Egypt Country Brief

Since the appointment of a reformist Government in July 2004, Egypt has embarked on a reform path. The reforms have been sustained until now (until the global crisis) and the Government has established a solid track record as one of the champions of economic reforms in the Middle East and North Africa region (MNA).

Key reforms implemented over the last years include:

(i) Improved exchange rate management, building on the floating of the Egyptian pound and currency depreciation of 2003-04;
(ii) Reduction in import tariffs to a weighted average tariff of 6.9 percent (which puts Egypt at the lower end of the international trade tariff scale);
(iii) Rationalization of the tax system, including reduction of tax rates (highest corporate and personal rate is now 20 percent down from 32 to 40 percent) and improved tax administration (number of taxpayers rose from 1.7 million in 2004 to 2.5 million in 2006);
(iv) Improvements in budget management and controls (e.g., introduction of a single treasury account);
(v) Restructuring of the financial sector, to gradually disengage the State; and
(vi) Enhancement of the business environment

These reforms have also improved the ease of doing business. Egypt is among the world's 10 most active reformers for the fourth time based on the Bank's 2010 "Doing Business" rankings. The country moved up to 106 from 116 among 183 economies worldwide in the overall ease of doing business ranking. Egypt made business start-up less costly, expedited the construction permit process, expanded the information available from the private credit bureau, and created commercial courts to speed up contract dispute settlements.

Against the backdrop of a positive external environment, Egypt experienced high economic growth in FY06-FY08 (about 7 percent on average). This economic growth was broadly based, with non-oil manufacturing and wholesale trade contributing to about half the overall total, and with construction, the Suez Canal, communications, and tourism among the fastest growing sectors.

Household surveys indicate that the reforms have had a positive effect on reducing poverty. Social indicators have improved dramatically over the last decade (e.g., between 1995 and 2005, infant mortality and malnutrition among under-5 children both decreased by half, and life expectancy increased from 64 to 71 years). The economic growth of the last years has improved outcomes and living standards of the vast majority of the population, although in an uneven manner. Yet, about 18 percent of the population still live below the poverty line (up to 40 percent in rural Upper Egypt), and about 20 percent of the population have moved in or out of poverty over the last few years, heightening a sense of social vulnerability and insecurity. Additionally, the food price crisis and the fuel price shock that led to higher inflation, plus the slowdown in economic activity due to the global financial crisis reversed some of the gains achieved in previous years.

The country is entering a period of parliamentary and presidential elections scheduled for 2010 and 2011.

Recent Economic Developments

The global economic slowdown had an adverse impact on Egypt during FY09. Real GDP growth fell to 4.7 percent in FY09 from 7 percent a year earlier and unemployment increased to 9.4 percent from 8.4 percent. Declining export earnings led to a current account deficit (of 2.3% of GDP) for the first time since FY01 and declining capital inflows, especially FDI (down by 39%), led to an overall BOP deficit of 1.8% of GDP compared with a 3.3% surplus a year earlier. The stock market index fell 20 percent from its FY08 close. Inflation has decelerated from a peak of 24 percent August 2008 but continues to be high at around 10 percent currently.

The Government implemented a crisis response plan featuring fiscal, monetary and direct support measures. Fiscal stimulus came in the form of additional spending of 15 billion Egyptian pounds, including higher subsidies and social benefits (up by 2.1 points to 12.4 percent of GDP). On the monetary side, the Central Bank of Egypt cut policy rates five times between February and July 2009, taking overnight deposit and lending policy down by 300 and 350 bps respectively. In FY10, the Government continues to implement a variety of measures to support growth. First, on the fiscal side, two new stimulus packages are being implemented in FY10, one in the amount of LE8 billion that was included in the FY10 budget and another in the amount of LE10 billion that was subsequently added. These packages add up to 1.5 percent of GDP. Second, the Government has decided to keep prices of energy products for non energy-intensive industries unchanged through June 2010. Third, a customs duties exemption on capital goods has been extended for another six months, also through June 2010.

Currently, a growth recovery is under way. Real GDP grew 5.3 percent in FY10, up from the 4.7 percent in FY09, but still below the rates recorded during the boom of 2005-08. Quarterly data show that growth was picking up steadily (up by 5.8 percent in the last 2 quarters) on the back of resilient domestic consumption and a substantial fall in imports. There has also been robust activity in sectors such as construction, tourism and communication. Yet, the recovery has not been rapid enough to significantly affect unemployment rate (down to 9.1 percent in March 2010 from 9.2 percent a year ago). Inflation has subdued, but remains at double-digit levels (down from 16.5 percent in FY09 to 11.5 percent in FY10), driven mainly by food price increases.

The fiscal deficit widened as a consequence of the slowdown and the corresponding fiscal stimulus. After six consecutive years of improvement, the budget sector fiscal deficit (the narrow definition) posted the largest increase in FY10 to reach 8.3 percent of GDP (almost LE100 bn), well above the 6.9 percent in FY09. The increase in the deficit was driven by a sharp fall in revenues (down by 4.8 points to 22.4 percent of GDP) which exceeded the decrease in expenditure (down by 3 points to 30.7 percent of GDP). Most of the revenues' fall is attributed to non-tax revenues (down by 3.1 percent of GDP). While income taxes fell by 1.2 percent of GDP (due solely to corporate tax revenues) and indirect taxes by 0.5 percent of GDP; property taxes increased by 0.4 percent of GDP. Except for interest payments (up by one percent of GDP), all expenditure lines fell, especially the contribution of the government in insurance funds (social benefits) and subsidies which fell by 2.4 and 1.1 percent of GDP. Public investment spending declined to 4 percent of GDP from 4.2 in FY09, yet still higher than the three previous years (ranging between 3.4 and 3.8 percent of GDP), reflecting the moderate size of the fiscal stimulus in FY10 (at most one percent of GDP).

The external position remains robust. Driven by lower imports, the trade deficit declined in the first 9 months of FY10 (to 8.6 percent of GDP from 10 percent a year ago). This more than offset the decline in the services surplus, narrowing the current account deficit to 1.2 percent of GDP (from 1.8 percent). Strong net portfolio inflows (3 percent of GDP after 3 years of net outflows) turned the overall external balance positive (surplus of 1.4 percent of GDP). Egypt's net international reserves increased to US$35.3 billion at the end of July 2010, up from US$31.6 billion a year ago. Finally, external debt continued to decline as a share to GDP (to 14.8 from 17 percent between March 2009 and March 2010).

World Bank Group Assistance

The World Bank Group has scaled up its support to Egypt over the recent period, with a comprehensive program of activities by IBRD, IFC, and MIGA. This effort is geared towards supporting the implementation of the ongoing reform program in a rapidly-growing Middle Income Country. The Bank is working on a Country Partnership Strategy with the Government this fiscal year for the period 2012-2015.

The current IBRD portfolio includes 17 ongoing projects (commitment value of about $3.4 billion of which about $2.8 billion still to be disbursed). The sectoral distribution of these projects (by value) is as follows: infrastructure (63%); financial sector (19%); agriculture (14%); and social sectors (4%).

IBRD is also providing substantial knowledge services, including through an expanded program of fee-based technical assistance, in particular in following areas: (i) assessing the expected macroeconomic impact of the crisis and possible stimuli; (ii) SME finance and savings; and (iii) health insurance and poverty monitoring.

Egypt is one of the IFC's two largest exposure countries in MENA region with a total committed portfolio of US$842 million for 35 projects as of August 2010. The portfolio is diversified and includes investments in the financial, infrastructure, oil and gas, agribusiness, manufacturing and health care sectors. IFC has a large program of Advisory activities which complement its investment program. During the last few years, Advisory activities have been scaled-up focusing on simplifying business start –up procedures, SMEs, corporate governance and providing transaction advice for public-private partnerships (PPPs).

MIGA does not have any exposure from guarantees in Egypt. However MIGA does retain $78.3 million in outstanding gross exposure for an Egyptian investment in support of a mobile communications project in Bangladesh. The project supports one of the pillars of the Agency's strategy which is to foster south-south investment.

All dollar figures are in US dollar equivalents. **Updated September, 2010**

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