

# EGYPT ECONOMIC DEVELOPMENTS: FADING MOMENTUM & CONFIDENCE?

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# Outline

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**Context:** A prolonged political transition is coming to an end at a time where currency pressures are intensifying & global conditions worsening

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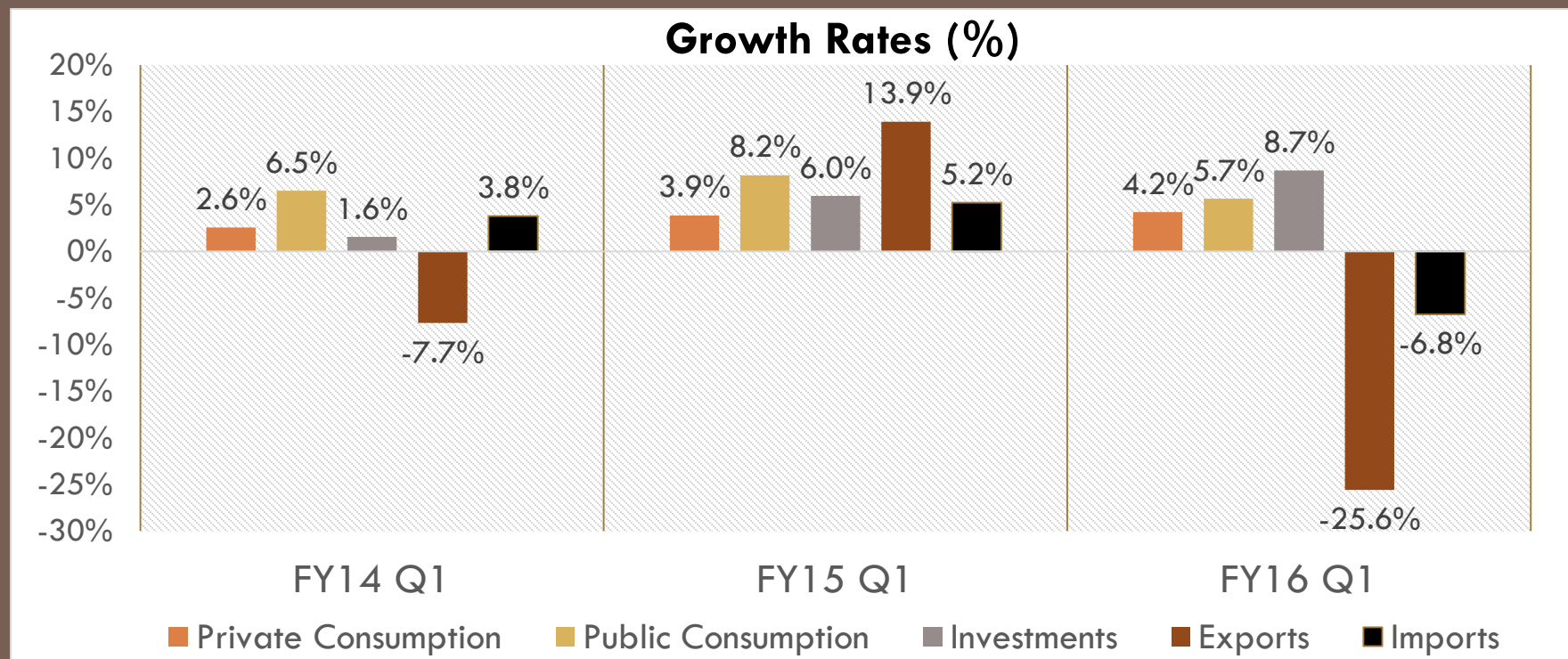
A newly elected House of Representatives convened in Jan. 2016 after 3 years of absence; regaining the legislative power and having the ability to endorse and/or reshuffle the Cabinet

Inadequate FX supplies and capital restrictions are binding constraints facing businesses and affecting confidence levels

Unfavorable global and regional conditions pose additional downside risks; need to be mitigated

# Egypt's Latest Economic Developments: *Growth decelerated on the backdrop of underperforming net exports*

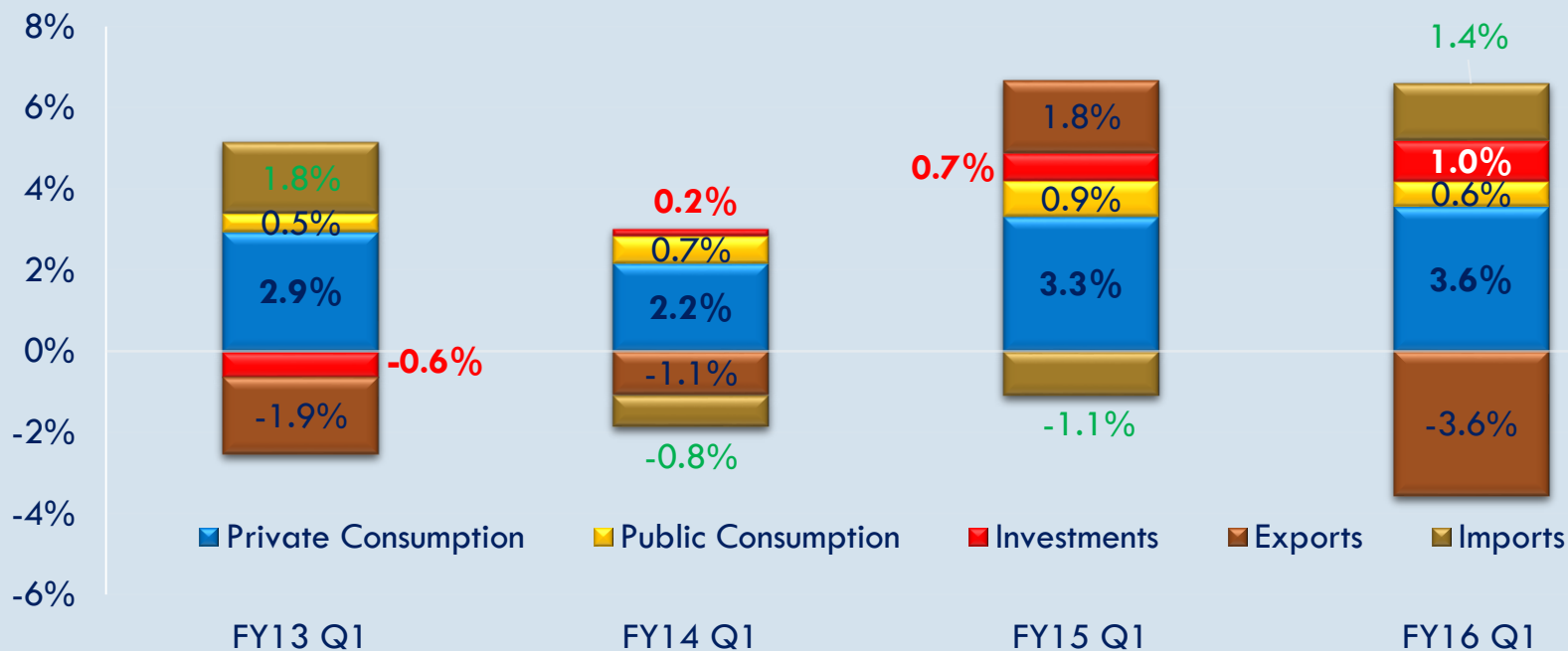
- Growth reached 3% in first quarter of FY16, compared to 5.6% in the first quarter of last year
- Growth reflects: resilient private consumption and higher investments (primarily public but also private), however net exports continue to be a key drag (due to drop in exports)



# Egypt's Latest Economic Developments: *Growth decelerated on the backdrop of underperforming net exports*

- Holding everything else constant, growth could have surpassed 5% in first quarter of FY16 if net exports stabilized in real terms (recorded neutral contribution)
- Strong growth will need to be maintained in the second half of FY16 in order to achieve projected growth for the whole year.

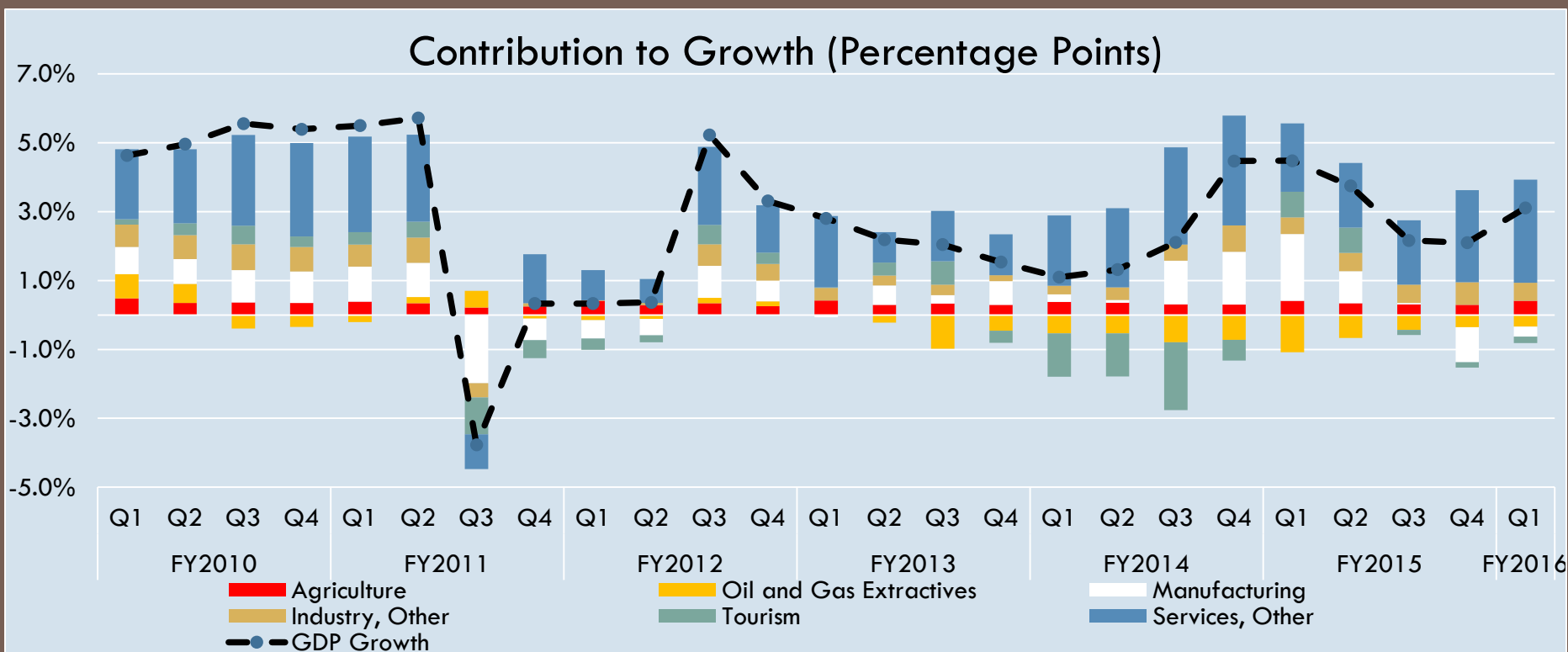
**Contribution to Growth (Percentage Points)**



## 2 Egypt's Latest Economic Developments: *manufacturing and exporting sectors are constraining growth*

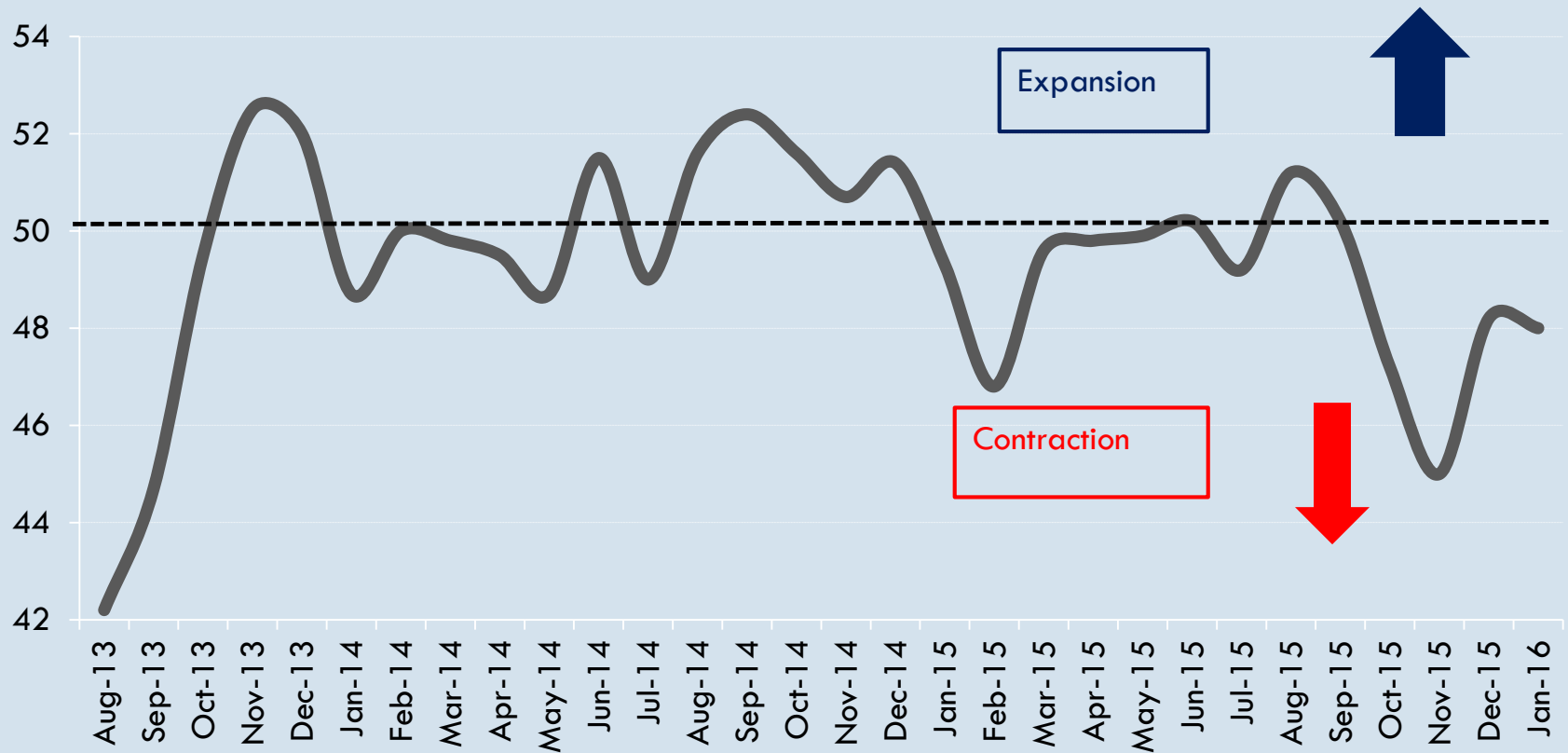
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- Services continue to be the main driver of growth despite deteriorating tourism
- Extractive industries remains a major drag on growth, yet its negative contribution is shrinking
- Manufacturing sector declined in real terms for the second quarter in a row



**Jean-Paul Pigat, Senior Economist at Emirates NBD :** “January’s survey represents a marginal slowdown from December, with the export sector appearing to be the main source of weakness. We expect economic activity to accelerate in the coming months, with our forecast for real GDP growth in FY 2015/16 at 3.9%.”

**Egypt Purchasing Manager Index (PMI)**  
Readings above 50 indicate an improvement in non-oil business conditions while readings below 50 indicate a deterioration

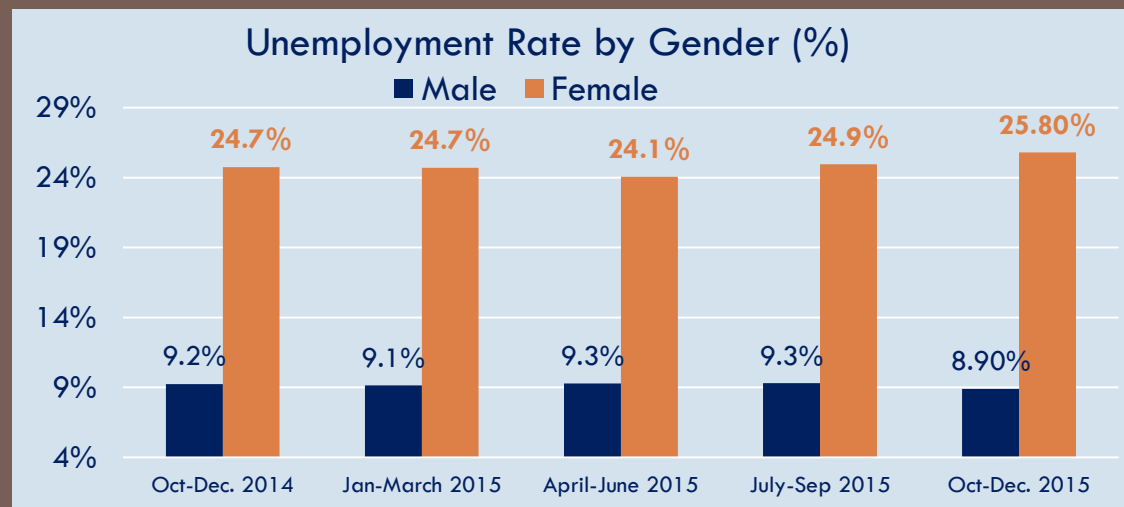
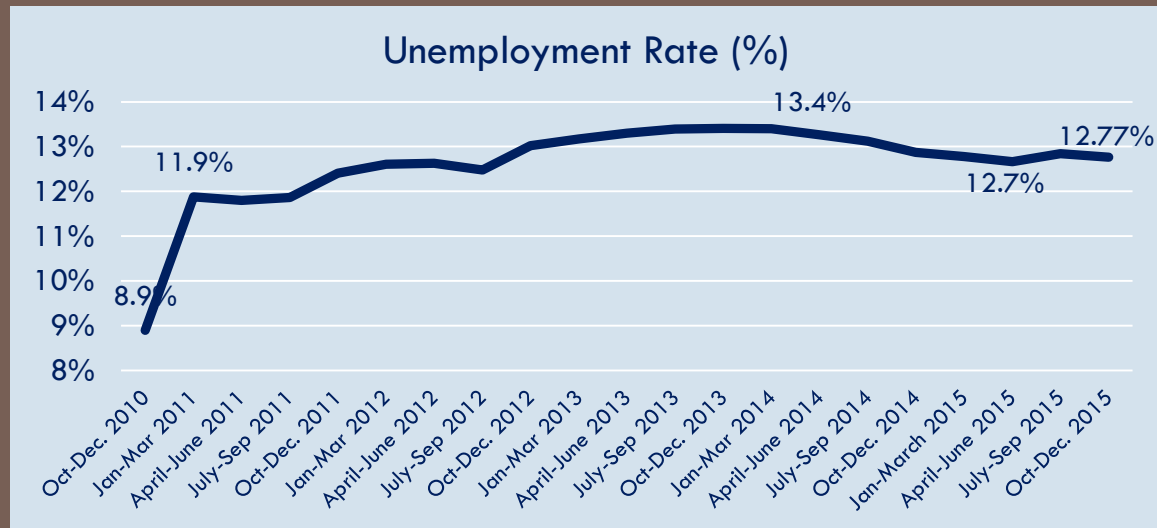


Source: Emirates NBD and Markit.

## 2 Egypt's Latest Economic Developments: *Unemployment stabilized recently, reversing a short-lived declining trend recorded in FY15*

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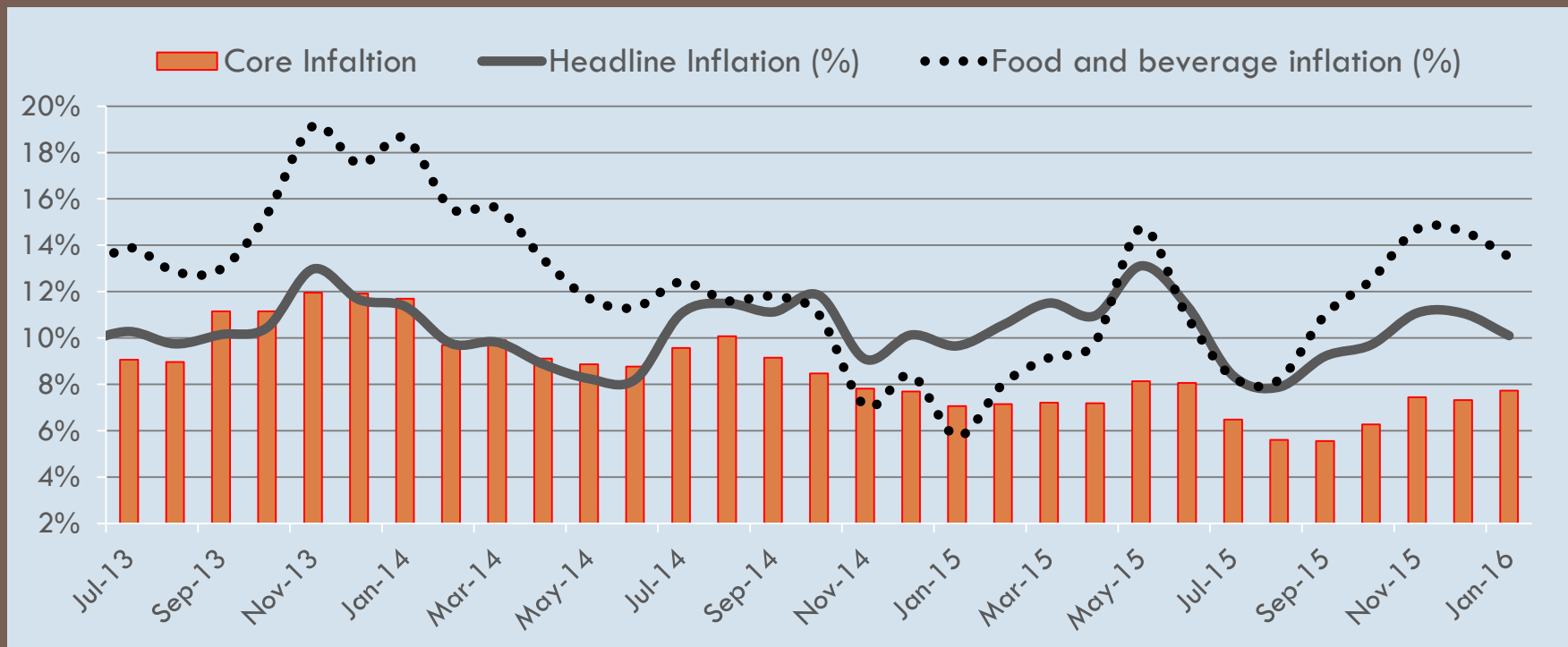
- Unemployment inched up slightly in July-Dec. 2015
- The Male-Female difference remains above 15 percentage points
- With recent measures aiming to control/limit public sector hiring, the private sector has to lead employment generation
- **Challenge:** can the private sector fill the gap and create adequate formal jobs ?



Source: CAPMAS

# Egypt's Latest Economic Developments: *Inflation remains persistently high despite declining commodity prices*

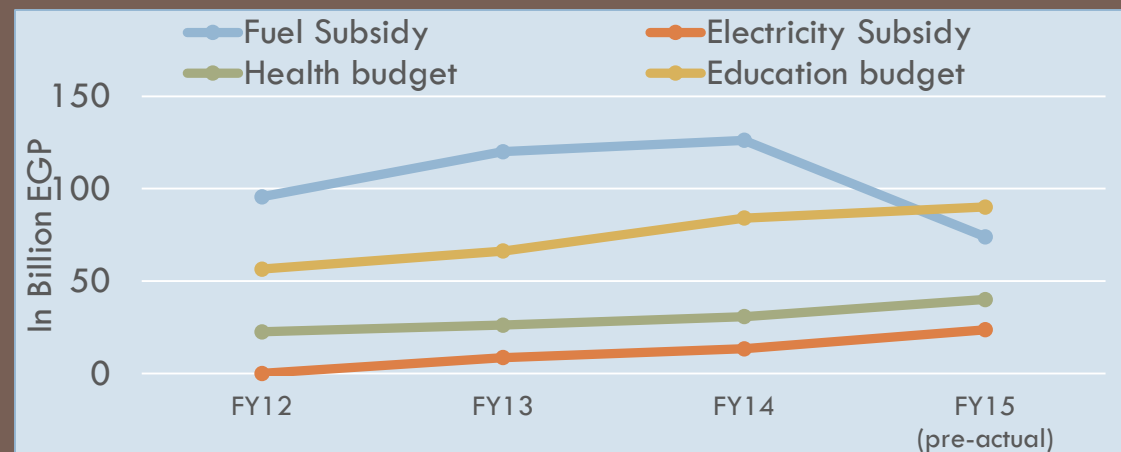
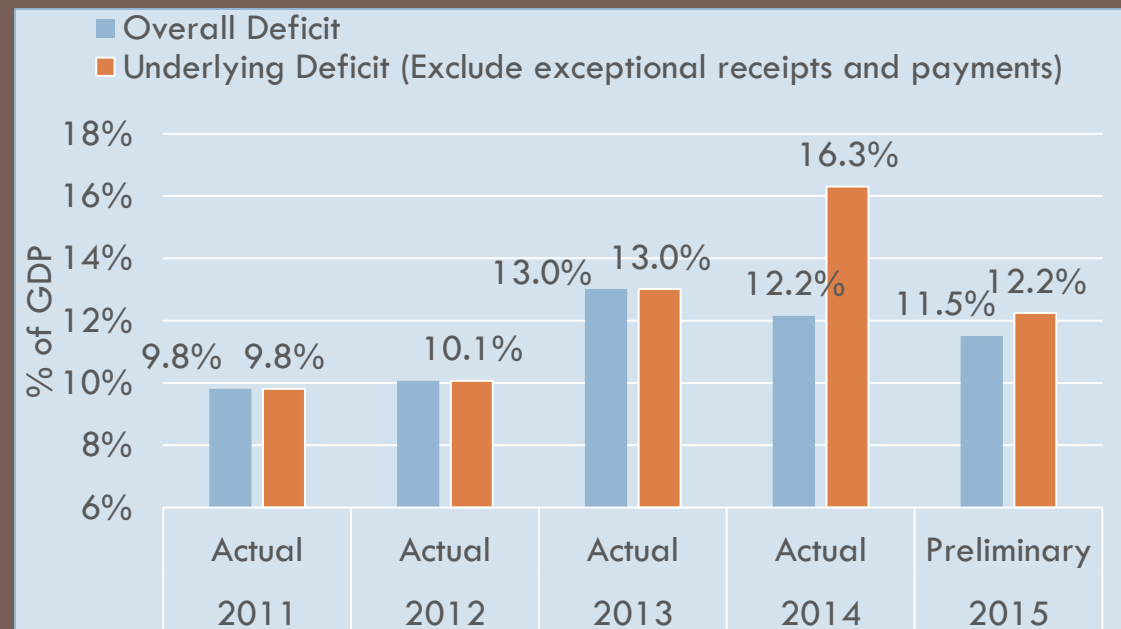
- After a short-lived period of declining prices in H1 of 2014, annual inflation started to pick up and remained mostly in double digits
- Recently the higher inflation reflects : supply bottlenecks, weaker pound in the parallel market, as well as pick-up in food prices (especially fruits and vegetables).



## 2 Egypt's Latest Economic Developments: *The fiscal situation improved in FY15, yet the outlook remains worrisome*

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- Bold fiscal consolidation measures adopted early in FY15 partially reversed the setbacks of the previous years' populous measures.
- Fiscal consolidation in FY15 reflects primarily contained expenditures (wages and subsidies).
- For the first time, the education budget surpassed that of the fuel subsidy in FY15.



# Egypt's Latest Economic Developments: *Fiscal consolidation is constrained by the delay in implementing reforms & excessive debt servicing.*

## Budget Sector Performance: Summary of Fiscal Outturns

LE Million

	July- November			
	2014/2015	2015/2016	Percent change (y-o-y)	% of GDP
<b>Revenues</b>	<b>126,102</b>	<b>160,108</b>	<b>27</b>	<b>5.7</b>
- Taxes	91,593	112,726	23	4.0
-Grants	666	2,729	310	0.1
- Other revenue	33,843	44,652	32	1.6
<b>Expenditures</b>	<b>231,804</b>	<b>289,435</b>	<b>25</b>	<b>10.3</b>
- Wages and compensation of employees	79,607	84,878	6.6	3.0
- Purchases of goods and services	8,693	10,251	17.9	0.4
-Interests	68,383	96,287	40.8	3.4
- Subsidies, grants, and social benefits	43,625	60,575	38.9	2.2
- Other expenditures	18,856	21,112	12.0	0.8
-Purchase of non financial assets	12,640	16,332	29.2	0.6
Cash Deficit	105,701	129,327	22	4.6
Net Acquisition of Financial Assets	2,217	9,149	313	0.3
<b>Overall Deficit</b>	<b>107,918</b>	<b>138,476</b>	<b>28</b>	<b>4.9</b>
<b>Primary Deficit</b>	<b>39,536</b>	<b>42,189</b>	<b>7</b>	<b>1.5</b>

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## Egypt's Latest Economic Developments: Monetary policy has been accommodative so far with M2 growing at high pace

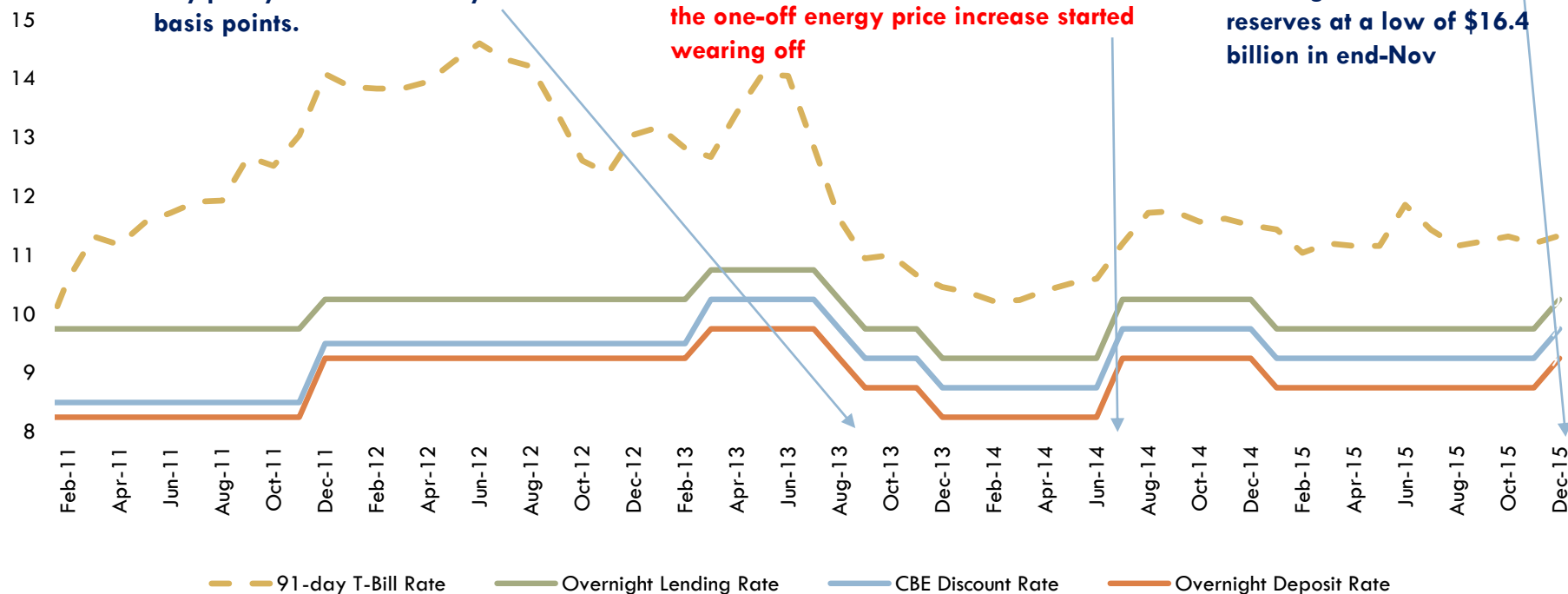
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- **CBE raised key policy rates in Dec. 2015** to curb inflation and support the exchange rate

Expansionary monetary policy Sept-Dec 2013, following the windfall of Gulf aid that helped ease foreign exchange and liquidity shortages. Key policy rates were cut by 150 basis points.

CBE undertook a one-off policy rate hike (by 100 bps) in order to curb inflationary pressures associated with the higher energy prices in July 2014. And then eased key rates in Jan 2015, as the one-off energy price increase started wearing off

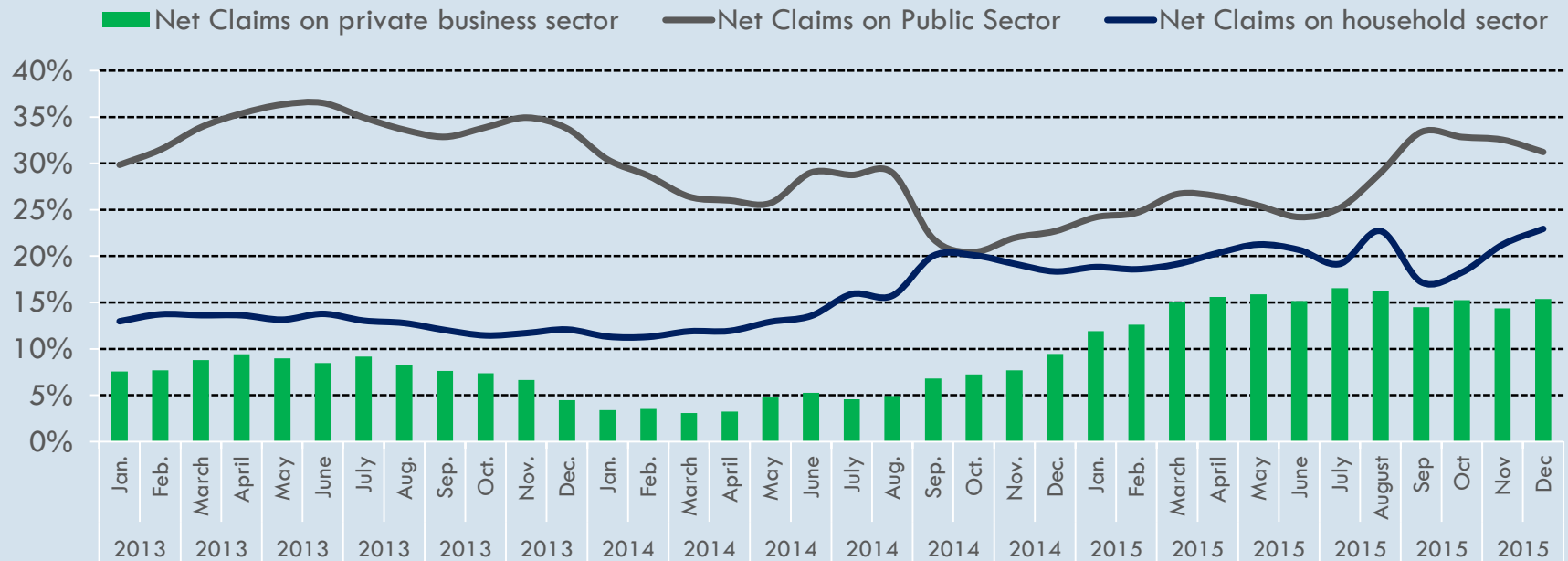
CBE raised key policy rates (by 50 bps) in Dec 2015 as inflation hit double-digits in November, and to support the exchange rate at a time when reserves at a low of \$16.4 billion in end-Nov



## Egypt latest Economic Developments: *Monetary policy has been accommodative so far with banks resuming their non-gov. lending*

- Banks are channeling additional credit to the private and households sectors, signaling improved confidence, and pick-up in credit demand by firms to resume their CAPEX and expansions
- However, lending to government remains highly elevated (growing at double pace of private sector) due to high deficit and borrowing needs.

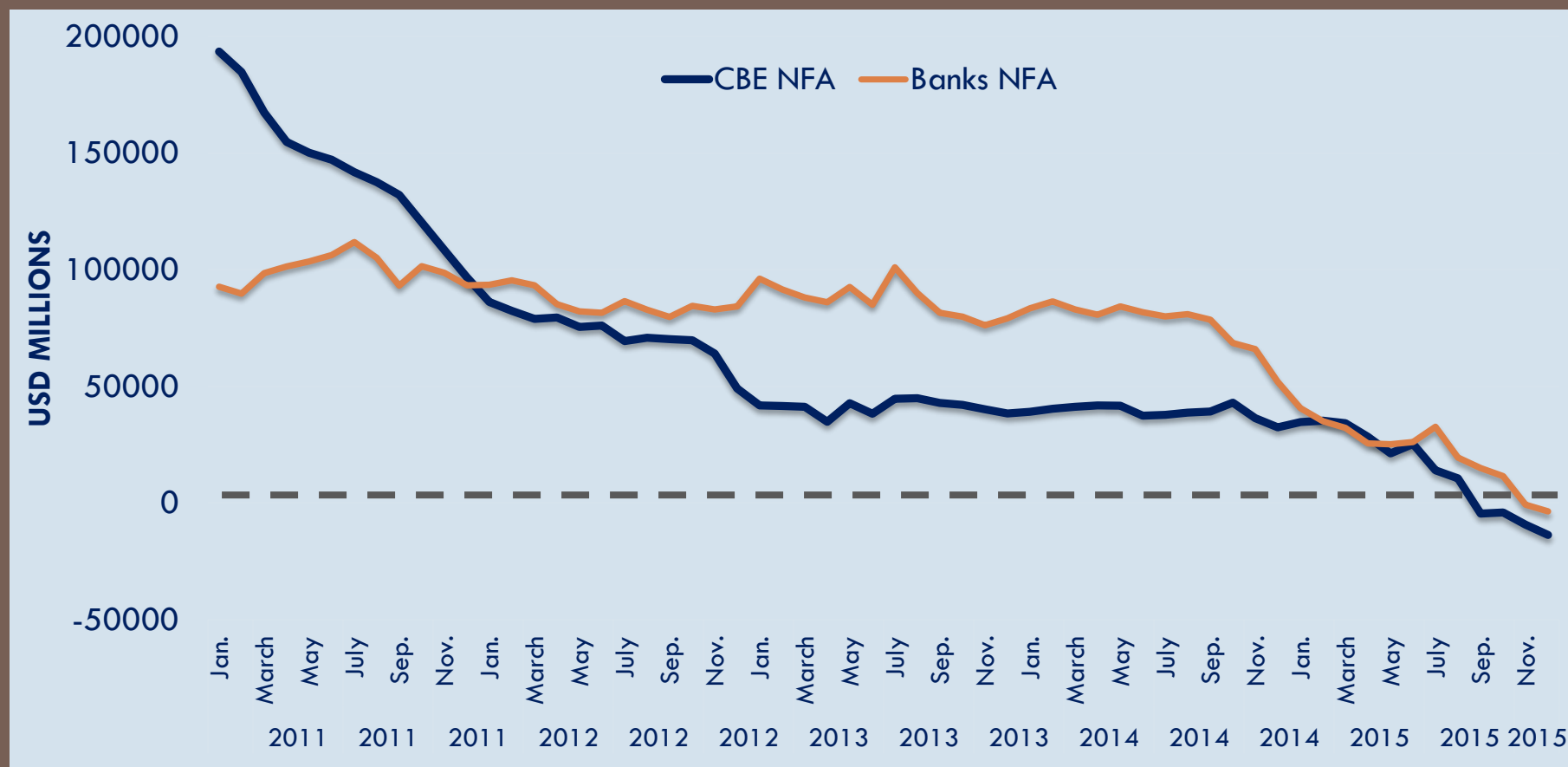
**Credit to Key Economic Agents (Annual growth rate)**



## Currency challenges & weakening of FX resources had led to the depletion of the banking sector net foreign assets

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- Both the Central Bank of Egypt and Commercial Banks operating in Egypt recorded recently (for the first time in 2 decades) net foreign liability position.



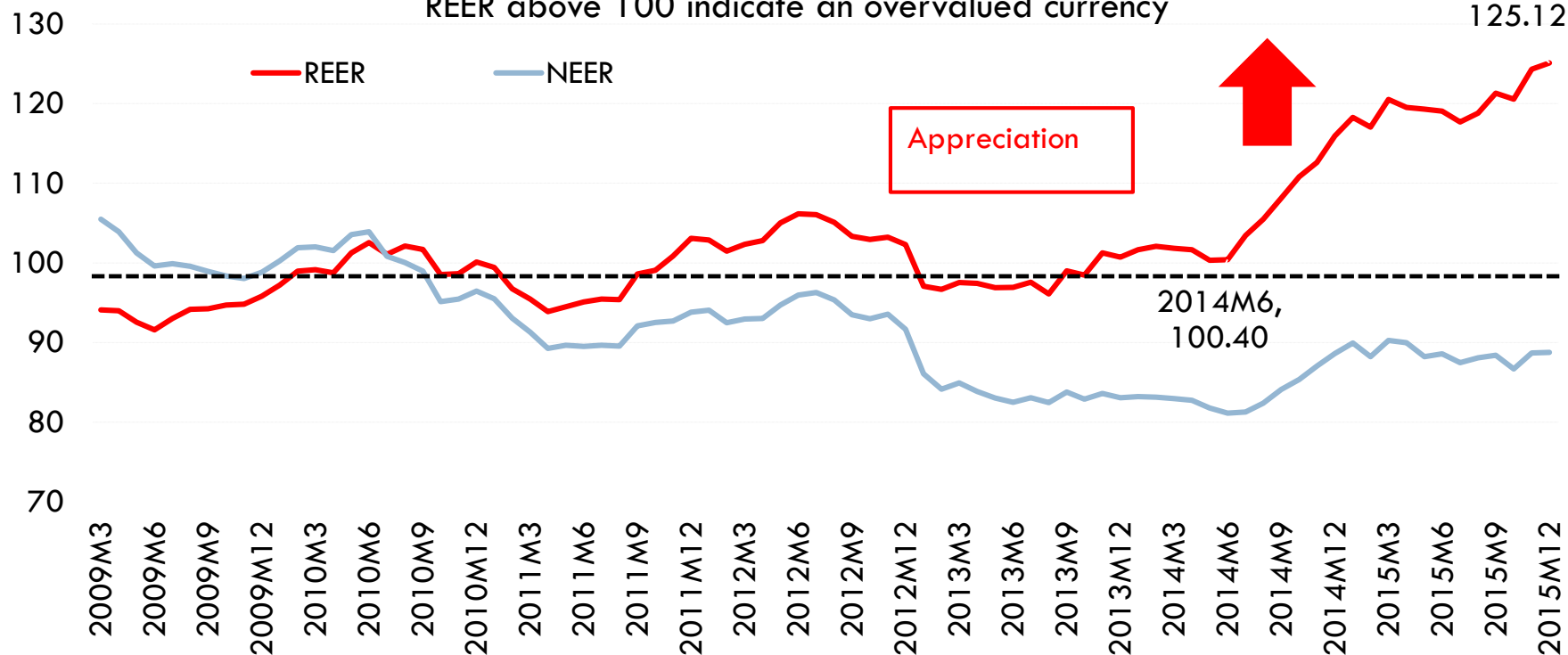
# Exchange rate trends suggest appreciating currency (REER) & declining competitiveness

- The Pound was on average fairly priced in real terms against USD during FY11-14
- The ER appreciated by 25% in real terms since beginning of FY15

## Egypt: Nominal and Real Effective Exchange Rate Indices

(Index 2010=100 , US\$ per Pound)

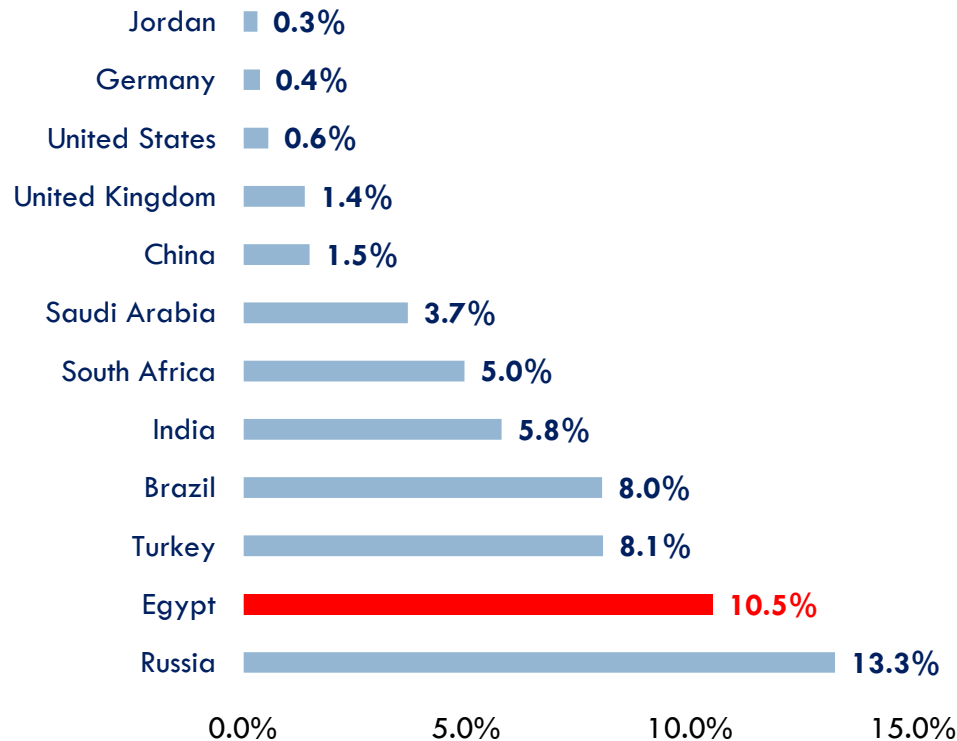
REER above 100 indicate an overvalued currency



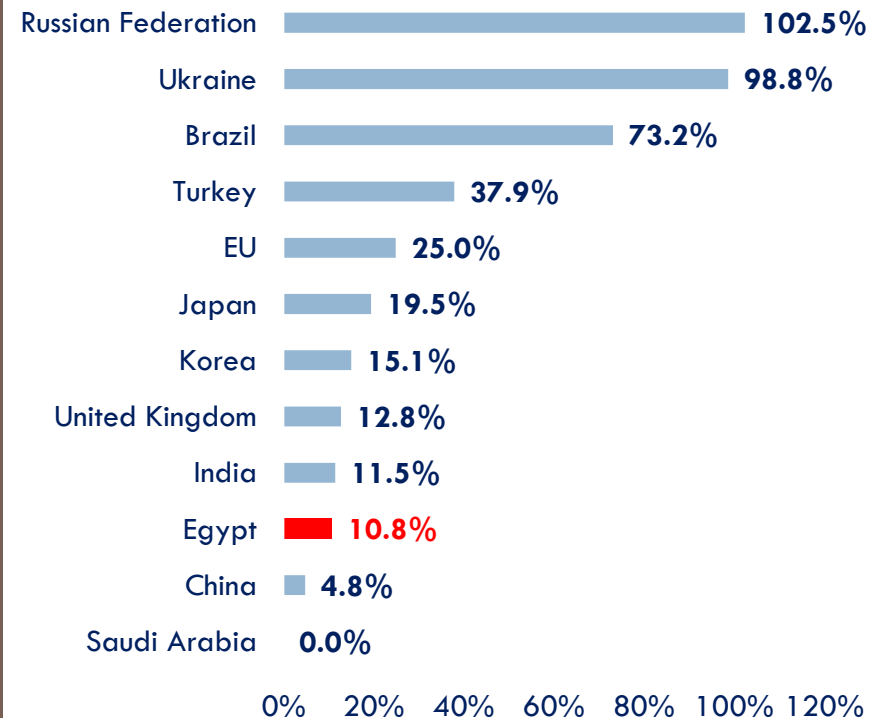
# Egypt RER is appreciating due to higher inflation relative to trading partners, strengthening of USD, and rigid exchange rate management

- Egypt recorded high inflation differential with key trading partners, while its NER versus USD depreciated marginally versus rates recorded by key EM and trading partners.

**Average Inflation (July 2014- Dec 2015)**



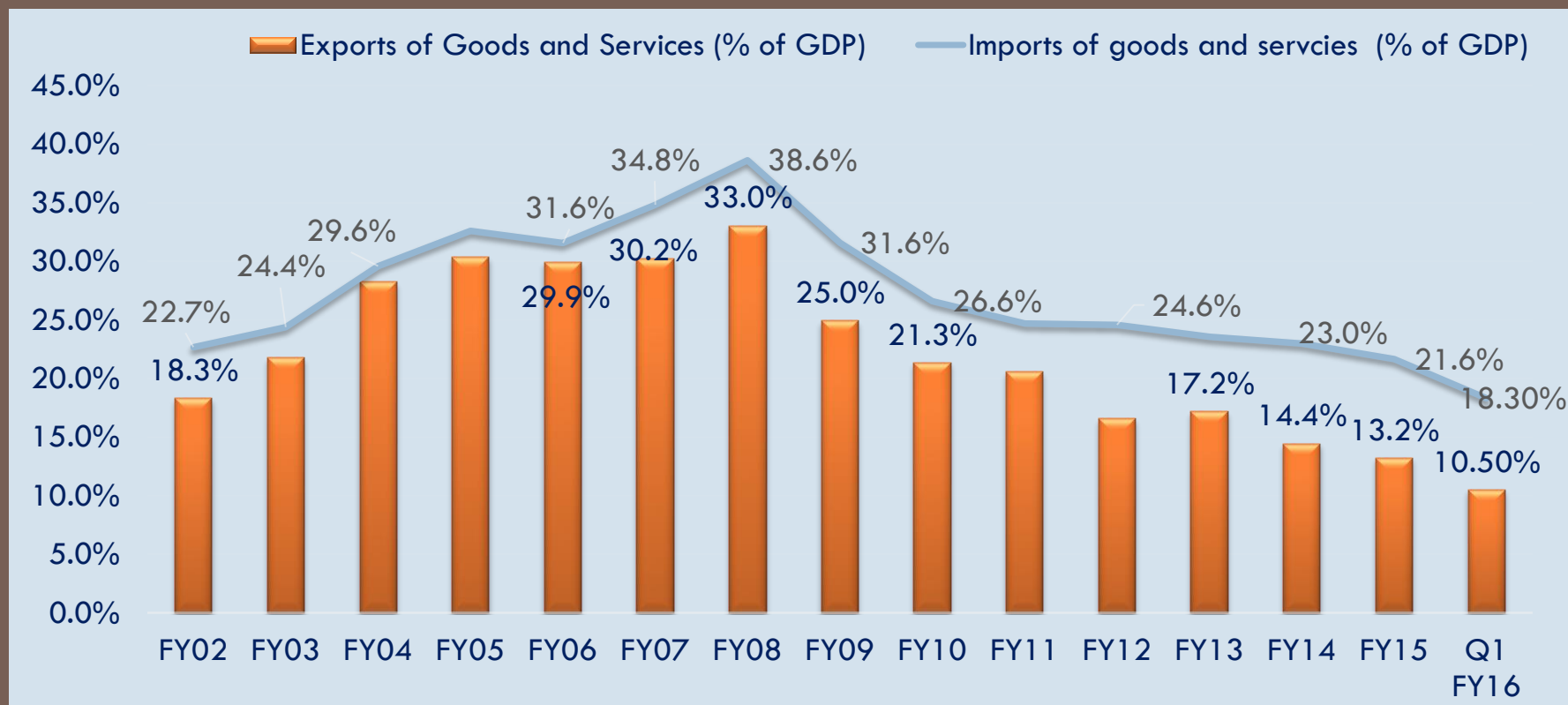
**Depreciation of Exchange Rate against USD (July 2014-Dec 2015)**



## 2 Egypt's Latest Economic Developments: *Trade gains realized during the previous decade have been eroded*

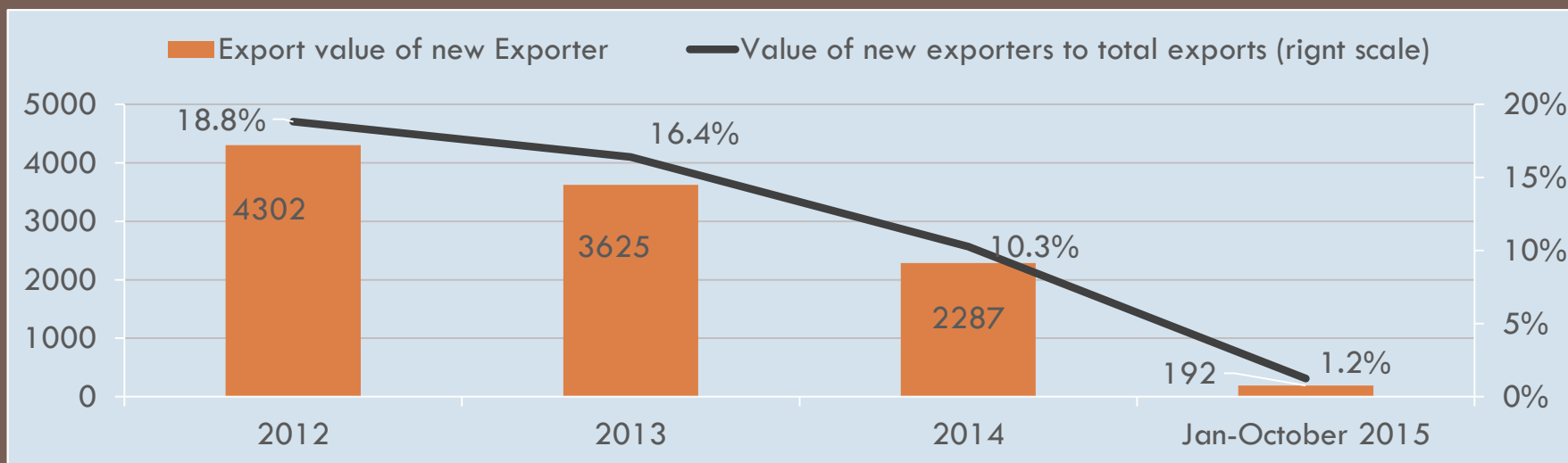
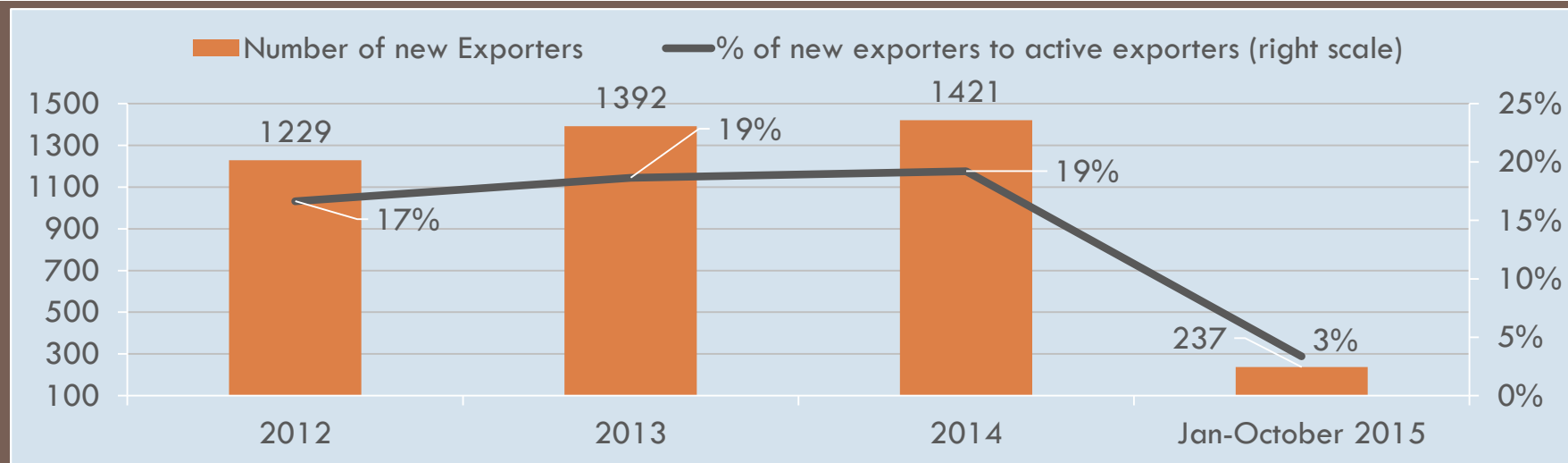
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- During July-Sep 2015, the share of imports and exports of goods and services to GDP reached their lowest levels in more than 15 years.
- Trade deficit as share of GDP declined to 7.8% in Q1 of FY16 versus average of 8.4% in FY15 and almost 9% in FY14; this is primarily due to stable oil-trade deficit in nominal terms.



## 2 Egypt's Latest Economic Developments: *Export sector is losing dynamism with new (mostly small) exporters suffering the most.*

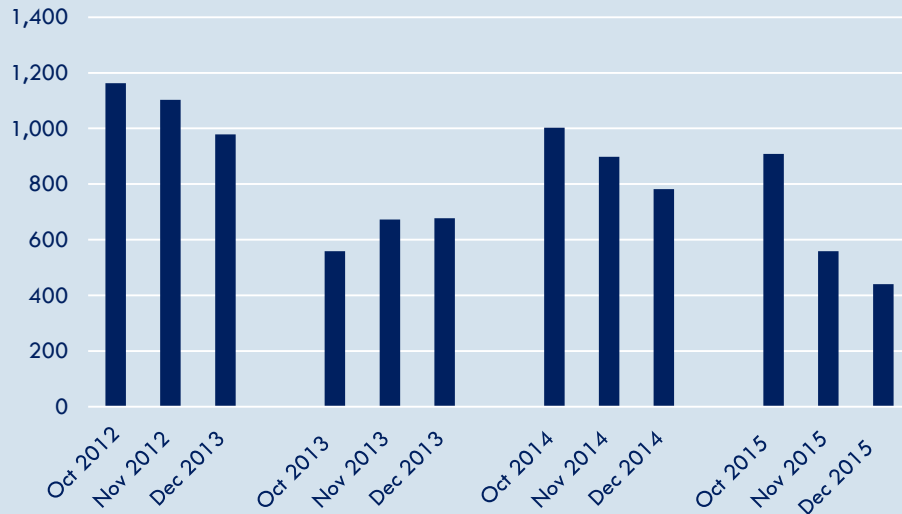
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# Egypt's Latest Economic Developments: *The tourism sector has been hard hit*

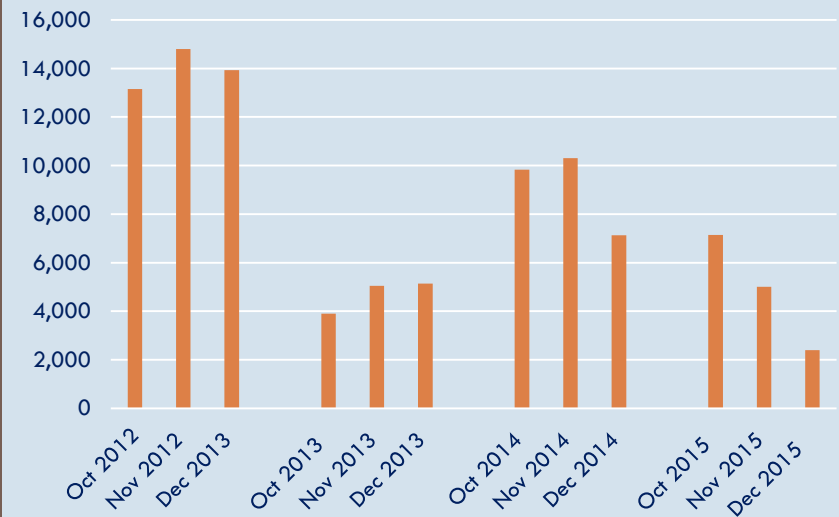
- **The tourism** sector has been hard hit in light of recent terrorist attacks; tourist arrivals are down by almost 30% year-over-year during Oct-Dec 2015 and tourist nights by 47%.
- This has notable repercussion for economic activities, employment and foreign earnings.

Tourist arrivals (in thousands)



Source: CAPMAS.

Tourist nights (in thousands)

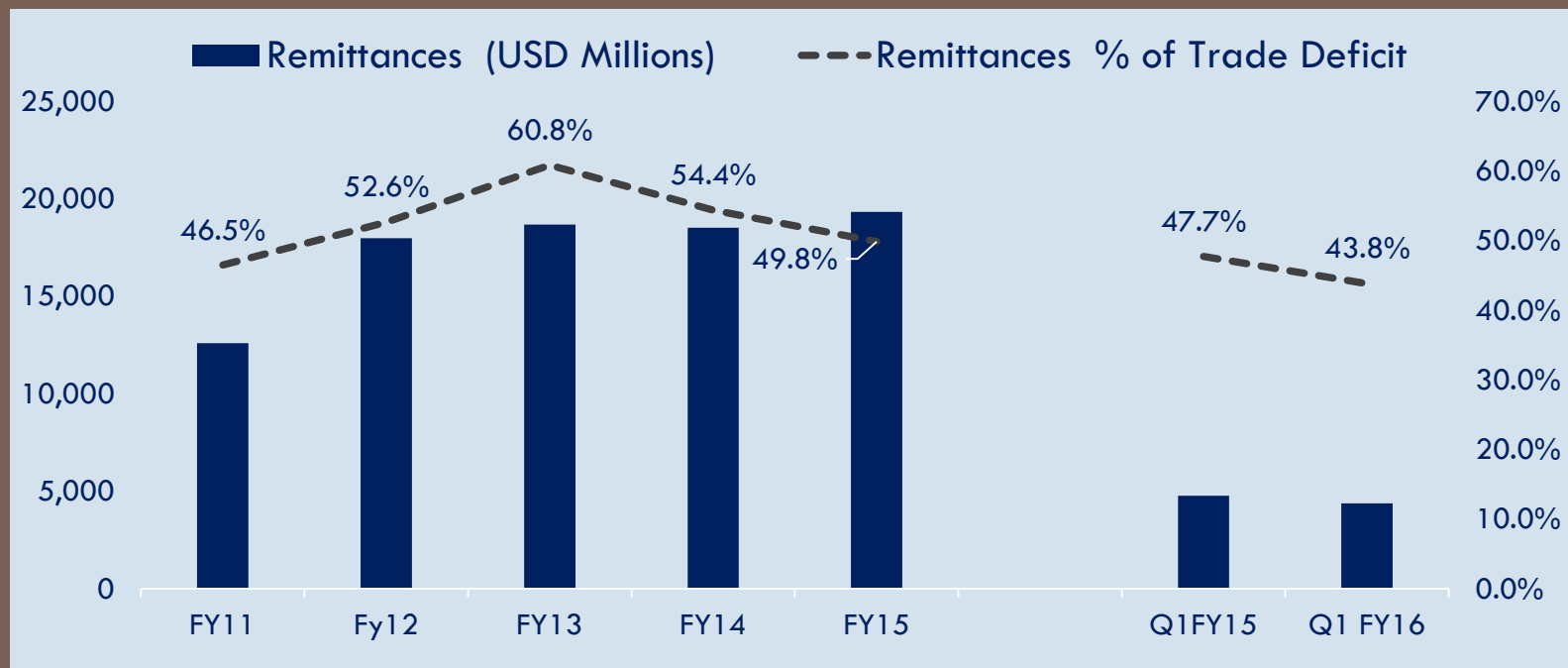


Source: CAPMAS.

# Egypt's Latest Economic Developments: *Remittances declined in Q1 of FY16 after showing resilience for 4-years*

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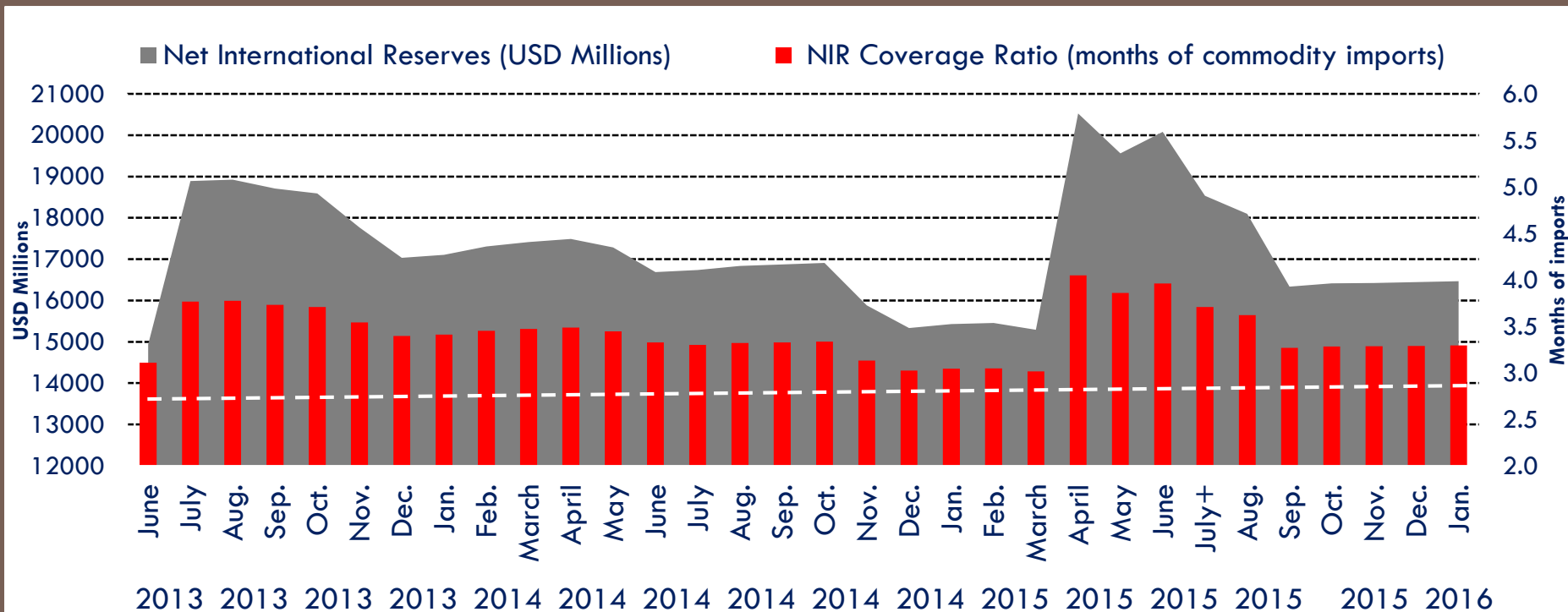
- Remittances is a major source of financing Egypt's trade deficit
- Two third of Egypt's remittances originates from Arab countries with around 50% of remittances coming from GCC countries
- This could be a source of concern, given the notable decline in oil prices, projections of subdued prices over the medium-term, and regional turmoil (especially in Libya)



Source: Central Bank of Egypt

# Egypt's Latest Economic Developments: NIR reached low levels and *forex availability through banks continue to be limited*

- NIR stabilized at \$16.4 bn. since end-Sept. 2015; at that level CBE policy options are limited
- FX shortages and capital controls are yielding welfare losses (output losses) and distortions (persistent black market and decline in competitiveness)



### 3 Egypt's Latest Social Developments: *High poverty rates, with gender and regional disparities.*

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- **Social indicators in Egypt point to dismal conditions:**
  - High Poverty Rates (Latest official estimate 26.3%; with poverty rates reaching 50% in rural Upper Egypt)
  - Inequality is not very high (Gini of 0.30). However, this mainly reflects the dampened welfare of the highest income brackets, rather than improved prosperity amongst the less privileged
  - More recent poverty data are not yet available, however following are the upside/downside factors to the poverty outlook

*Note: Figures here are based on CAPMAS data for FY13; not necessarily comparable to previous years' estimates.*

## Egypt's Latest Social Developments: *Social protection programs are being revamped*

- The government, with the Bank's support, has launched in Mar. 2015 a new conditional and unconditional cash transfer programs (*Takaful and Karama*).
- The Government is rolling out the programs over three phases, covering in total 1.5m families/beneficiaries by end 2017. **As of today some 170 thousand beneficiary are enrolled in both programs**
- Geographical targeting as well as a Proxy Means Testing (PMT) are conducted for screening applicants (to reduce leakage).
- Conditionality under the Takaful program will comprise semi-annual health growth monitoring of children under 5 and participation in health/nutrition awareness events for families with children under 6; and 80% school attendance for families with children aged 6-18.

## Egypt's Latest Social Developments: *Social protection programs are being revamped*

- The government is reforming the **food subsidy system** that suffered severe leakages in the past (around 73% of non-poor Egyptian households have access to food ration cards).
- Around 22 million smart card holders (almost 70 million beneficiary) and the number of subsidized commodities reached 20 items, yet this heavily depends on the location. Urban areas have much more available commodities than rural areas due to better storage and refrigerating capacity together with easier logistics.
- Key features of the new system:
  1. A quota of 5 loaves of bread for each individual daily.
  2. A shift from subsidizing commodities to an allowance based system.
  3. Unused bread turned into points and used to purchase other subsidized goods.
  4. Each citizen is entitled to a monthly allowance of EGP15, and is free to buy any product from a basket of 20 food commodities.

## Egypt's Latest Social Developments: *Social protection programs are being revamped*

- A Healthcare Program for the Poor has been launched recently (January 2016).
- .... to provide free comprehensive health to the poor targeted according to three parameters:
  1. - *Recipients of social solidarity pension (1.5M families);*
  2. - *Dwellers of the poorest villages (1,153 villages in 10 Governorates); and*
  3. - *People below the poverty line.*

# Egypt's Economic Outlook is dependent primarily on policy choices and the external environment

## Economic Outlook:

- Real growth is expected to slowdown to 3.8% in FY16 versus 4.2% in FY15; growth can underperform if key constraints (ER distortions and FX supplies crunch) are not timely and adequately addressed
- Prices projected to remain at high single digits in the short-term (mixed forces at play including price adjustments, demand pull factors, tightening of monetary policy, and supply bottlenecks)
- Overall fiscal deficit is likely to gradually improve to about 10.5-10.7% of GDP in FY16 versus 11.5% of GDP in FY15; this is predicated on the implementation of VAT in Q3 of FY16
- BoP and the current account are projected to record deficits in FY16 due to widening trade deficit of goods and services (primarily reflecting sluggish exports)

## Key Challenges:

- Currency availability and RER appreciation (binding constraints at the moment) .
- Steadfast reform implementation and efficient SSNs.
- Ability to invest and save more.
- Security conditions at home and in the region.
- Adverse spillovers from weakening global growth, tightening financial conditions and heightened risk aversion.

# Egypt's Economic Outlook is dependent on policy choices and the external environment

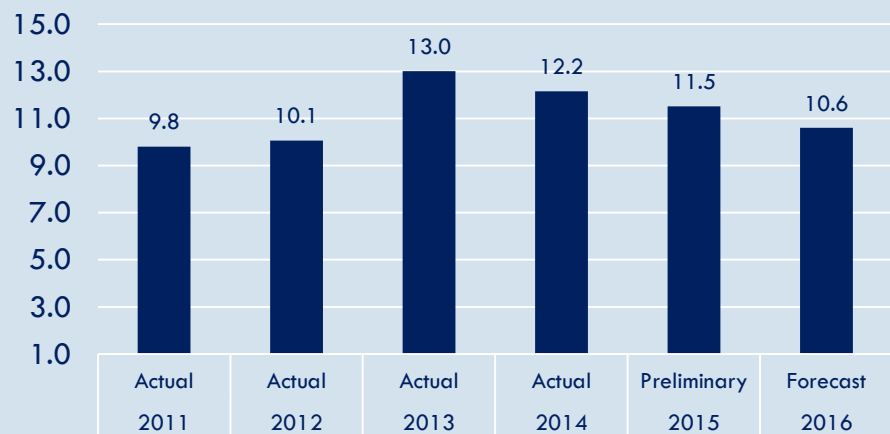
## Real GDP Growth Rate (y/y)



## CPI Annual Inflation Rate (Period Average, y/y)



## Overall Budget Deficit (% of GDP)



## Overall Balance of Payments (% of GDP)

