Egypt's Economic Prospects & Challenges[1]
9/22/2010

The 2008-2009 global crisis affected the Egyptian economy, but its impact was relatively moderate. GDP growth was maintained at a rate of 4.7% in 2009, down from 7.2%. There were financial outflows in the form of withdrawals from Egypt's equity and government debt markets. In total, these outflows amounted to an estimated US$14 billion. Holdings of government debt fell by 80% through April 2009; losses in the stock market amounted to 70% from the April 2008 level. Foreign exchange reserves fell significantly, as assets were converted from Egyptian Pounds into foreign currencies. The exchange rate depreciated by approximately 6% between October 2008 and March 2009.

From a current account deficit of US$1.331 billion in 2008, the deficit increased to US$3.195 billion in 2009, due to reductions in service exports (mainly tourism and revenues from the Suez Canal), remittance receipts and income from Egyptian migrant workers having lost their jobs in Gulf countries (the main destination of Egyptian migrant labor).

Investment and activity in the manufacturing, building and construction sectors fell and unemployment rose to 9.4% in 2009 from 8.7% in 2008. Private consumption growth, amounting to 5.7% of GDP in 2008, declined to 4.5% of GDP in 2009. Gross fixed investment, which had grown by 14.8% in 2008, contracted sharply by 10.2% in 2009.

The economic outlook looks broadly favorable, but concerns remain. Growth rates are strengthening; the latest International Monetary Fund (IMF) Article IV consultation report (April 2010) projected that growth would reach 5.0% in 2009/2010 and 5.5% in 2010/2011. More recent projections from the Economist Intelligence Unit (EIU) are broadly in line with the IMF's, at 5.2% in 2009/2010 and 5.5% in 2010/2011. The economic recovery in the EU and the US, while underway, remains fragile. This presents a major risk to Egypt's economic prospects, as exports will play a large part in enabling growth levels that, if not realized, will significantly increase the government burden of sustaining the economy. Gross fixed investment, another key factor in growth, is expected to start growing again in 2010 and 2011, by 8.2% and 11.6% respectively, in large part thanks to government fiscal stimulus. Private consumption is expected to grow by 4.8% in 2010 and 5.2% in 2011.

These projections, however, could be jeopardized by political factors. Elections in the lower house of parliament (the People's Assembly) in October and November 2010 are expected to favor the ruling party, the National Democratic Party (NDP), and ensure the reelection of the president, Hosni Mubarak, or his son, Gamal in 2011. The NDP's control over the majority of

[1] This report was prepared by Thibaut Muzart, Management Systems International, for USAID/EGAT's Business Growth Initiative Project, through a buy-in from USAID/ME/TS. The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

governing bodies, a powerless opposition and legal obstacles to the election of independent candidates are creating tensions. Change seems unlikely and the population is increasingly dissatisfied with general welfare conditions, governance issues tied to the independence of the press and the judiciary, and the high level of control exercised by the NDP. Serious political unrest, were it to become widespread, could hinder the resumption of key economic activities, notably tourism and the coherent and efficient formulation and implementation of government stimulus programs.

Pre- and post-crisis policy interventions helped to limit the contagion. Domestic credit growth had been slow and as a result the global downturn did not have severe repercussions on the domestic financial sector, households and businesses relative to other countries where credit had been extended significantly. In addition, the banking sector's integration in global financial markets was limited and the sector had been strengthened by a series of reforms between 2003 and 2007, which included consolidating banks, getting rid of toxic debt and improving overall management and governance. In addition, to avoid the possibility of panic-driven bank runs, the central bank renewed its guarantee of 100% of all local bank deposits. In parallel, the central bank cut deposit and lending rates by a cumulative 325 basis points and 375 basis points respectively between February and September 2009, which helped limit the impact of the crisis on credit and investment. As such, for the most part the global crisis spared the Egyptian financial sector, even though some measure of decline in lending and investment was observed.

Fiscal support from the government averted more severe declines in employment growth rates and overall economic activity and was instrumental in sustaining investment and domestic demand. After rising by only 2.1% of GDP in 2008, government consumption grew by 8.4% in 2009. Government expenditures have focused principally on infrastructure construction projects such as drinking water, sewage and roads, some of which began as early as September 2008. New projects, such as the second phase of the Upper Egypt-Red Sea Road and a potential US$1 billion tunnel under the Suez Canal, were announced in July 2010. The stimulus package included in the 2009/2010 budget amounted to US$3.2 billion and government consumption is expected to grow by 7.9% in 2010 and 7.2% in 2011. The upcoming parliamentary election in 2010 and presidential election in 2011 will provide additional impetus for government spending. Fiscal revenues should grow in 2010-2011 despite the stimulus package, as trade resumes and brings in earnings from the Suez Canal and customs duties. In addition, the government is expected to begin implementing measures to increase tax revenues (such as improving tax compliance and abolishing certain tax exemptions). The introduction of the property tax is being delayed because of concerns that it might spark political unrest. The fiscal deficit should diminish to 7.6% of GDP in FY 2010/2011 (from 8.2% of GDP in FY 2009/2010) if the economy performs as expected and because of domestic as well as (moderate) foreign borrowing.

Unemployment remains a major problem. The moderate rate of projected economic growth is expected to be insufficient to respond to the demands of new entrants in the labor market in the medium-term. After having risen to 9.4% in 2009 (from 8.7% the previous year), the EIU expects unemployment to rise again in 2010, to 9.7% before dropping in 2011 (to 8.9%).

Poverty numbers have increased since 2000. Poverty, measured using the Egyptian income poverty line, has steadily risen since 2000 despite economic reforms and high rates of GDP growth since 2004, according to a 2010 UNICEF report. In 2008/2009, an estimated 22% of the population lived in poverty. Consistent with this picture, previous estimates from the World Bank indicate that 18% of the population lived on less than $2 a day in 2004/2005 in purchasing power terms, and 2% lived on less than $1.25 (World Bank estimate). Because income from work is the largest source of income for the poor, the fact that growth has occurred in sectors that were mostly not labor-intensive or require relatively skilled labor, could explain why growth has not at least been able to lift people out of poverty. Another factor could be that the poor seem to benefit less from government assistance: in 2008, the non-poor only received around 17% of the value of food subsidies, which benefited only between two-thirds and three-quarters of the poor.

Whether the current economic performance will have a strong impact on poverty is uncertain. While Egypt is currently doing fairly well in terms of GDP growth and overall macroeconomic indicators, its unemployment levels are expected to remain high in 2010-2011. Most job losses during the crisis occurred in labor-intensive sectors such as manufacturing (whose growth declined by one half), tourism and construction. According to some observers, manufacturing, agriculture and construction, each with a sizeable proportion of informal activity, are the sectors in which poverty is most concentrated. Therefore, the revitalization of these sectors seems to be an important condition for poverty reduction in the short- to mid-term.

Exports are expected to rise. Achieving the projected growth rates of 12% in 2010 and 6% in 2011 will depend on the level of demand in Egypt’s largest markets, the EU and the US. The current account is estimated to have been in deficit in 2009 (by US$3.195 billion) but is expected to be in surplus in 2010 (by US$375 million) and 2011 (by US$2.290 billion) due to improvements in the trade balance, services balance (chiefly the resumption of tourism and traffic through the Suez Canal), income balance, and current transfers balance. Cotton prices are now markedly higher than in 2009 (at US$86.7 cents/pound vs. US$62.7 cents/pound in 2008) and are expected to rise slightly in 2011 (to US$88 cents/pound). This should also help the trade balance.

The Egyptian pound is strong. From its low points during the crisis, the pound appreciated on the back of a resumption of foreign investment in the economy in July-December 2009 and attractive interest rates on Egyptian debt. From E£5.55:US$1, the pound is expected to depreciate moderately against the US dollar in 2010 and 2011 (to E£5.61:US$1) and appreciate against the euro in 2011. These exchange rate movements are expected to have an impact on exports and, by extension, on the degree to which economic growth strengthens. The Central Bank is expected to intervene when needed, in order to limit the range of upward exchange rate variations.

Monetary policy will be tightened. Although the central bank maintained a loose monetary stance during much of 2009, it is expected to reverse that course towards the end of 2010, given the resumption of economic activity and the phasing out of energy subsidies (which will contribute to increasing price levels) expected to begin this year. Inflation in 2009 averaged 11.8%, down from 18.3% in 2008. In May 2010, the latest available data, inflation was down to 10.5%, but it is expected to average 11.8% in 2010 and 9.7% in 2011. This is a clear improvement over 2008, when inflation remained above 20% between June and November.

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