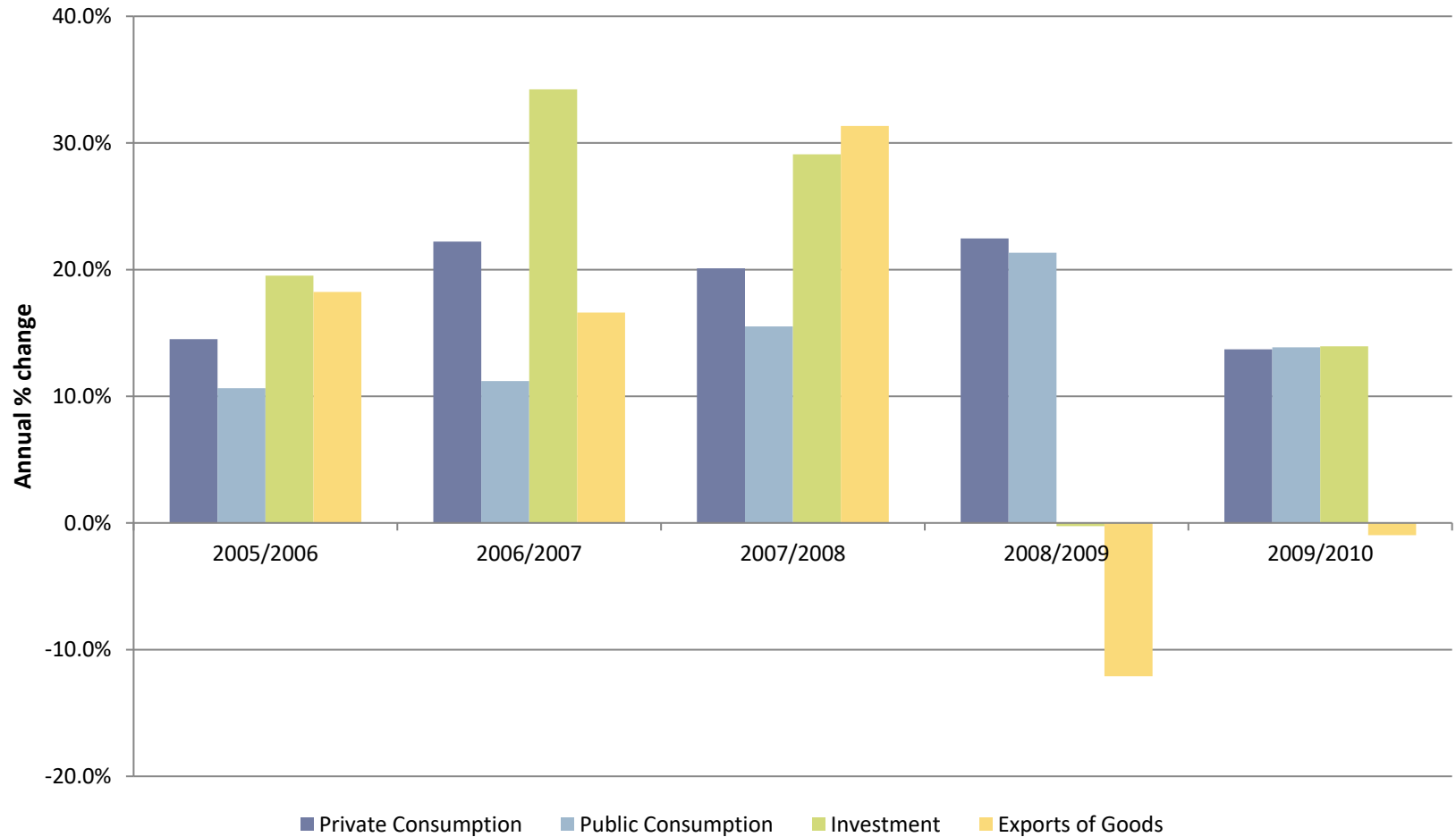
• Resilient domestic consumption has been the main driver of growth

## Composition of GDP



- Supported by a pickup in the contributions of investment and exports to growth

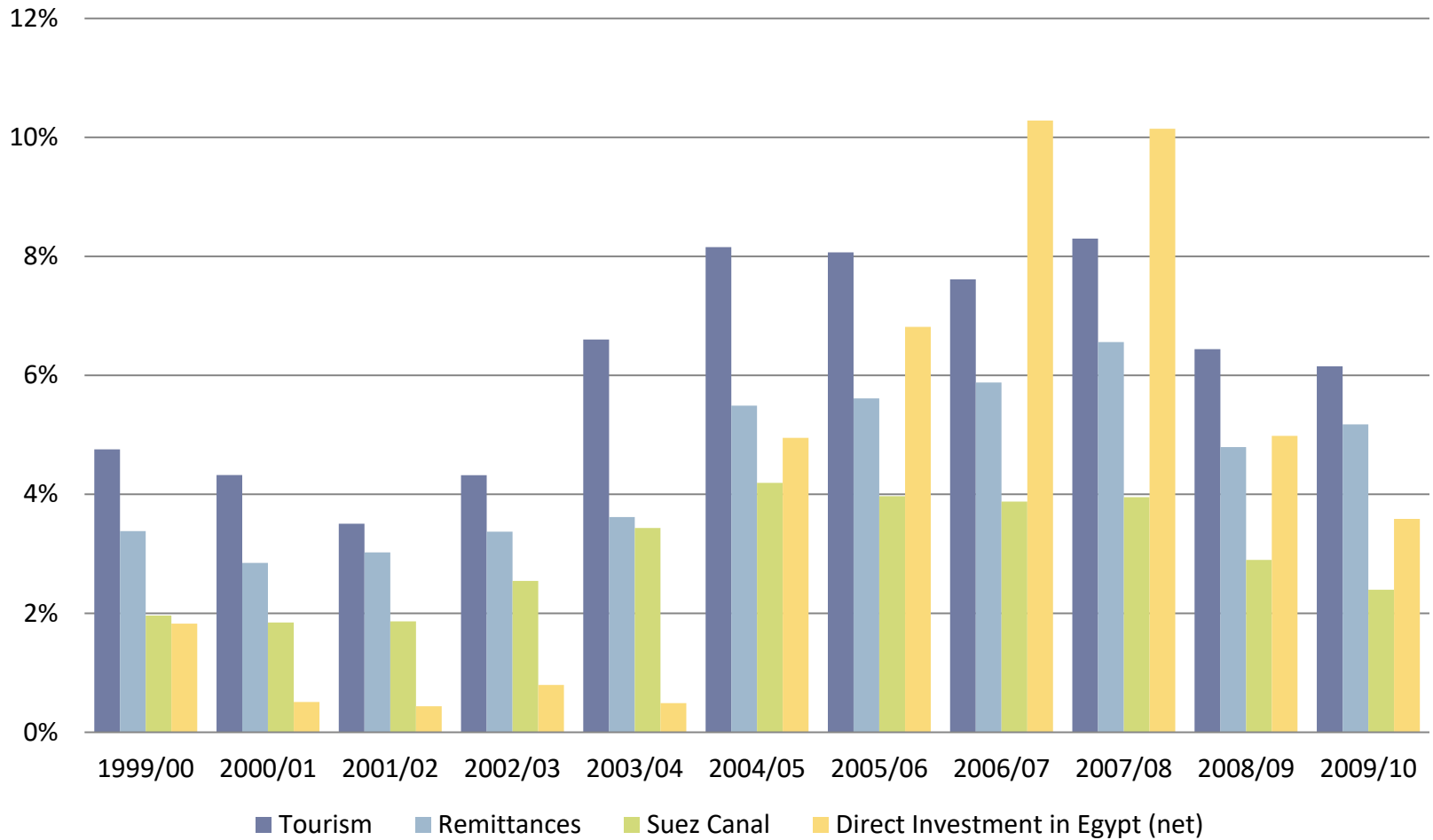
## Drivers of Growth



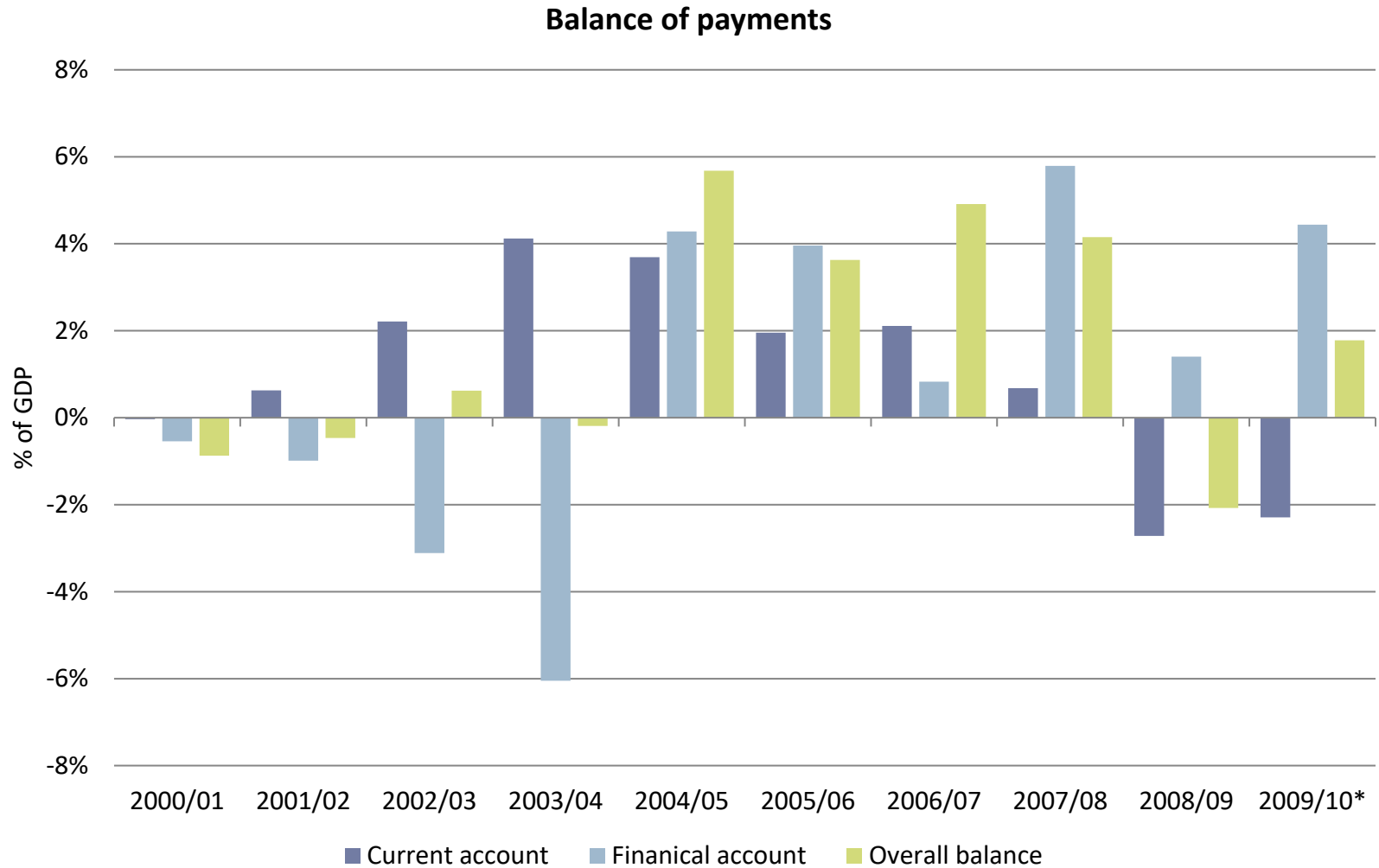


- Foreign receipts have increased relative to GDP over time

Foreign receipts as % GDP

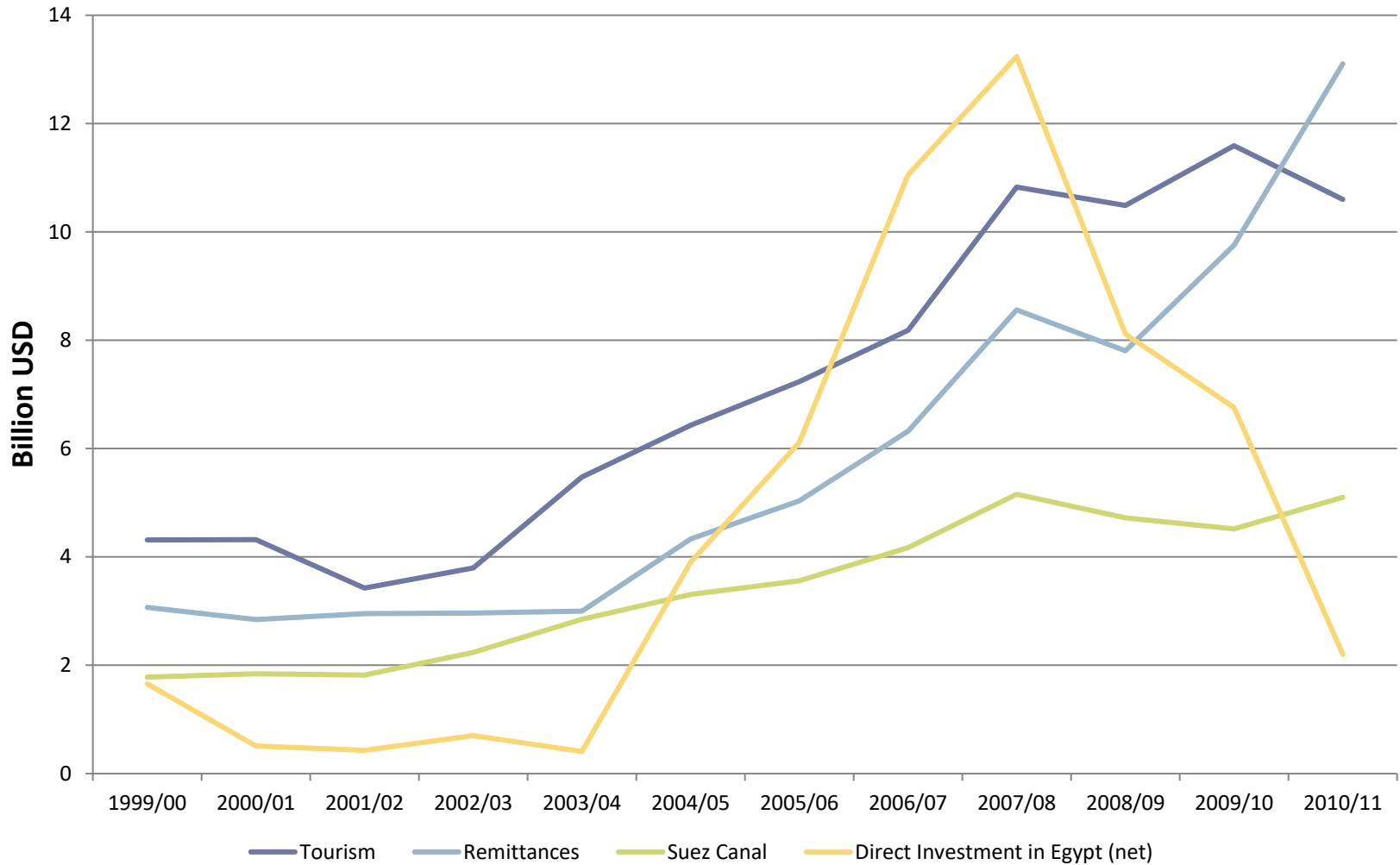


- Robust financial inflows, before the revolution helped finance the current account deficit and contributed to build up of foreign reserves



- Foreign receipts have been on a rising trend, yet they deteriorated after the revolution

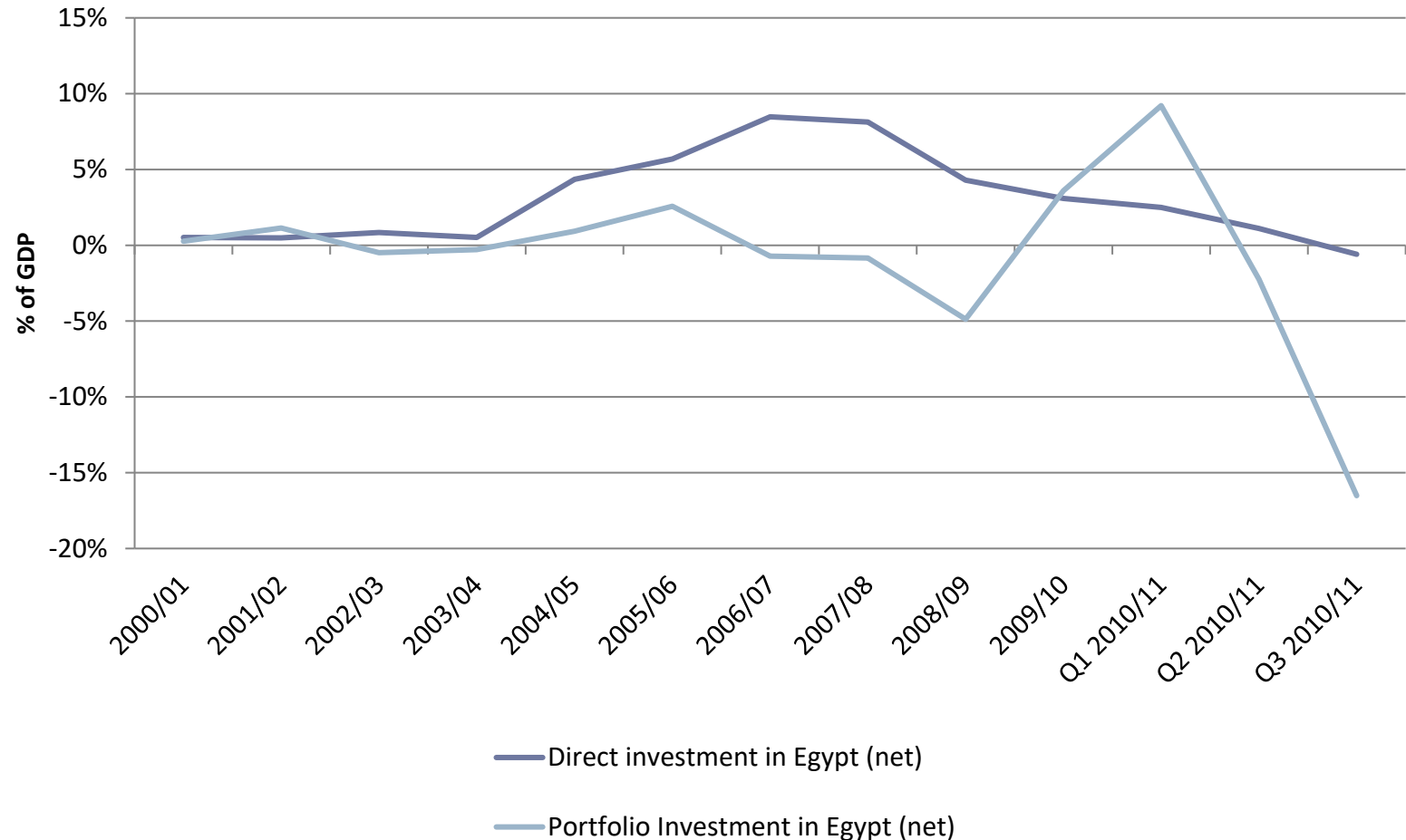
### Sources of foreign currency income



# Balance of Payments

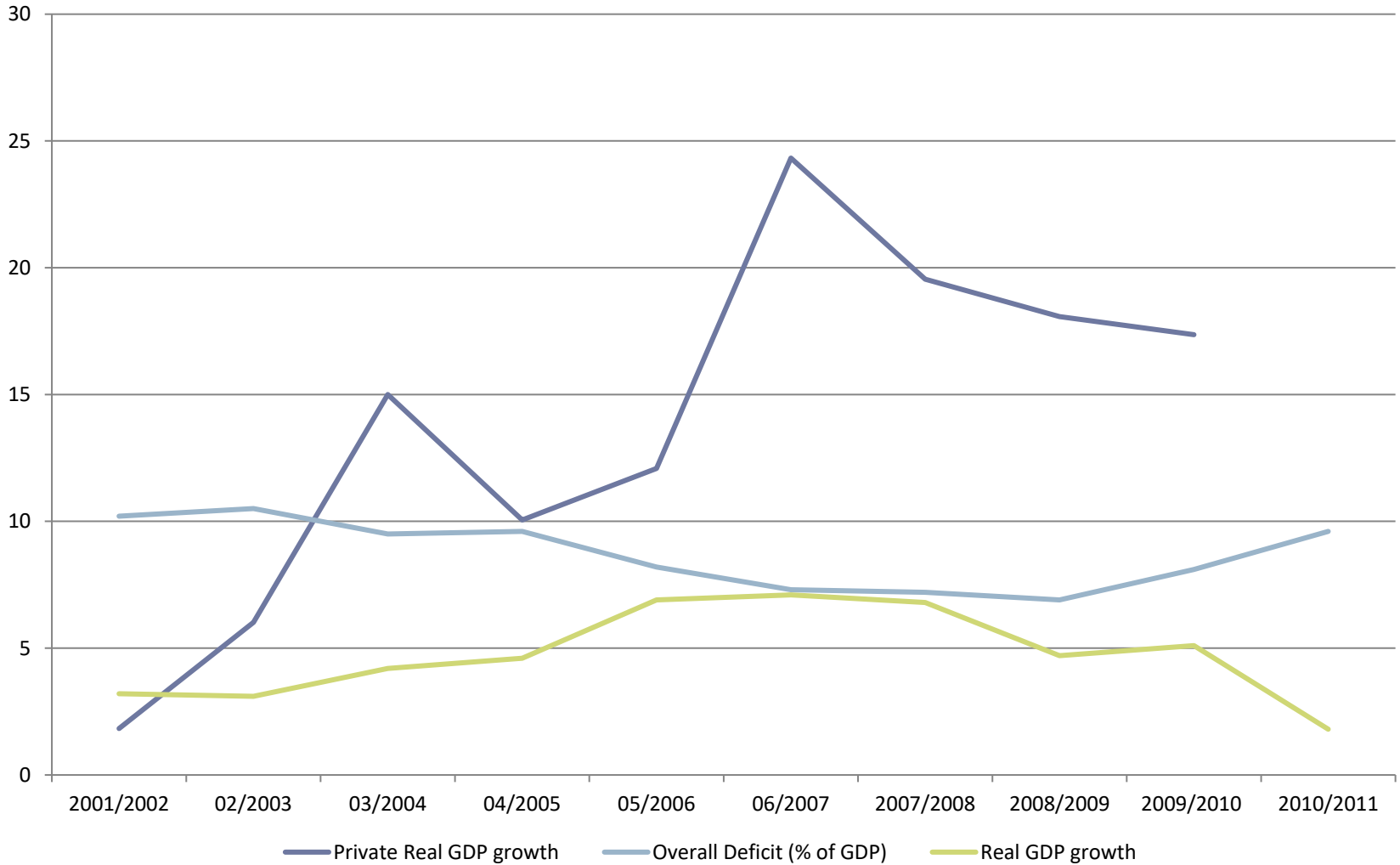
- FDI had been slow to recover, after the global crisis while portfolio inflows had picked up significantly to reverse course after the revolution

## Direct and Portfolio Investment

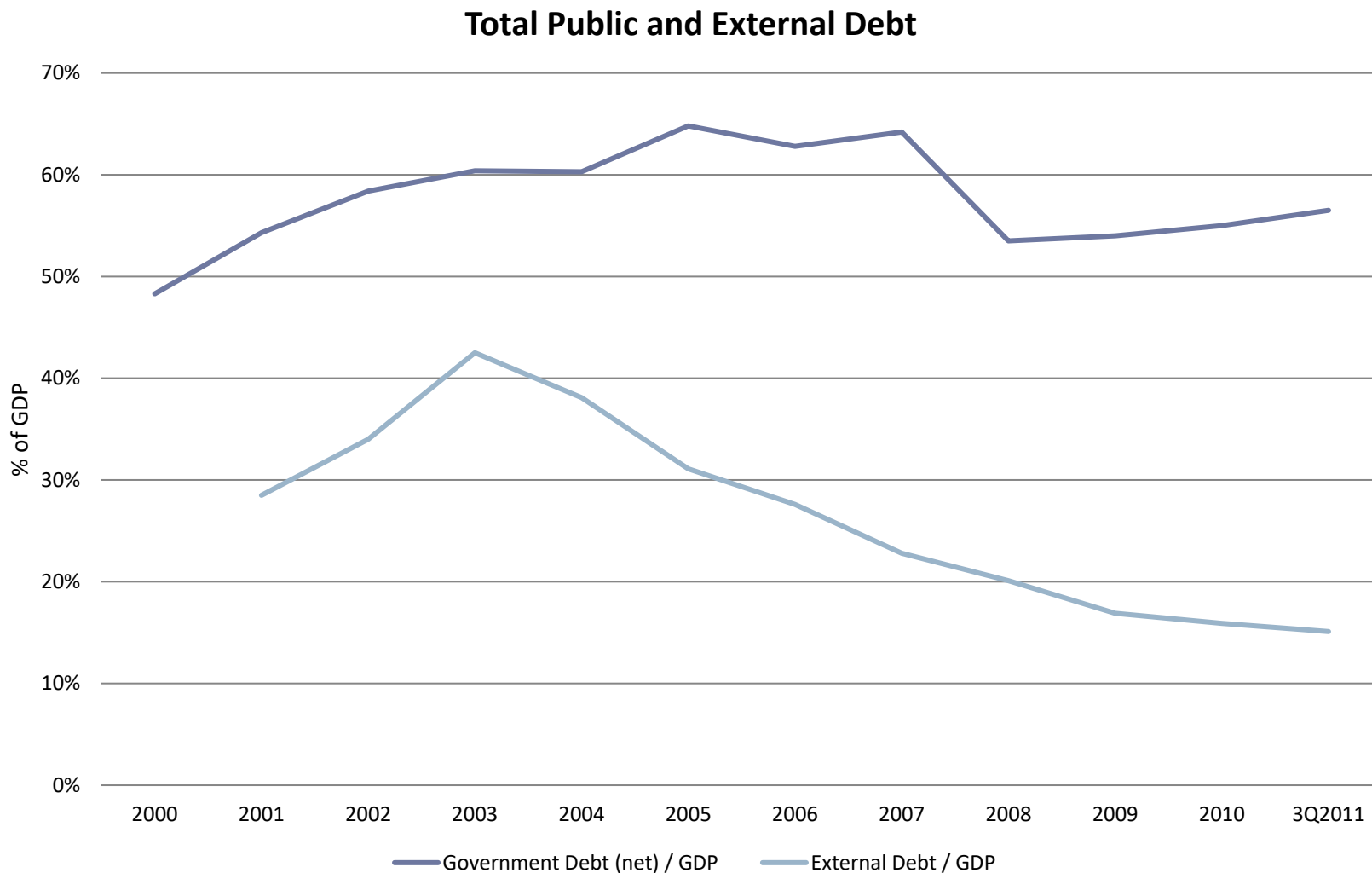


# Fiscal Policy

•Fiscal Consolidation coincided with a pick up in private led growth

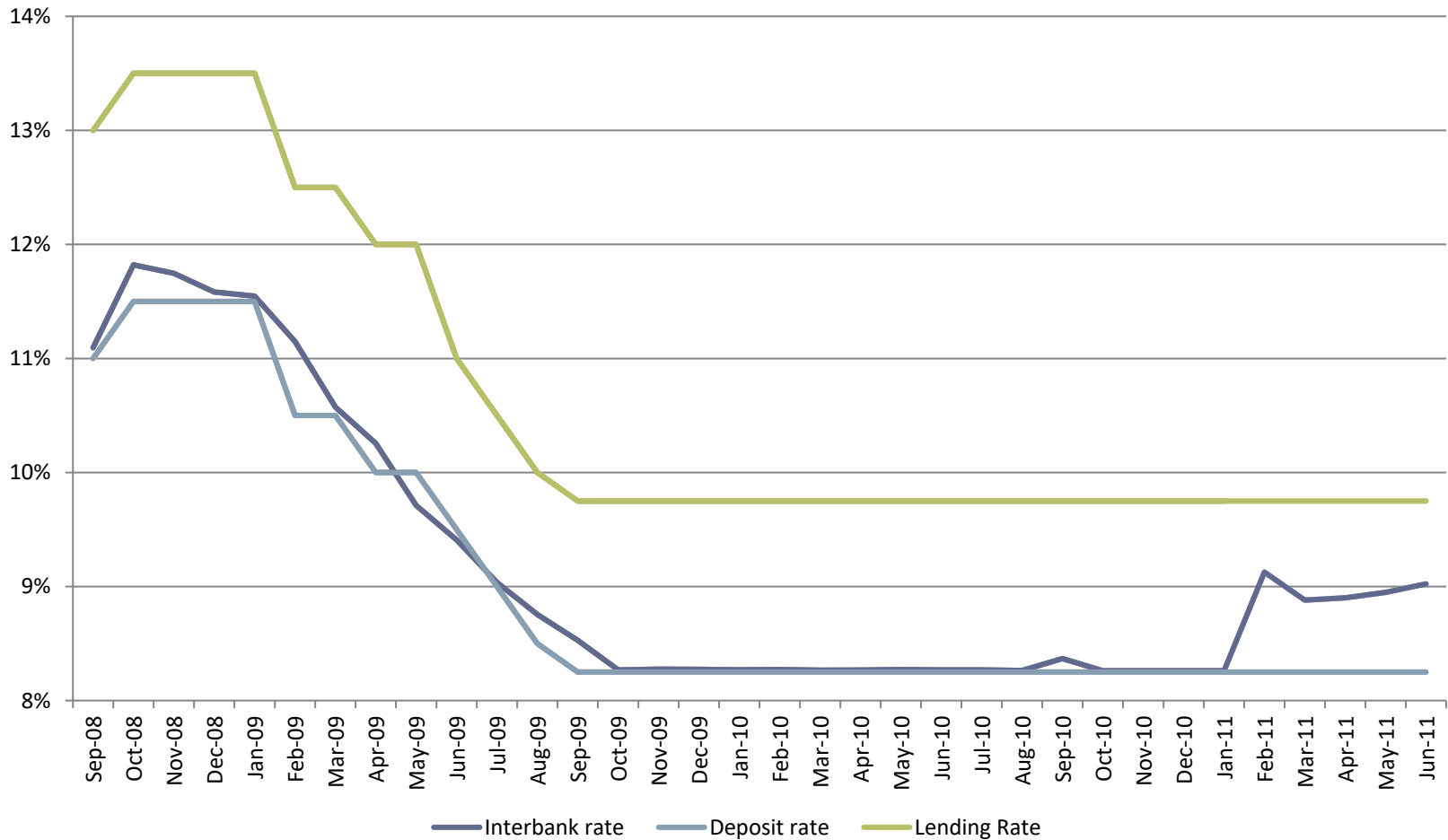


- **Wider fiscal deficit has contributed to a rising public debt ratio, although the external debt has been on a declining path**



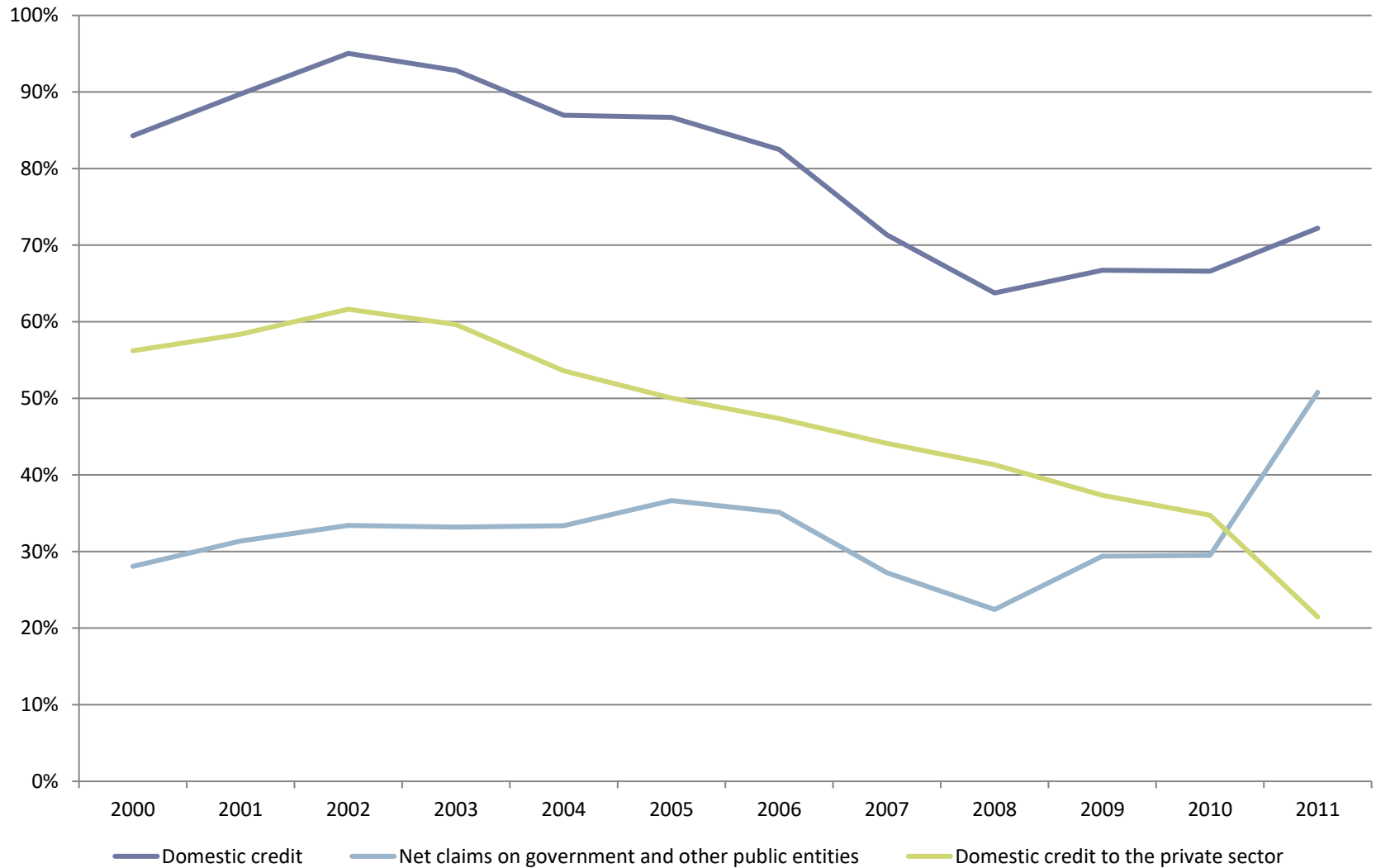
- Monetary policy has been on a neutral stance to sustain growth resorting to non-traditional monetary policy instruments to stem temporary inflationary pressures

## Policy Rates



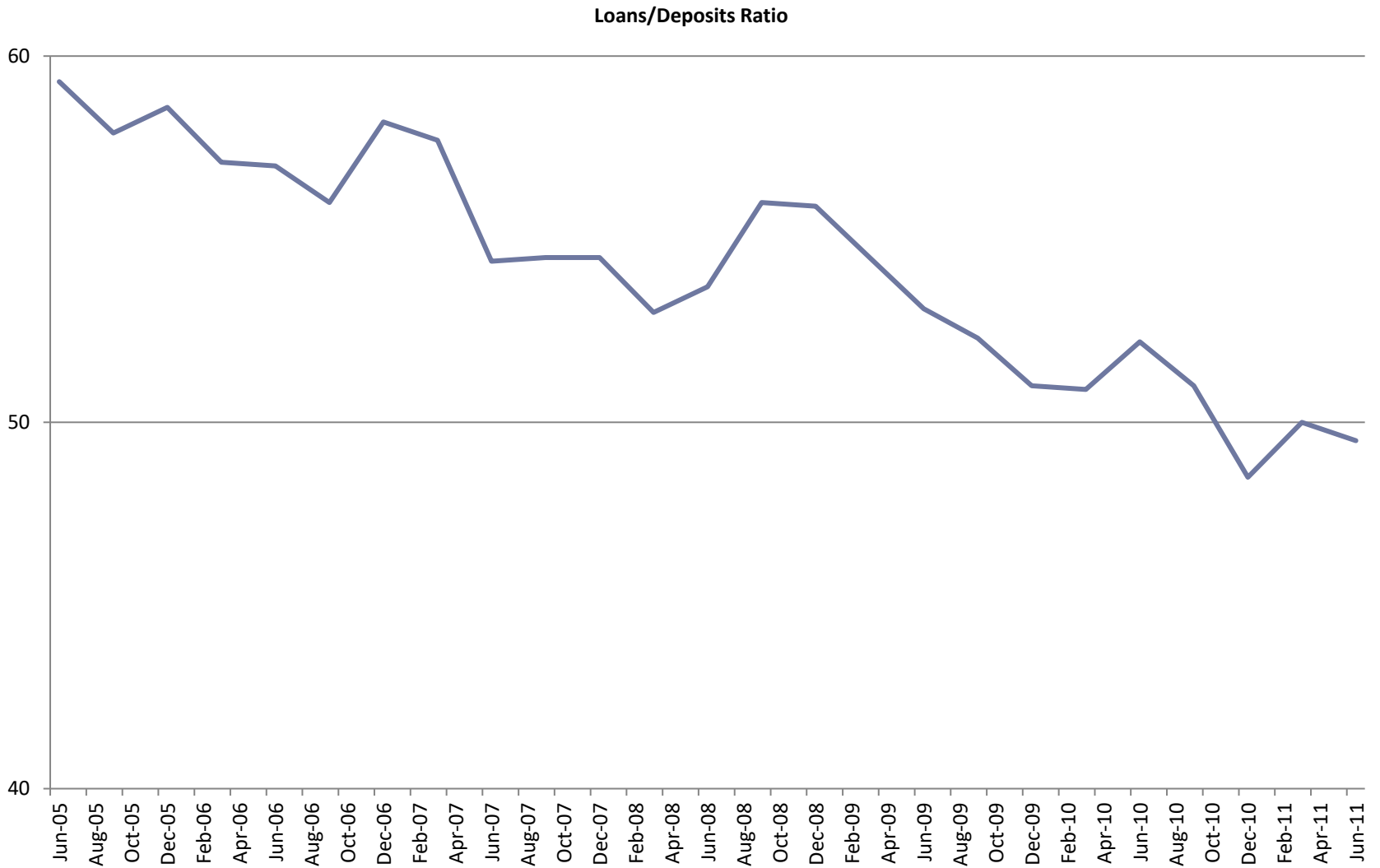
## This was coincident with..

- Slowing demand for private credit, coupled with a rebound in government credit





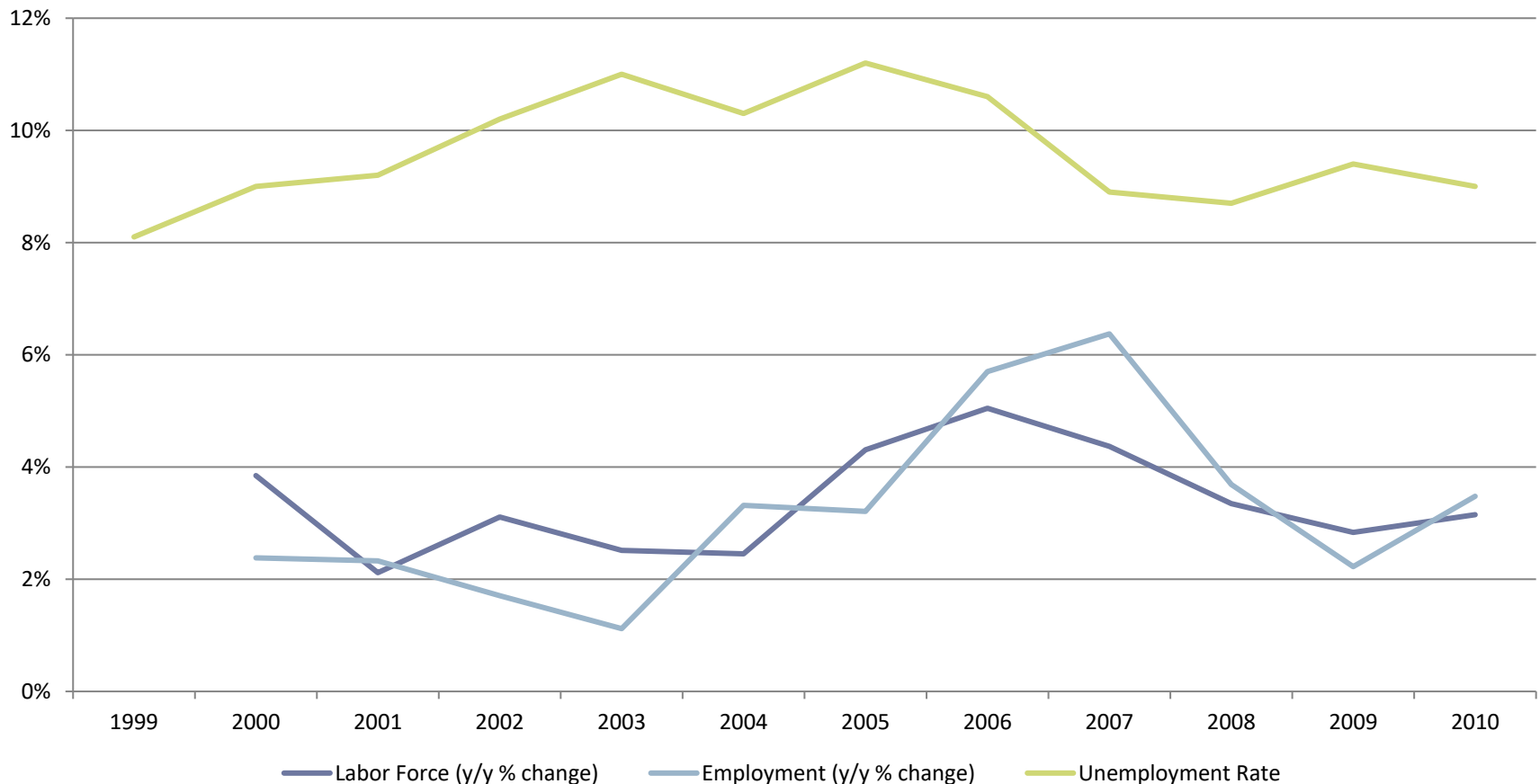
- All this, despite ample liquidity in the banking system



# Labor Market and Social Indicators

•Despite high growth rates, inadequate education and labor market structural rigidity have slowed employment growth ...resulting in a high unemployment rate and dire social conditions

## Labor force, employment and unemployment



- Manifested in high levels of income inequality and extreme poverty

	2000	2005
Poverty headcount ratio at \$2 a day (PPP) (% of population)	19.37	18.46
Income share held by highest 10%	28.34	27.62
Income share held by lowest 10%	3.88	3.85
Income share held by highest 20%	42.1	41.46
Income share held by lowest 20%	8.95	8.96
GINI index	32.76	32.14

# Recent Political and Social Unrest and Economic Consequences

---

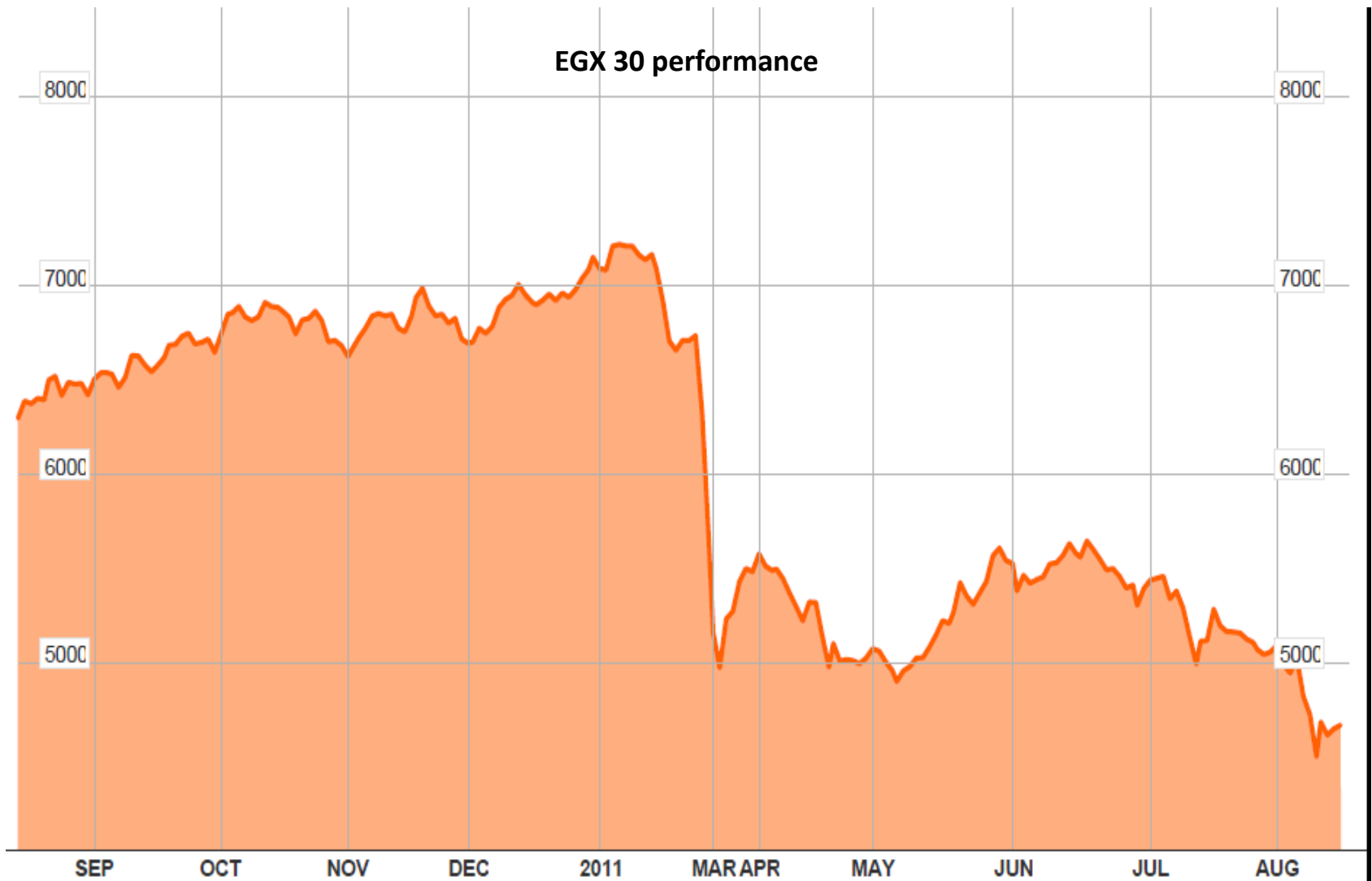
- ▶ 2010 was an eventful year for Egypt, ending with very controversial parliamentary election that caused mounting uproar over “legitimacy crisis” and gross allegations of fraud.
- ▶ Egyptians started a nation-wide uprising on January 25 and protests continued over political reform and social inequity, even after the resignation of President Mubarak who had been in power for 30 years.
- ▶ The political upheaval and surrounding unrest has had an adverse effect on economic activity, due to the curfew and business closures.

# Economic Losses

---

- ▶ The adverse effects on the economy have undermined growth performance for 2010/11, decreasing to 1.8%.
- ▶ The stock market went into a slump and trading was suspended following significant losses that led to a complete shutdown on January 28.
- ▶ Several agencies downgraded Egypt's rating:
  - ▶ Moody's - Ba1 → Ba3
  - ▶ S&P - BBB-/A- → BB+/B
  - ▶ Fitch - Stable → Negative

- Significant losses in 2011 have offset all the gains of 2010



# Disruption of Economic Activity

---

- ▶ The economic reform agenda and plans of foreign investment will – most likely – be delayed. Foreign investment deteriorated from 6.8 to 2.1 USD Billion for FY 2010/2011 (July-March). It is expected to further decrease to 1.2 USD Billion for FY 2011/2012.
- ▶ However, if political stability is restored, growth could rebound in the next fiscal year such that it is expected to increase from 1.8% to 3.2% for FY 2011/2012.

# Impact on Domestic Demand

- ▶ Other unfavorable effects of the political unrest were manifested in the decrease in domestic demand.
- ▶ Private consumption and investment were undermined due to the temporary disruption of economic activity and uncertainty.
- ▶ This latter adverse effect may linger till political stability is restored.

Indicator	Preliminary Actual 2009/2010	Projected 2010/2011	Budget Proposal 2011/2012
Domestic Investment rate	18.9%	15.4%	15.2%
Domestic savings Rate	14.1%	10.8%	9.9%
Foreign Direct Investment (Billion USD)	6.8	1.3	1.2



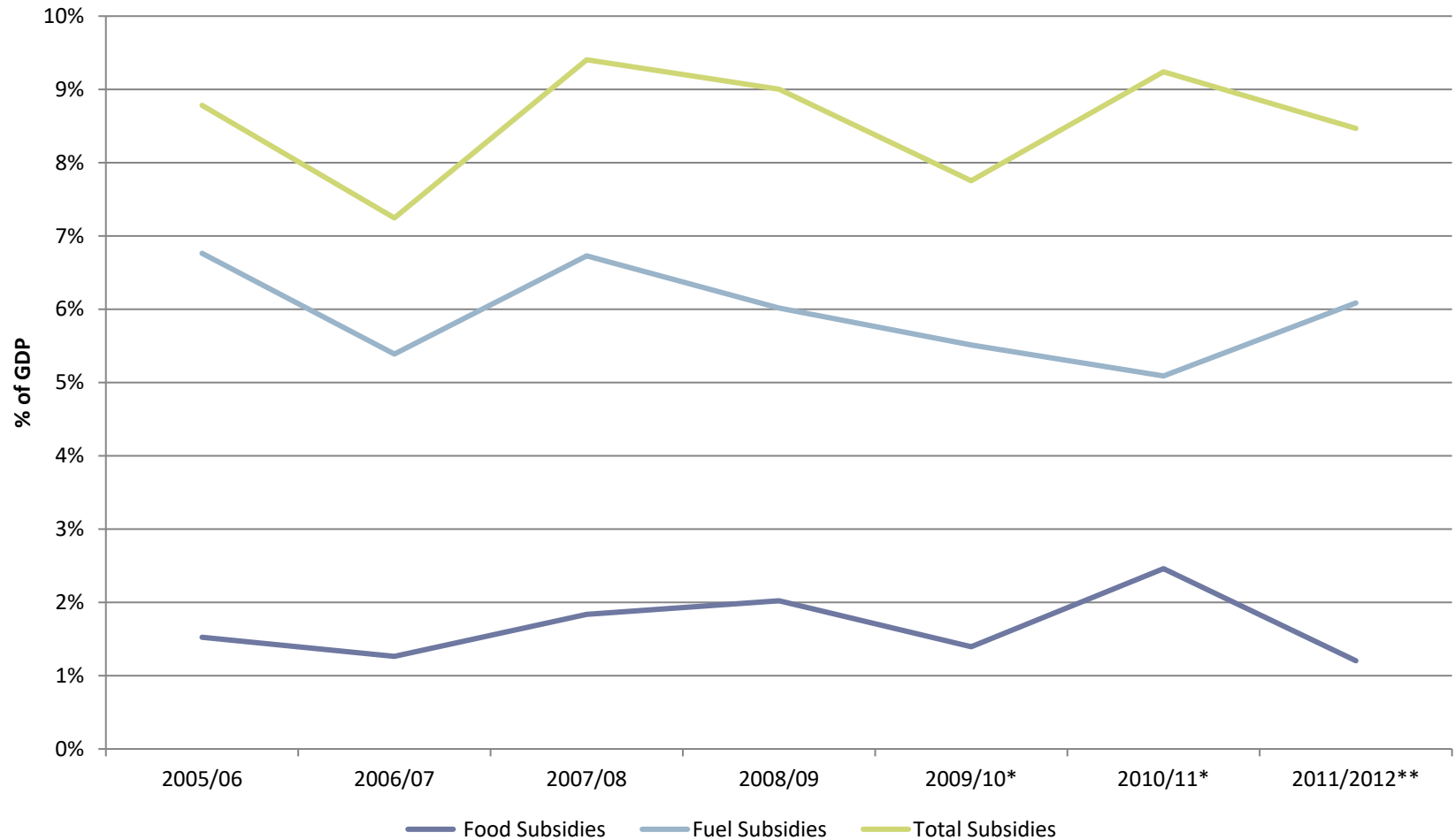
# Fiscal Policy Response

---

- ▶ Concerns about inequity have forced an expansionary fiscal policy in 2010/11 to ameliorate the economic implications of the political unrest.
- ▶ A 15 percent increase in wages and pensions was stipulated by the government effective April 2011.
- ▶ A decision was taken to immediately appoint temporary government employees in their jobs.
- ▶ Subsidies reached almost EGP123 EGP billion in 2010/2011, exceeding 9% of GDP.
- ▶ In 2009/10, the petroleum subsidy alone was estimated at EGP66.5 billion, in contrast to EGP67.7 billion and EGP95.5 billion in 2010/11 and 2011/12.

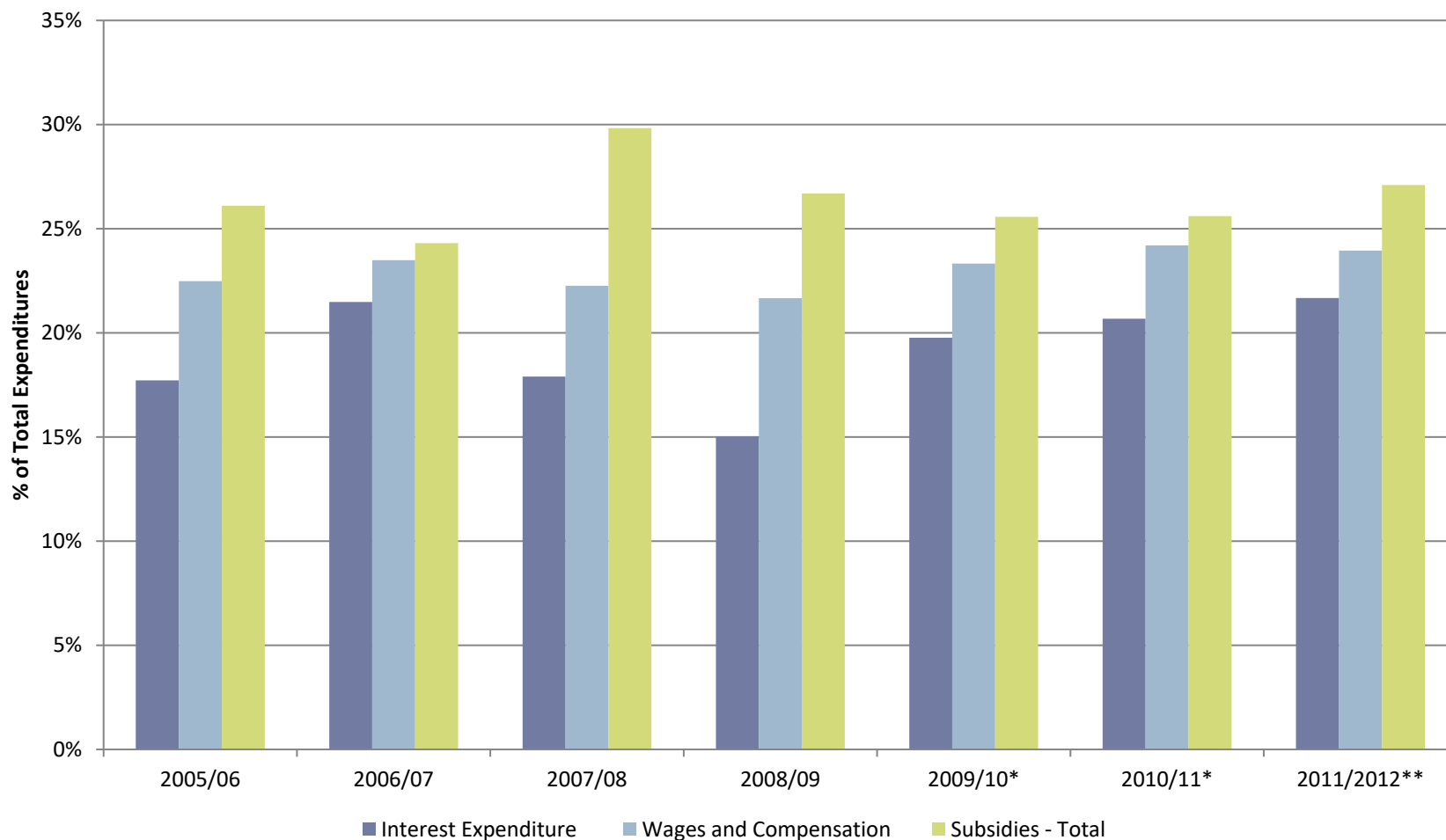
- With the increase in international food and fuel prices, subsidies have exceeded nine percent of GDP in 2010/11 and remain a big burden on the budget

### Food and fuel subsidies



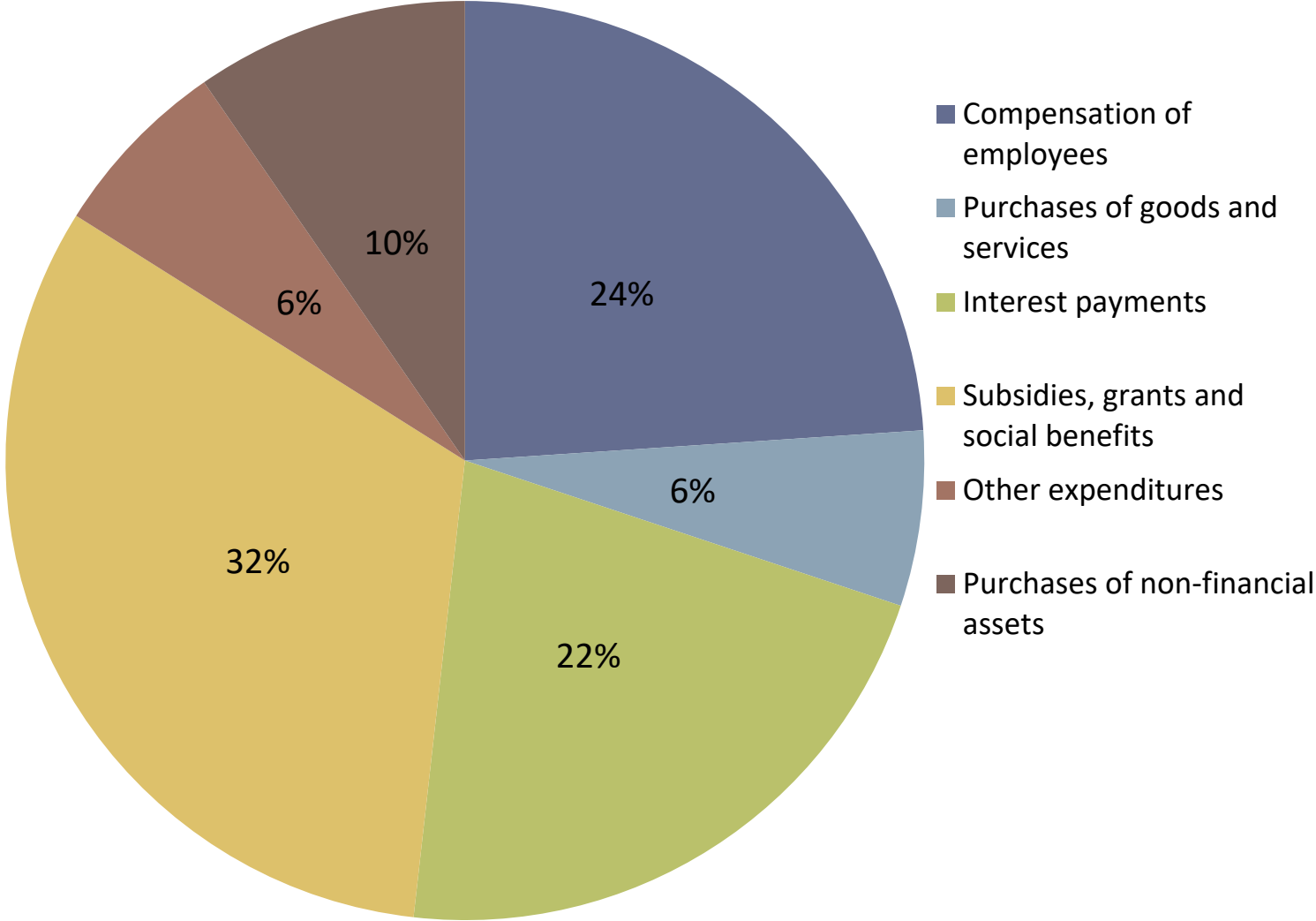
- Expenditures on subsidies, wages and salaries, and interest payments have steadily grown, representing nearly 75% of total spending

### Components of Government Expenditures



• Current budget does nothing to address these fiscal concerns

FY 2011/2011 Budget Proposal



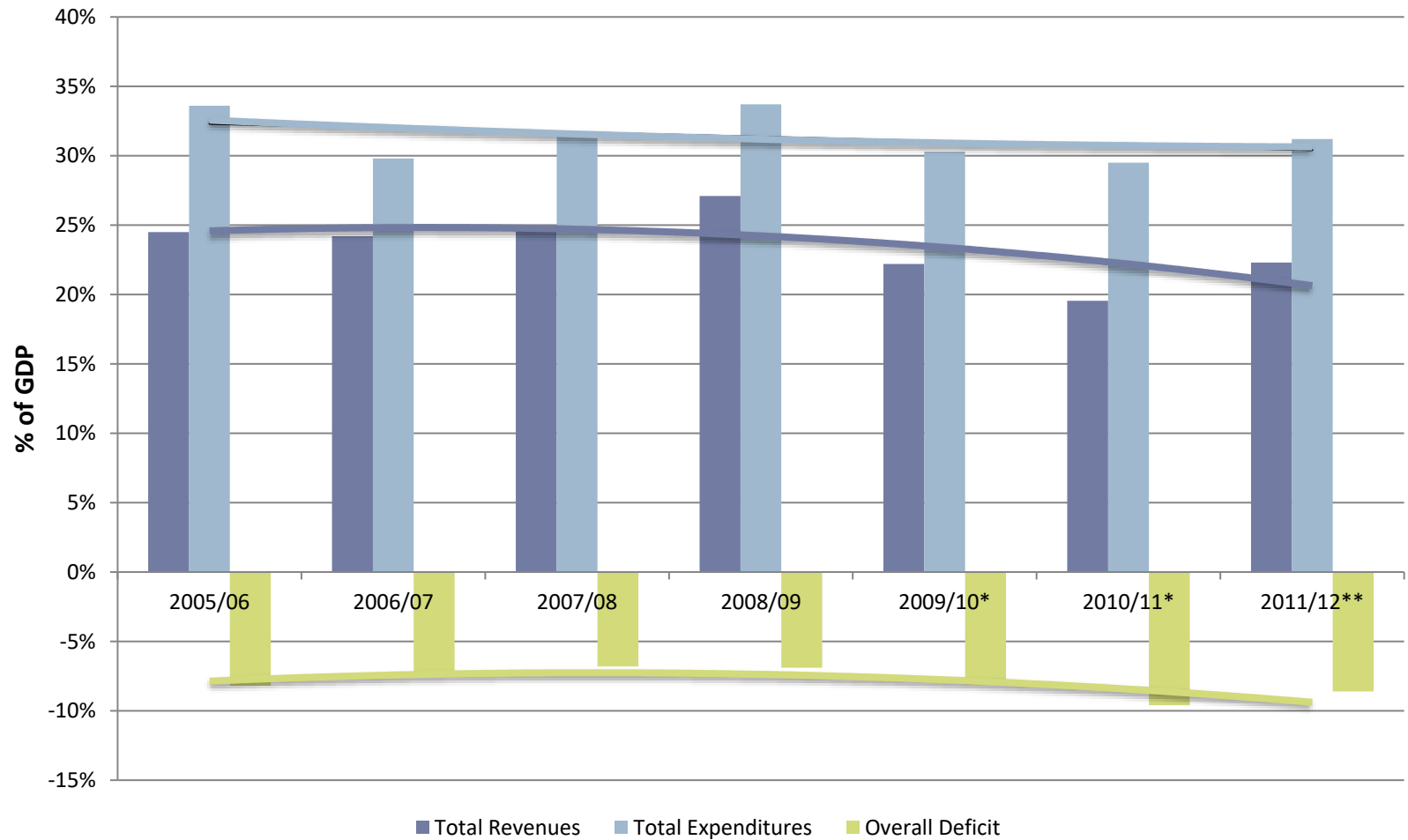
# Fiscal Policy Response

- ▶ The overall budget deficit widened in 2010/11 to 9.6%, compared to the budgeted deficit of 7.9 percent.
- ▶ Significant increase in spending on subsidies, wages and salaries and compensations for losses, coupled with significant reduction in revenues due to slowdown, has increased the deficit by 35 percent.

Indicator (As percent of GDP)	Preliminary Actual 2009/2010	Preliminary Actual 2010/2011	Budget Proposal 2011/2012
Revenues	22.22%	19.55%	22.27%
Expenditures	30.33%	29.5%	31.25%
Overall Deficit	8.1%	9.6%	8.6%

- Following a drive for fiscal consolidation, stimulus and social packages widened the fiscal deficit

### Fiscal Indicators

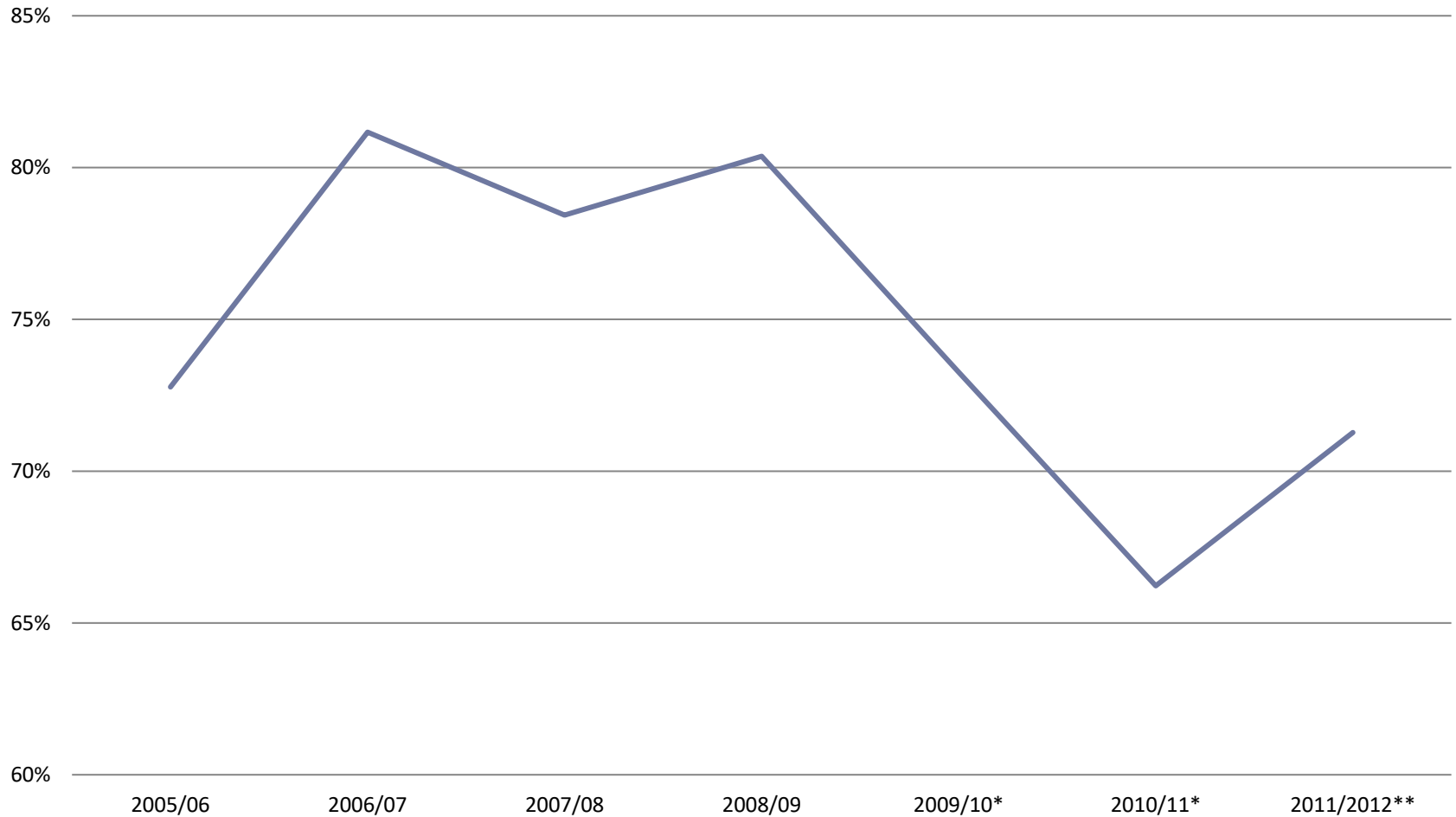


\*Preliminary actual

\*\*Budget proposal approved by the SCAF

- Even worse, revenues have shrunk considerably relative to growing expenditures

### Revenues per Expenditures



# External Sector

- ▶ Egypt's current account deficit improved in 2010/11, reflecting higher energy and non-energy exports.
- ▶ However, a significant portion of foreign receipts was lost, owing to lower FDI and higher capital outflow.

Indicator (USD Billion)	2009/2010	2010/2011
Current Account Deficit	4.3	2.8
Oil Exports	10.3	12.1
Average price of Suez Blend (July-March)	72.5 \$	98.6 \$
Non-Oil Exports	13.6	14.9
Percentage of Non-Oil Exports from Total	57%	55%
Foreign Direct Investment	6.8	2.1 (July-March)



# External Sector

---

- ▶ On the positive side, remittances have improved.
- ▶ However, higher interest payments on public debt and profit outflow for foreign companies countered these inflows.
- ▶ In addition to significant drop in tourism receipts since Jan.

Indicator (USD Million)	2009/2010	2010/2011
Remittances (Total)	10460	13140
Private remittances	9500	12400
Official Remittances	960	740
Growth in Tourism in percent	10.5%	-8.62%

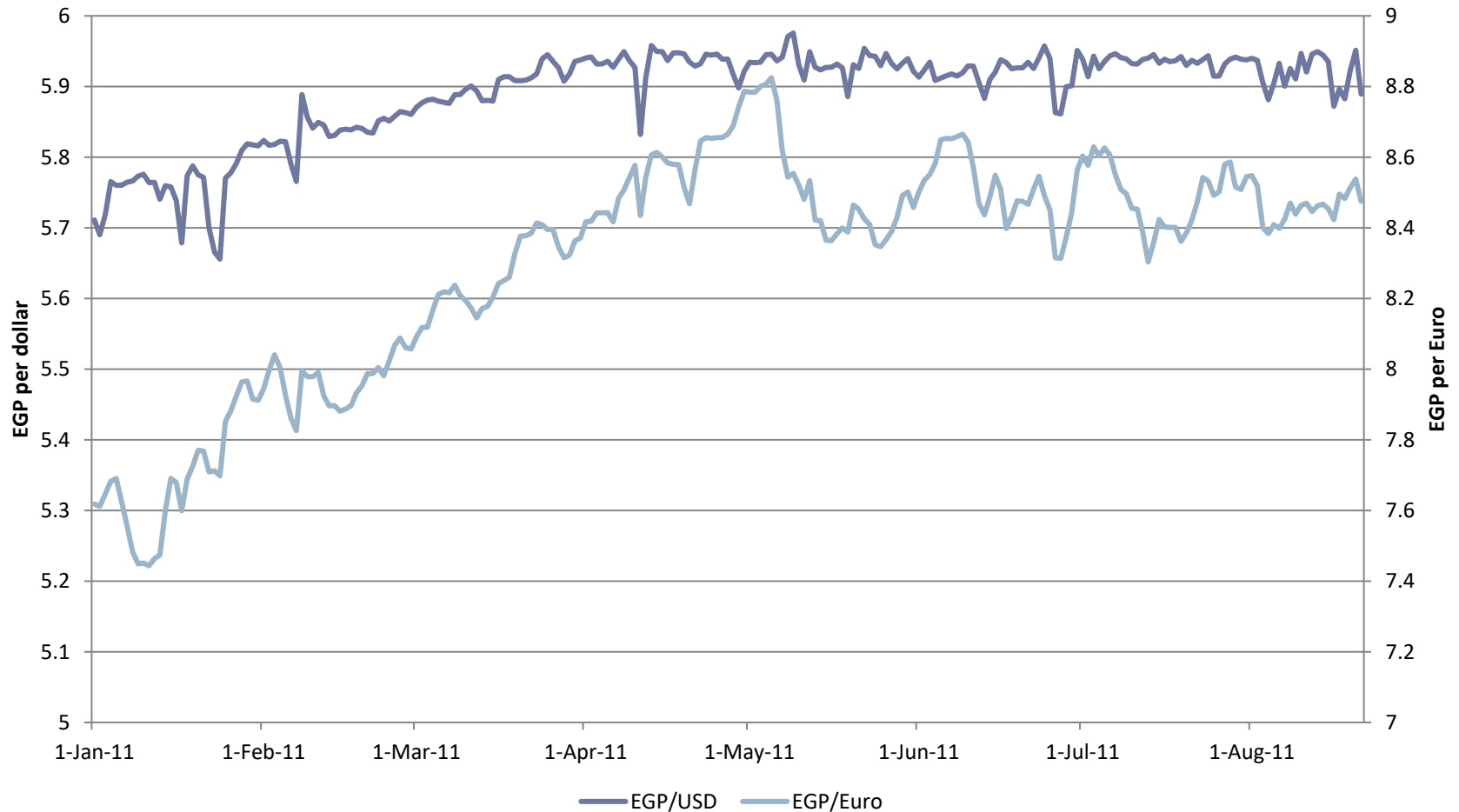
# Exchange Rate

- ▶ The loss of foreign receipts and significant outflows weakened the Egyptian pound relative to the US dollar, reaching EGP 5.937 per US\$ as of June 2011.
- ▶ The exchange rate of the pound remains depreciated relative to the pre-crisis level and compared to the average over the past six years.

Exchange rates relative to EGP	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
USD	5.685	5.681	5.690	5.715	5.744	5.785	5.797	5.884	5.918	5.947	5.935	5.937
GBP	8.771	8.997	8.950	9.140	9.256	9.116	9.081	9.409	9.540	9.698	9.707	9.605
EUR	7.331	7.418	7.498	8.007	7.931	7.718	7.696	7.967	8.265	8.564	8.511	8.512

- Since the beginning of 2011, the EGP has depreciated by nearly 3 percent against the USD and 11 percent against the Euro, increasing the cost of imports

### Exchange rate movements



# Monetary Policy Response

---

- ▶ The Central Bank of Egypt (CBE) affirmed that it guarantees all deposits in the banking system.
- ▶ Further, the CBE put a ceiling of EGP50,000 on daily cash withdrawals in early February to avoid panic that would potentially affect the banking system's liquidity. The limit on local currency withdrawals was lifted in early April.
- ▶ Further, the CBE intervened to prevent further depreciation of the exchange rate.

# Sources of Inflationary Pressures

---

- ▶ Inflation has picked up again in 2010/11, estimated at a year average of 11.1 percent.
- ▶ The depreciation of the Egyptian pound relative to the US dollar is likely to increase the cost of imports.
- ▶ Recovery in the global economy (if sustained) is likely to raise international food prices.
- ▶ Lingering political unrest in oil-producing countries has pushed oil prices up.
- ▶ Higher food and fuel prices will increase pressures and deteriorate the fiscal deficit.

# Forward Looking Economic Strategy

---

- ▶ The revolution has emphasized the importance of associating economic liberalization with political reform.
- ▶ Since the early 1990s, Egypt has been rapidly integrating in the world economy.
- ▶ The absence of regulatory framework and sound institutions have increased corruption and prevented the trickle down of the economic gains to wider population.
- ▶ Egypt's economic outlook in 2011/12 will depend on the speed of the reform agenda towards achieving political and social stability.

# Primary Objectives

---

- ▶ Key priorities are poverty alleviation and improving living standards.
- ▶ The economic agenda should revolve around achieving a high sustained and equitable growth rate.
- ▶ Addressing social concerns demands actions to tackle high unemployment, the poor level and deteriorating quality of educational and health services, and achieving more equitable distribution of wealth and earnings.

# Fiscal Priorities

---

- ▶ Fiscal consolidation is key to the realization of Egypt's economic objectives.
- ▶ Reform efforts have been hampered by significant waste of government resources, reflecting untargeted subsidies, resulting in persistently high deficit and increasing public debt ratio to GDP.
- ▶ Gradual reduction in the deficit is necessary to bring the debt ratio down to 60 percent of GDP.



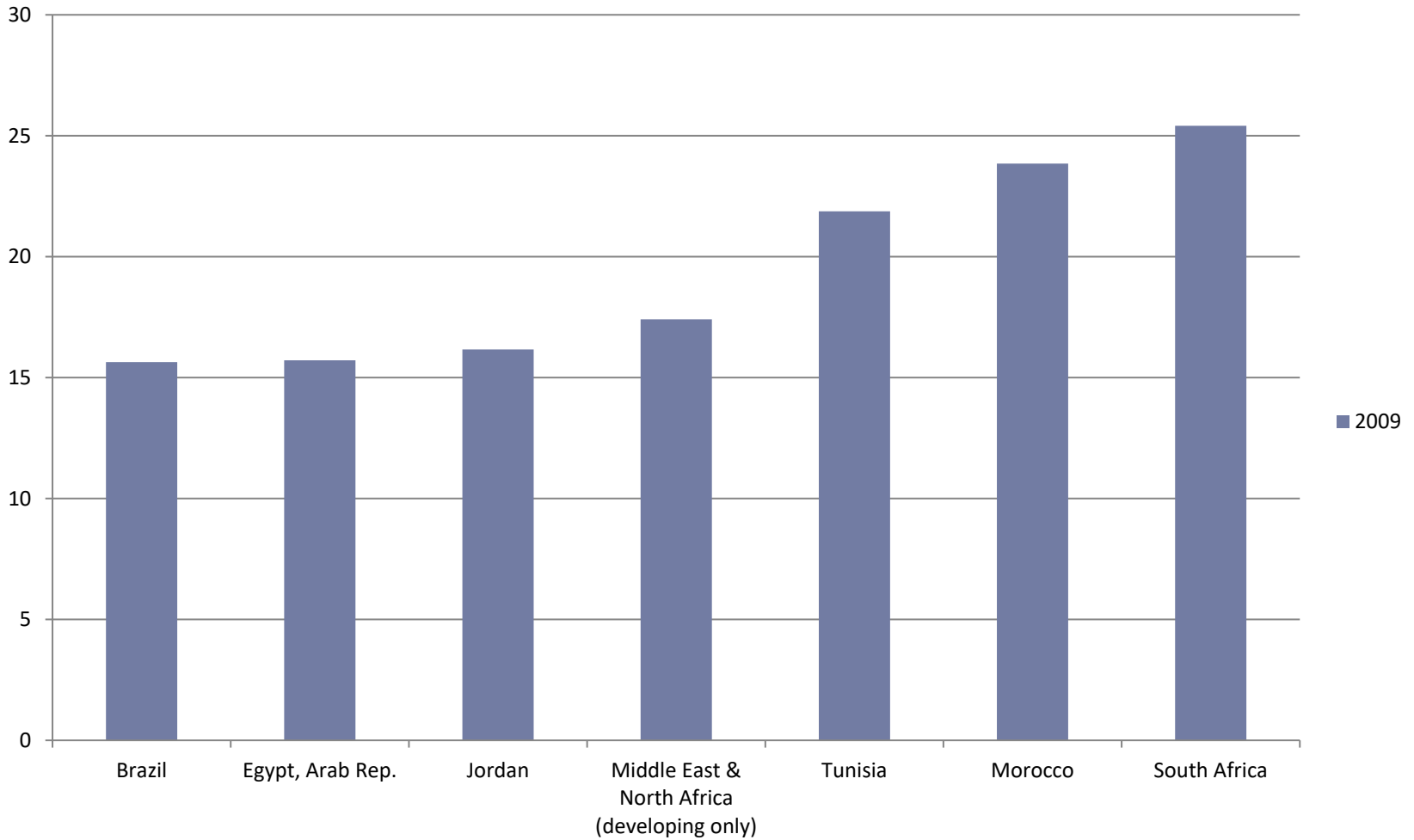
# Fiscal Reforms

---

- ▶ Previous plans by the government to phase out subsidies will most likely be stalled.
- ▶ Tax revenues (which constitute more than 60 percent of government revenues) may be undermined by the slowdown of economic activity during the second half of 2010/11.
- ▶ Fiscal sustainability demands consolidation plans in the near term to reduce the fiscal deficit and concerns about rising public debt.

- Mobilizing additional revenues is key to fiscal consolidation as revenues remain low relative to GDP

Tax revenues- % of GDP



# Monetary Policy Challenges

---

- ▶ Despite rising core inflation index in the first half of 2010/11, the CBE decided to keep the policy rates unchanged at 8.25 for the overnight deposit rate and 9.75 percent for the overnight lending rate.
- ▶ The rest of 2011 will experience higher inflationary pressures owing to the political unrest, depreciation of the Egyptian pound, widening fiscal deficit, in addition to volatile international prices.

# Monetary Policy Priorities

---

- ▶ Priorities should be focused on inflation targeting to increase competitiveness and contain inflationary expectations.
- ▶ Management of the exchange rate policy in line with the underlying fundamentals is necessary to sustain economic growth, contain the inflationary cost of imports and mitigate the risk of supply-side shocks on the economy.
- ▶ Regulations should aim at eliminating distortions in distribution and enforcing surveillance.
- ▶ Priorities should be established to avail credit to the private sector, particularly to SME, and offer tax incentives for business firms that are tied to the employment agenda.

# Structural Agenda

---

- ▶ Efforts to improve the performance of the public sector should continue, notably state-owned enterprises.
- ▶ It is crucial to press ahead with the plan for public/private partnership to reduce pressures on the budget and engage the private sector in infrastructure and capacity building.
- ▶ A comprehensive strategy should evaluate state-owned enterprises and set a plan to reform or privatize non-performing enterprises, while ensuring transparency and enforcement of rule of law to avoid previous problems and sustain productive capacity of privatized firms to protect workers' rights.

# Conclusions

---

- ▶ Social inequality and inadequate human development in Egypt have signified the downside risks attributed to the lack of political reforms alongside the economic reform agenda that the country has embraced.
- ▶ Even though the Egyptian economy has achieved strides in terms of economic liberalization and growth figures, reform efforts have been challenged by political stagnation and corruption, depriving the lower end of the Egyptian society from the fruits of economic growth.

# Forward Vision

---

- ▶ Priorities for the social agenda in the near term should include rationing government spending, including by subsidies' reform, to have a better targeted scheme that would eliminate waste in spending and establish better equity.
- ▶ In parallel, the agenda should target a reform of the tax system to mobilize additional revenues and increase efficiency in tax collection and better compliance.

# Medium Term Agenda

---

- ▶ Availing more jobs in support of productive activity to help vulnerable groups graduate from continued dependency on subsidies.
- ▶ Increasing incentives for job creation and availing more credit to small and medium enterprises.
- ▶ Addressing structural bottlenecks in the labor market towards closing the gap between supply and demand, by increasing investment in education and training and gearing efforts towards matching qualifications with available jobs.



# Political and Institutional Reforms

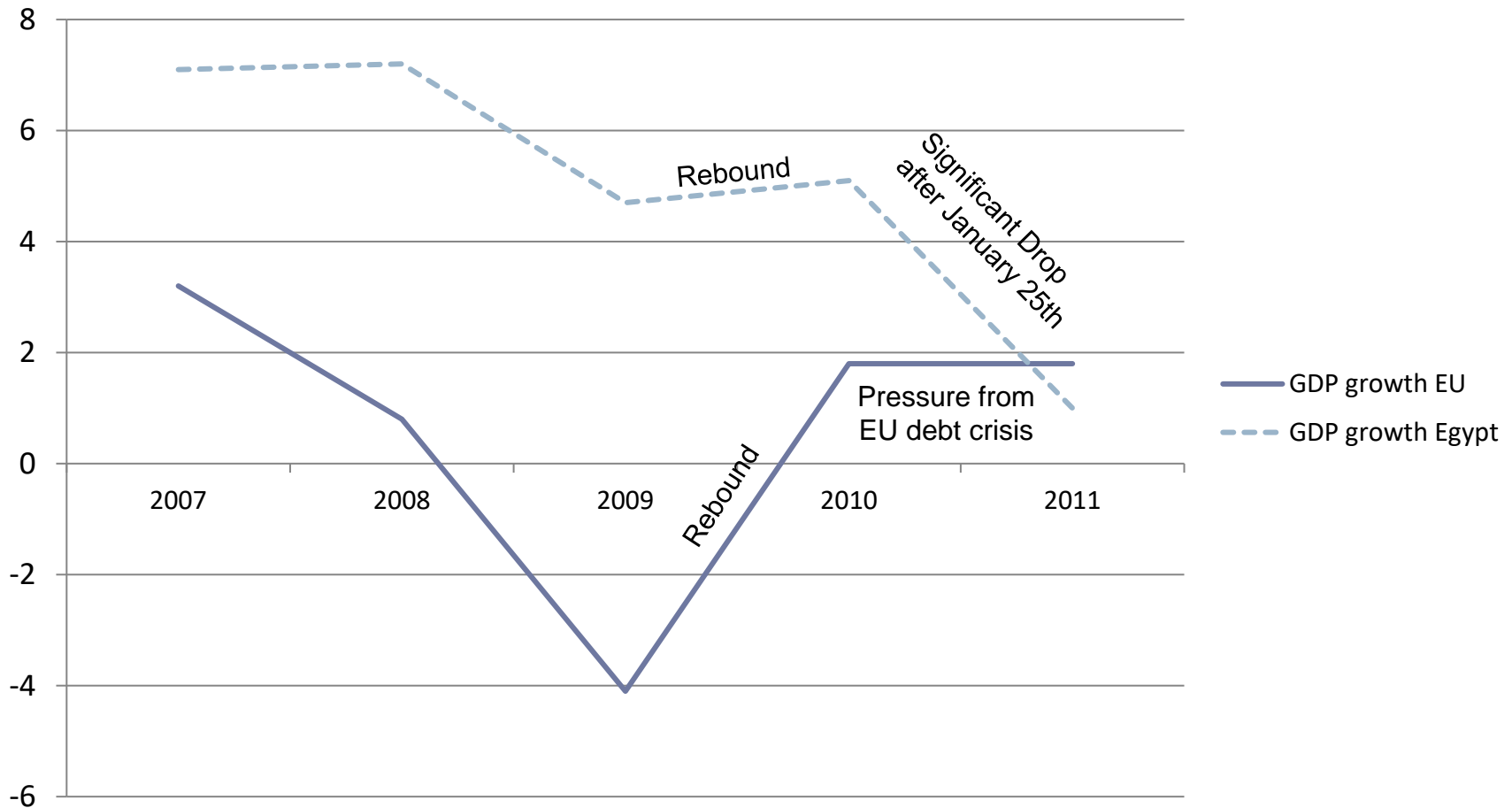
---

- ▶ Enforcing rules and laws that increase flexibility in the labor market and, therefore, incentives for formal jobs in the private sector.
- ▶ The ongoing political reform agenda bodes well for investment in quality institutions, good governance, transparency, rule of law, and fighting bureaucracy and corruption.
- ▶ Political reforms will reinforce fundamentals towards boosting investors' confidence and securing sustainable and equitable growth to attain higher welfare for Egypt's growing large population.

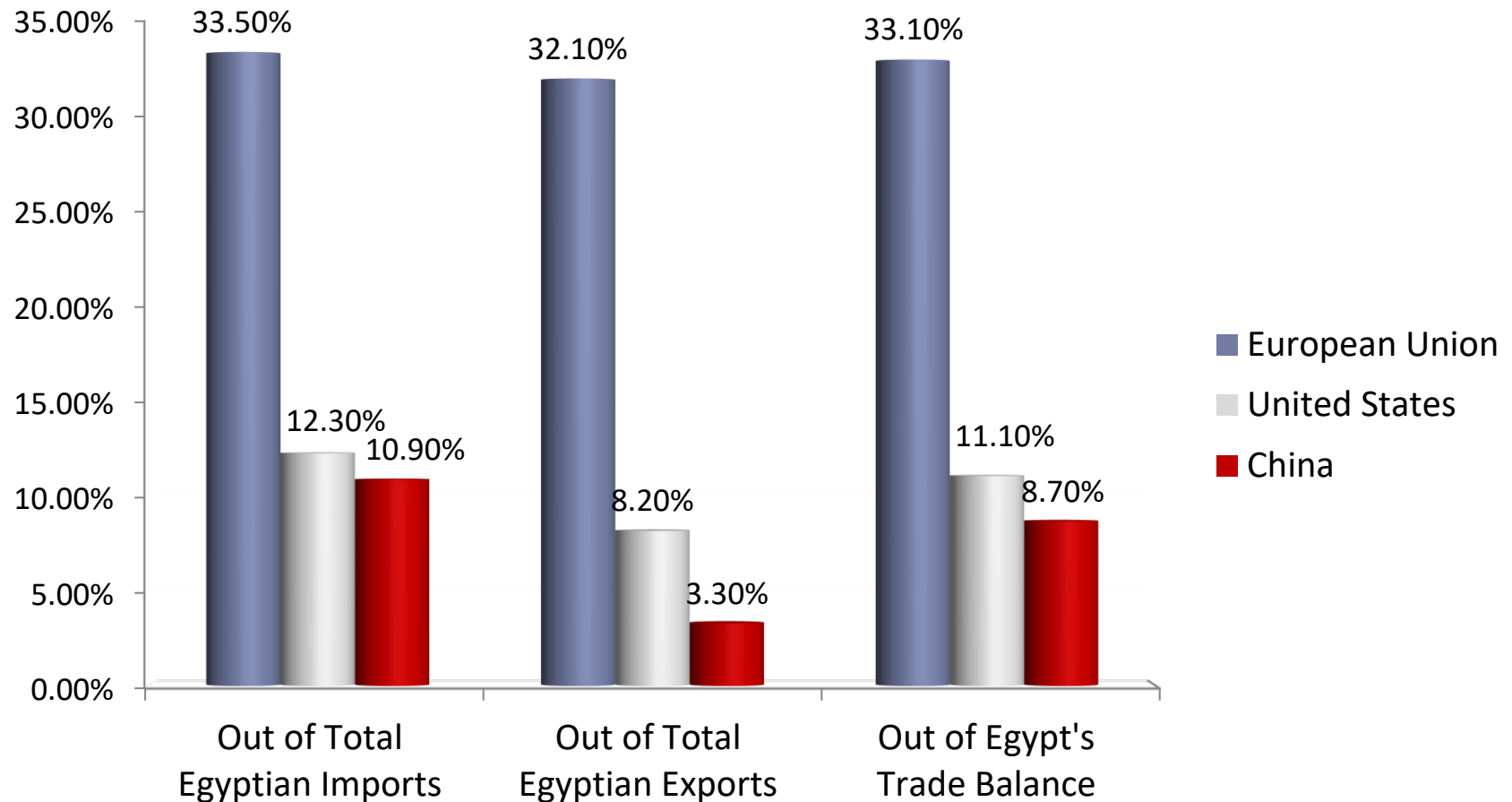
# Egypt and the EU

Competitiveness, Trade, Investment and Financial Assistance

# While Egypt withstood the Global crisis better than the EU, Egypt's rebound was reversed by the revolution in 2011



# Historically and up until 2010, the EU remains Egypt's largest trading partner, in terms of both imports and exports



From the EU's perspective, Egypt is the 28<sup>th</sup> largest trading partner, providing a large scope to grow this partnership

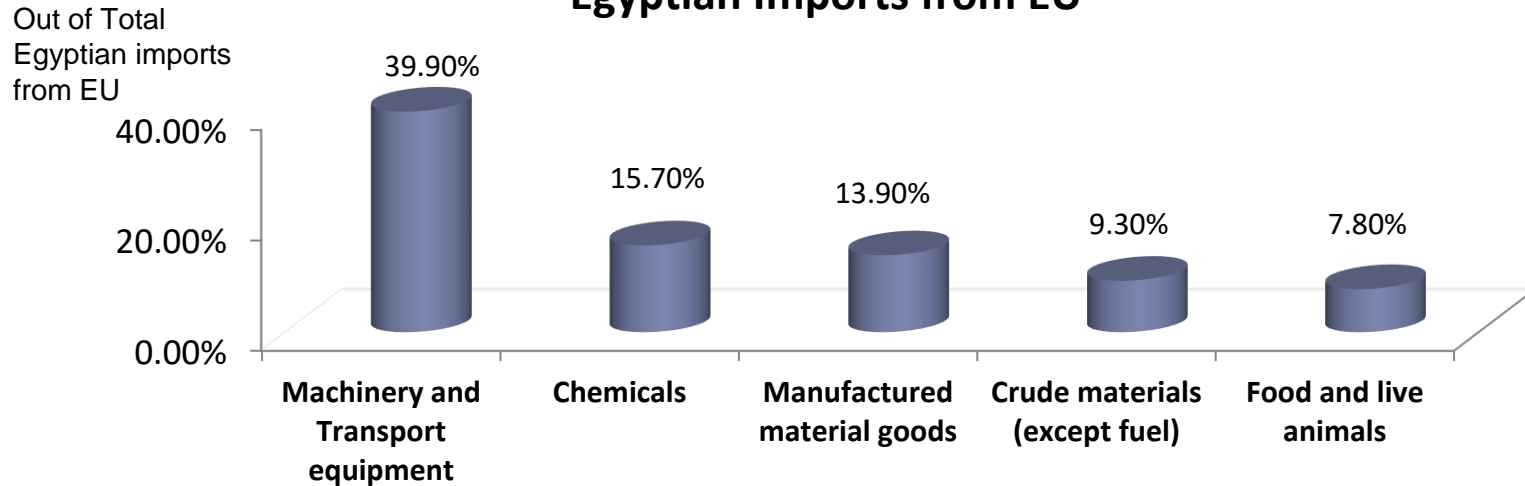
### EU's Main Trading Partners (2010)

Rk	Partners	Mio euro	%
<b>Extra EU27</b>		<b>2.850.636,3</b>	<b>100,0%</b>
1	United States	411.562,5	14,4%
2	China	395.128,8	13,9%
3	Russia	244.893,7	8,6%
4	Switzerland	189.559,5	6,6%
5	Norway	121.039,5	4,2%
6	Japan	108.628,2	3,8%
7	Turkey	103.277,7	3,6%
8	India	67.946,1	2,4%
9	South Korea	66.636,4	2,3%
10	Brazil	63.603,3	2,2%
11	Canada	46.642,4	1,6%
12	Singapore	42.747,7	1,5%
13	South Africa	39.418,7	1,4%
14	Saudi Arabia	38.956,3	1,4%
15	Taiwan	38.895,5	1,4%
16	Hong Kong	37.541,2	1,3%
17	Australia	36.602,9	1,3%
18	Algeria	36.423,4	1,3%
19	Libya	35.534,2	1,2%
20	Mexico	34.501,4	1,2%
21	United Arab Emirates	33.433,1	1,2%
22	Malaysia	31.944,6	1,1%
23	Ukraine	28.731,6	1,0%
24	Thailand	27.204,7	1,0%
25	Iran	25.662,4	0,9%

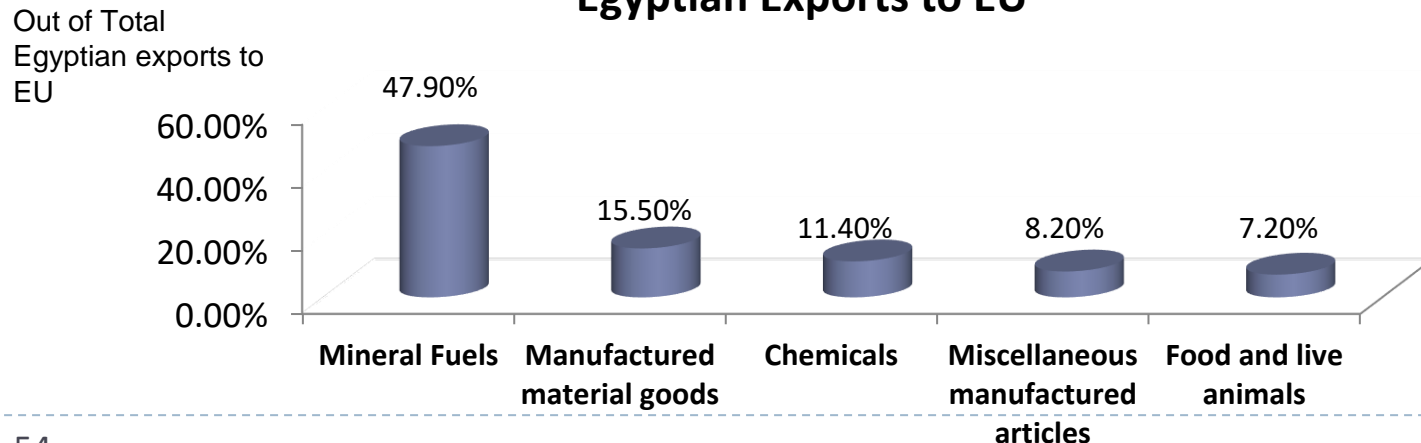
Rk	Partners	Mio euro	%
<b>Extra EU27</b>		<b>2.850.636,3</b>	<b>100,0%</b>
26	Israel	25.583,4	0,9%
27	Nigeria	25.370,8	0,9%
28	<b>Egypt</b>	<b>22.007,4</b>	<b>0,8%</b>
29	Morocco	21.352,5	0,7%
30	Kazakhstan	21.102,3	0,7%
31	Tunisia	20.581,9	0,7%
32	Indonesia	20.101,3	0,7%
33	Argentina	16.725,7	0,6%
34	Chile	15.406,9	0,5%
35	Croatia	15.208,7	0,5%
36	Vietnam	14.103,6	0,5%
37	Qatar	13.087,9	0,5%
38	Azerbaijan	12.110,3	0,4%
39	Serbia	11.482,2	0,4%
40	Iraq	10.149,2	0,4%
41	Belarus	9.343,0	0,3%
42	Philippines	9.115,0	0,3%
43	Colombia	8.636,1	0,3%
44	Angola	8.540,4	0,3%
45	Bangladesh	8.212,1	0,3%
46	Venezuela	7.895,0	0,3%
47	Kuwait	7.871,5	0,3%
48	Pakistan	7.459,0	0,3%
49	Peru	7.421,5	0,3%
50	Syria	7.243,1	0,3%

# At the disaggregate level, Nearly Half of Egypt's Exports to the EU are Fuel and its derivatives

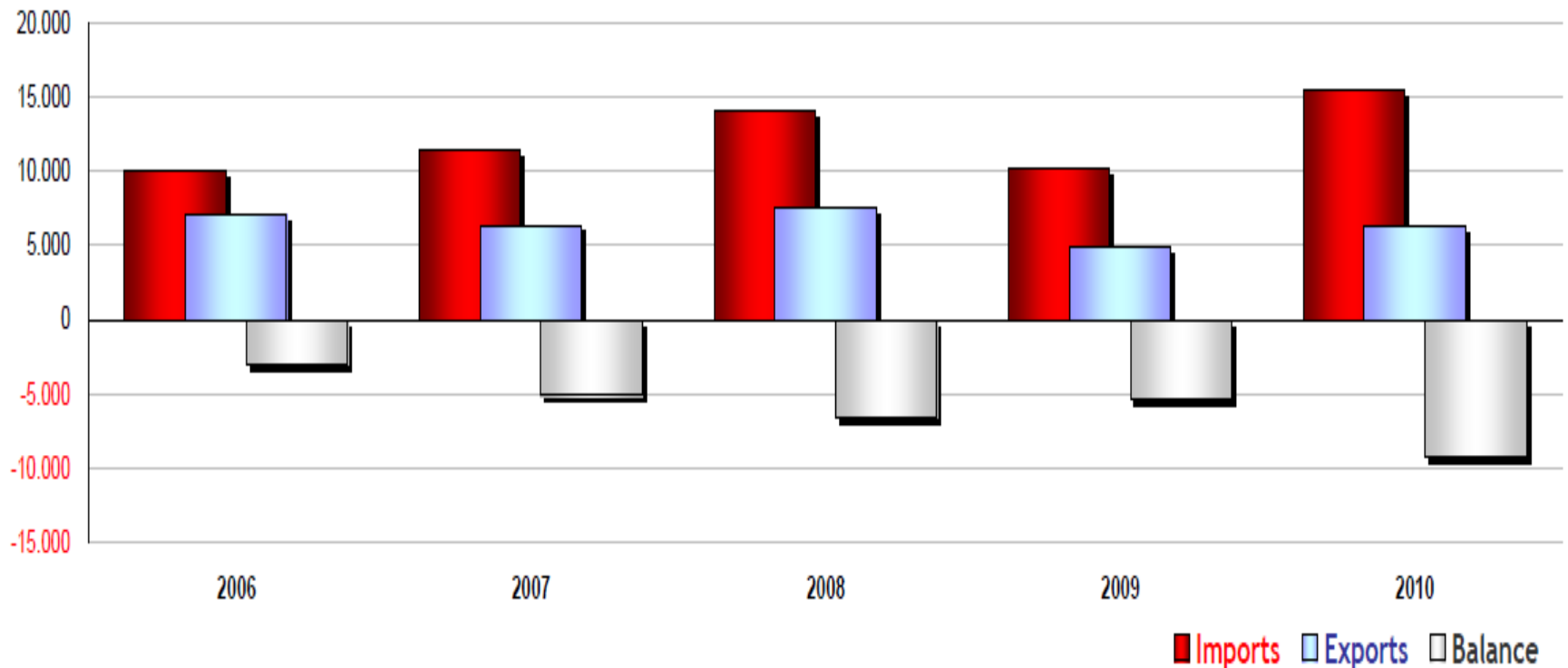
## Egyptian Imports from EU



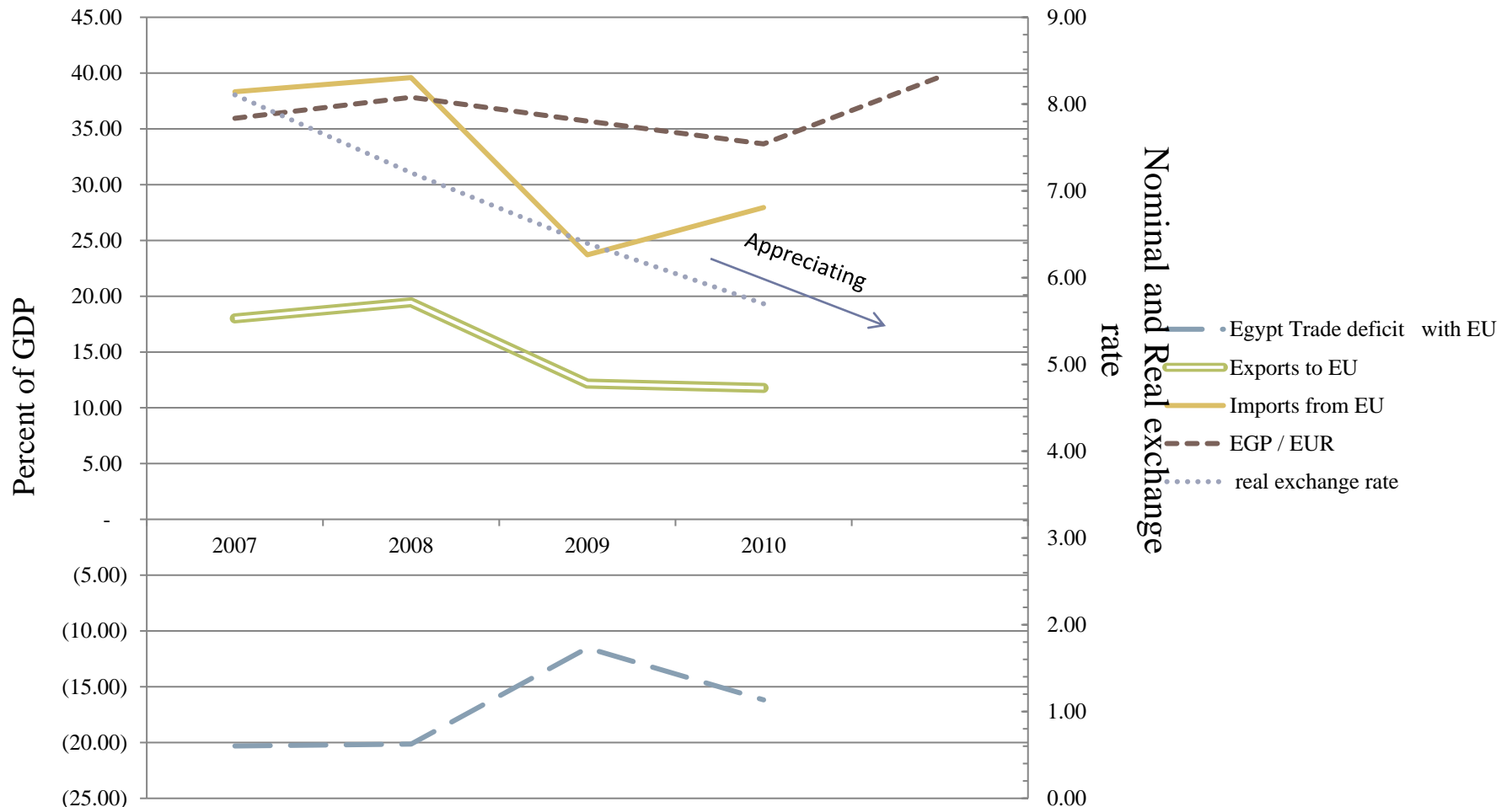
## Egyptian Exports to EU



Over time, Egypt's trade deficit with the EU has widened, driven by the increase in Egyptian imports and failure to mobilize Egyptian exports.



# Nominal and Real Appreciation of the Egyptian pound decreases export competitiveness, while imports are increasing, widening the trade deficit

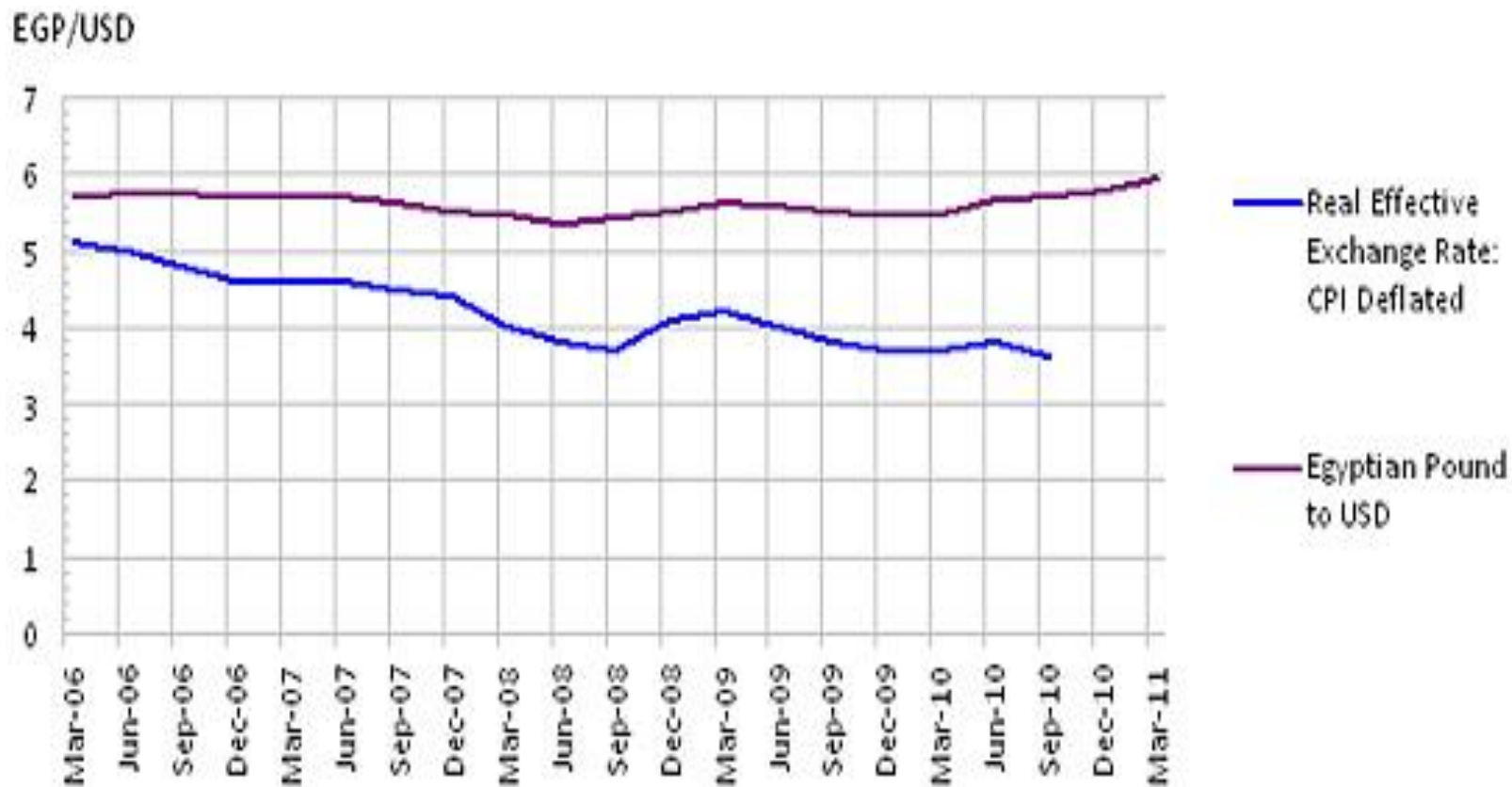




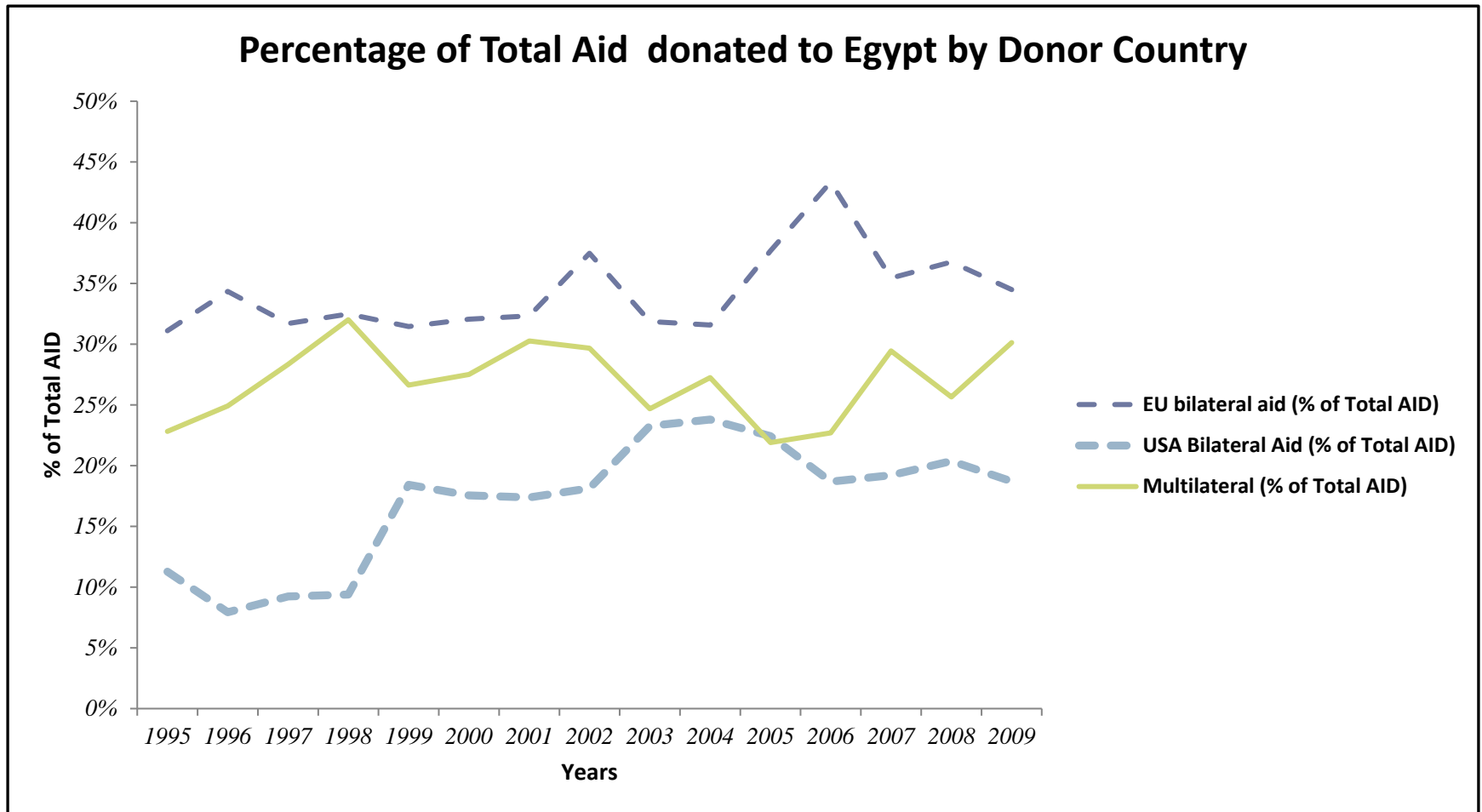
# None the less, inflationary pressures remain the biggest threat to Egypt's competitiveness, prioritizing the need to control inflation



Hence, the real exchange rate is appreciating despite the nominal depreciation of the EGP lately



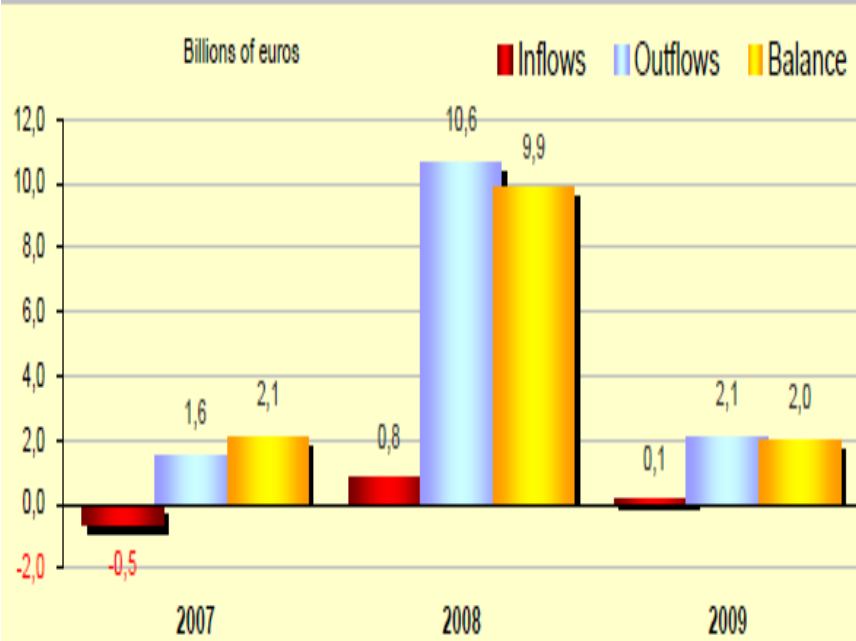
# Combined together, the European Union is the largest donor of foreign Aid to Egypt



However, there is a lot to be desired in terms of natural financial flows towards boosting more direct investments, particularly in the non-energy sector, to grow jobs

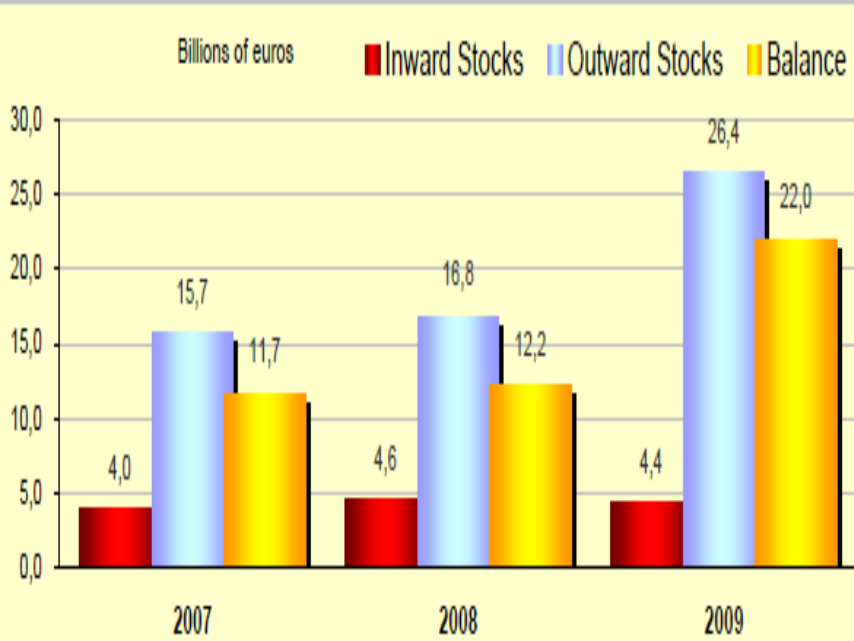
**FOREIGN DIRECT INVESTMENT**

**EU27 FDI WITH EGYPT**



Source: Eurostat (NewCronos)

**EU27 STOCKS OF FDI WITH EGYPT**



Source: Eurostat (NewCronos)

## Concluding Remarks

---

- ▶ The EU has successfully capitalized on its geographical proximity to the Egyptian economy, benefiting from its large size and strategic location.
- ▶ In theory, Egypt stands to benefit more from the large European market. However, this prospect has been undermined by challenges to competitiveness and domestic imbalances.
- ▶ Despite episodes of nominal depreciation of the Egyptian pound, persistent inflationary pressures have eroded competitiveness, increasing imports and Egypt's Trade deficit with the EU.

## Concluding Remarks

---

- ▶ Moreover, almost half of the Egyptian exports to the EU are mineral fuels, with relatively high volatility in prices, emphasizing the need for diversification.
- ▶ Despite the EU's long standing investments and financial assistance packages to Egypt, the current dire situation of the Egyptian economy in the aftermath of the January 25<sup>th</sup> revolution demands more careful assessment towards enhancing economic partnerships, trade relations and investment flows for the mutual benefits of both sides of the Mediterranean.