EGYPT

Highlights

- **Growth has slowed in the fiscal year 2019-20.** The Covid-19 crisis has contributed to a sharp rise in unemployment, but inflation has slowed, a primary surplus was achieved, and the current account deficit narrowed.
- **In response to the Covid-19 crisis, the authorities took a range of measures.** The government introduced a stimulus package and fast-tracked the release of overdue payments to contractors and export subsidies. The Central Bank of Egypt (CBE) announced a new debt relief initiative for those at risk of default, and issued loan guarantees to banks to on-lend to private sector companies active in the manufacturing, agriculture and contracting sectors.
- **Structural reforms advanced.** The government continued with subsidy reform through increases to electricity and public transport prices, and a series of laws were passed, including the new Banking and Central Bank Act, the SME law, the Unified Economic Operators Registry Act, and amendments to the Sovereign Fund Law and the Public Enterprises Act.

Key priorities for 2021

- **The authorities should step up measures to promote alternative water solutions.** Water security is at the forefront of Egypt's national security. To stem the worsening of its water shortage, systematic investments are required to promote efficient water utilisation in agriculture, industry and beyond.
- **Further steps to strengthen competition and promote a level playing field are needed.** Approving the revised Competition Law would ensure the institutional independence of the Egyptian Competition Authority and empower it to regulate mergers and acquisitions that meet certain thresholds.
- **Upgrading digital infrastructure and advancing digitisation would create much-needed job opportunities in a post-Covid-19 world.** The Covid-19 crisis has accelerated the move to remote working, online education and e-government services, and there is now an urgent need to upgrade available platforms.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020
GDP growth	4.3	4.1	5.3	5.6	3.6
Inflation (average)	10.2	23.5	20.9	13.9	5.7
Government balance/GDP	-12.5	-10.4	-9.4	-7.4	-7.5
Current account balance/GDP	-6.0	-6.1	-2.4	-3.6	-3.2
Net FDI/GDP [neg. sign = inflows]	-2.0	-3.3	-3.0	-2.6	-1.7
External debt/GDP	16.8	33.4	37.0	36.0	34.4
Gross reserves/GDP	5.1	13.0	17.4	14.5	10.3
Credit to private sector/GDP	26.3	28.3	24.4	22.9	25.0

* Fiscal year is July-June.

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Covid-19: macroeconomic implications

GDP growth slowed in the fiscal year 2019-20. The economy grew by 3.6 per cent, versus 5.6 per cent in the previous fiscal year and well below the initial target of 6.0 per cent. Growth in the first half of the fiscal year, before the Covid-19 crisis, was 5.6 per cent year-on-year, declining slightly to 5.0 per cent in the third quarter. In the last quarter (April to June 2020), GDP contracted by 1.7 per cent year-on-year, when a lockdown was imposed, thus negatively affecting both private consumption and investment. Unemployment rose sharply to 9.6 per cent in this quarter, reflecting the economic impact from the Covid-19 crisis on labour-intensive sectors, such as tourism. Inflation slowed to 3.7 per cent year-on-year in September 2020, reflecting a decrease in food prices and lower housing costs and utilities inflation. In a pre-emptive move to support the economy in the face of the Covid-19 crisis, the CBE cut its policy rate by 300 basis points in March 2020 and another 50 basis points in September 2020, the lowest level since early 2015.

The fiscal position continued to improve, despite the Covid-19 crisis. The budget deficit remained around 7.5 per cent of GDP in fiscal year 2019-20, slightly above the initial target of 7.2 per cent of GDP. The crisis saw tax revenues fall because of exemptions provided to businesses as part of the pandemic mitigation measures, but this was partly offset by strong revenues from state-owned enterprises (SOEs) and banks. Spending on subsidies declined, as most petroleum products have been indexed to actual procurement costs since April 2019, resulting in a sharp fall in energy subsidies. Overall, a primary surplus was achieved in the fiscal year 2019-20, amounting to 1.8 per cent of GDP. The latter, coupled with robust growth, led to a decline in the public debt-to-GDP ratio to 86.1 per cent.

External imbalances have fallen, but reserves declined. The current account deficit narrowed to 2.6 per cent of GDP in the first three quarters of fiscal year 2019-20 as imports fell due to weak commodity prices, the impact of Covid-19 and related measures on incomes and consumption, and supply disruptions. Exports also declined, as well as tourism revenues. Inflows of foreign direct investment to Egypt declined to US$ 2.1 billion in the same period. International reserves have dropped to US$ 38.4 billion in September 2020, but continue to comfortably cover over six months of imports.

Covid-19-related measures will hold back growth in the first half of the fiscal year 2020-21. GDP growth is projected at 3.5 per cent in the fiscal year 2020-21, due mainly to the weak outlook in the tourism sector, disruptions in global value chains, weaker demand from trading partners and the slowdown in foreign direct investment. However, large public construction projects and the boom in the telecommunications sector have so far sustained growth. The main risks to the outlook arise from the need for a tougher lockdown should the spread of Covid-19 accelerate, and from the negative outlook in Egypt's main trading partners.

Policy response to Covid-19

In response to the Covid-19 crisis, the government undertook a range of measures. A stimulus package of EGP 100 billion (US$ 6.4 billion) was announced in March 2020, of which EGP 50 billion (US$ 3.2 billion) was dedicated to the tourism sector. The petroleum and tourism ministries gave airlines a US$ 0.10-per-gallon discount on fuel, and several airlines were reportedly in negotiations with the government in pursuit of measures to mitigate the economic repercussions of the pandemic, including talks with banks and Egypt's Sovereign Wealth Fund over potential stake sales and zero-interest loans. Fiscal measures introduced by the government included: lower energy costs for the industrial sector; real estate tax relief for the industry and tourism sectors; an extended moratorium on agricultural land tax for two years; reduced stamp duty on transactions and dividend tax; postponed capital gains tax; and deferred utility payments for tourism and airline companies. On the social front, the government expanded Takaful and Karama (the national social protection programmes) to reach more families; and implemented a targeted support initiative for irregular workers (EGP 500, or US$ 32, in monthly grants for three months).

The CBE has also intervened with crisis-mitigation measures. In March 2020, the CBE increased the limit for electronic payments via mobile phones, announced a new debt relief initiative for those at risk of default, implemented an EGP 20 billion (US$ 1.3 billion) stock-purchase

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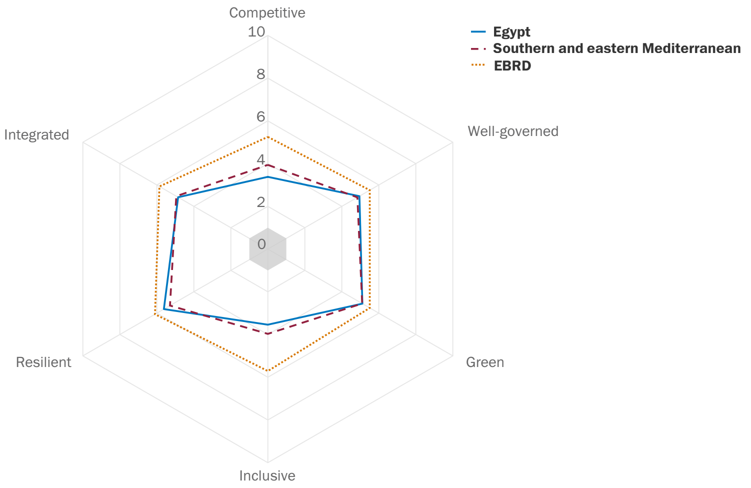
programme, suspended blacklists of loan defaulters, and provided loans with two-year grace periods to the aviation sector. The CBE also issued EGP 100 billion (US$ 6.4 billion) in loan guarantees to banks to on-lend to private sector companies active in the manufacturing, agriculture and contracting sectors, in addition to a EGP 3 billion (US$ 190 million) guarantee on three-year loans to tourism companies and hotels at a subsidised rate of 5 per cent with a one-year grace period.

Assessment of transition qualities (1-10)



Structural reform developments

A new International Monetary Fund (IMF) programme is in place. The programme, a US$ 5.2 billion one-year standby arrangement, was signed in June 2020. Coupled with a US$ 2.8 billion rapid financing instrument approved by the IMF in early May, this will help the government tackle the economic impact of the Covid-19 crisis and reinforce the progress on macroeconomic stabilisation and structural reforms carried out under the previous US$ 12 billion extended fund facility (EFF), which ended in 2019. The new programme's primary focus will be on enabling the government to finance spending on health services and social protection by bolstering the balance of payments and the state budget. Among the other pertinent features of the IMF programme is reforming the National Investment Bank, the state development bank, through the hiring of an international auditor to evaluate its financial position.

The parliament approved a new Banking and Central Bank Act. The legislation, approved in May 2020, gives the CBE increased discretionary powers to regulate the banking sector. Another provision of the law puts the CBE in charge of licensing companies that want to offer credit risk guarantees. The law will also allow the CBE to provide short-term bailout funding to struggling banks. Under the legislation, future boards and chairpersons of state-owned banks will be appointed by the prime minister and will be subject to some form of competency approval from the CBE.

Reforms to subsidies have advanced. In June 2020, the government announced increases in electricity prices, which went into effect in July. Residential users will face an average increase of 19.1 per cent, following a 21.2 per cent rise in July 2019. Electricity prices remain subsidised, and the plan for abolishing electricity subsidies completely was extended from 2021 until 2025. In August 2020, the metro fares on all lines in Cairo were increased by 50 per cent on average, following a previous increase in May 2018. The fuel indexation mechanism that was introduced in 2019 ensures that retail fuel prices remain at cost recovery and that the budget is unaffected through regular quarterly adjustments to reflect changes in world oil prices and movements in the exchange rate.

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The long-awaited SME (small and medium-sized enterprise) law was approved. Under the new law, approved in August 2020, the government will grant tax and custom incentives to the micro, small and medium-sized enterprises (MSMEs) sector. MSMEs will be given preferential tax rates ranging from 0.5 to 1.0 per cent according to the volume of their revenues, and will be excluded from stamp duty taxes and fees for registration of articles of association for five years. The law includes a range of tax exemptions for MSMEs, and provides support in securing land and credit, and in marketing their goods and services. Companies will be entitled to exemptions from stamp duty and fees for company registration, land contracts and credit agreements for five years from the date of their registration and will not be liable for capital gains tax. The law will also create a special income tax regime for MSMEs. One of the key advantages cited for the new law is that it would help MSMEs to gain better access to credit, as the process of formally registering these businesses for tax purposes would make it easier for banks to make risk assessments.

The Sovereign Fund Law and the Public Enterprises Act have been amended. The amendments, approved by parliament in June 2020, provide value-added tax refunds to any company that is more than 50 per cent owned by the Sovereign Fund of Egypt (SFE) and its sub-funds, and limits the scope of legal action that can be taken against the fund, shielding the SFE and its co-investors from third-party lawsuits. The Public Enterprises Act amendments reclassify listed companies in which the government holds up to a 75 per cent stake and brings them within the scope of the Companies Act, introduces a cap on board compensation, and puts in place new regulations requiring SOEs to provide evidence that their subsidiaries are economically viable.