

# Egypt:

## Economy

September 2015



# EGYPT

## SUMMARY

### Violence and political delays

The terrorist violence that has struck Egypt over recent months has escalated over the early summer of 2015. In late June Egypt's chief prosecutor, Hisham Barakat, one of the leading forces in the country's crackdown on dissenters against the current regime, was killed by a car bomb. In July an organisation affiliated to Islamic State killed 35 people in a series of attacks on military posts in the Sinai. The potential for unrest arising from both geopolitical tensions and internal politics could undermine stability. The murder of 38 tourists in Tunisia and the suicide bombing in a Kuwaiti mosque on the same day in June 2015 highlight the threat of Islamic violence. In February Egypt launched jets in a bombing raid in Libya on jihadi units accused of executing Egyptian Christians working in the country. Meanwhile the latest delay in parliamentary elections as a result of a ruling by the Supreme Constitutional Court is a reminder that the political transition that has been underway since the overthrow of ex-president Hosni Mubarak is still not complete. In a ruling in March 2015 the court said the laws on electoral constituencies and dual citizens running for election were unconstitutional and needed to be rewritten. The elections due to take place in April and May will not be held until after Ramadan in mid-July. Egypt has not had an elected legislature since 2012.

### Foreign investor confidence

Egypt's economic outlook was given a major boost at its Economic Development Conference in Sharm el-Sheikh in March. Representatives from more than 100 countries and CEOs from several leading firms attended the event and signed deals or memoranda of understanding estimated to cover almost \$50bn in terms of financial support for the government from Gulf countries and corporate investment deals. This follows strong endorsement by the International Monetary Fund in January 2015 in its first major assessment of the economy since the 2011 Arab Spring. The IMF praised the authorities for pursuing structural reforms, promoting investment and developing measures to protect the poor. "The measures implemented so far, along with some recovery in confidence, are starting to produce a turnaround," it said. In April 2015 the IMF raised its growth forecasts for the 2015-2018 period. However the latest speculation of a Greek exit from the eurozone could hit trade between Egypt and the EU.

### Inflation rises

The annual inflation hit a six-year high of 13.1% in May 2015, up from 11.1% in April, as food prices that make up 40% of the basket rose sharply. The food component of inflation rose from an annual rate of 9.8% in April to 14.8% in May. However analysts believe that the rise is temporary and will not lead to a rise in interest rates. Indeed in June the Bank of Egypt kept rates on hold at 8.75% for the third meeting in a row after taking the proactive step in January of cutting its benchmark interest rates by 50 basis points. Economists believe that the bank will lower rates again in the second half of 2015 once the spike in food prices recedes.

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## Economics forecasts

Subject Descriptor	Units	2013	2014	2015	2016	2017	2018
GDP, constant prices	% change	2.1	2.2	4.0	4.3	4.5	4.7
GDP, current prices	US dollars	271.4	286.4	324.3	365.9	408.0	461.4
GDP per capita, current prices	US dollars	3,205	3,304	3,723	4,120	4,504	4,993
Total investment	%, GDP	14.2	14.0	14.6	14.7	14.8	15.0
Inflation, average consumer prices	% change	6.9	10.1	10.3	10.5	9.7	9.3
Volume of imports of goods and services	% change	1.3	3.9	9.5	10.1	8.9	7.9
Volume of imports of goods	% change	-1.0	5.1	9.0	9.9	10.1	7.8
Volume of exports of goods and services	% change	8.1	-11.6	6.8	3.9	9.4	9.2
Volume of exports of goods	% change	5.8	-5.3	0.8	0.5	8.3	8.3
Unemployment rate	%, total labour force	13.0	13.4	13.1	12.5	11.8	11.0
Population	Millions	84.7	86.7	88.4	90.2	92.0	93.9
General government structural balance	%, potential GDP	-13.4	-13.0	-11.5	-9.3	-8.6	-8.5
General government gross debt	%, GDP	89.0	90.5	90.5	88.5	86.0	83.8
Current account balance	%, GDP	-2.4	-0.8	-3.3	-4.3	-4.5	-4.7

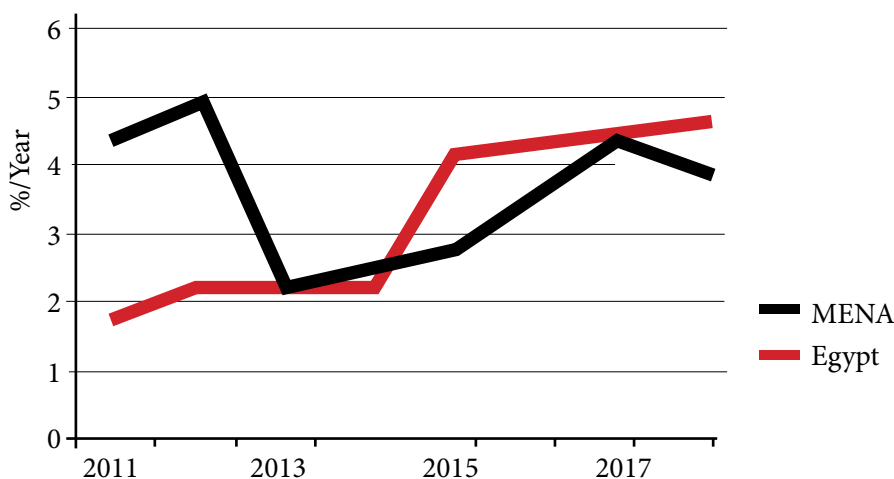
Source: IMF

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## GDP growth on track despite slowdown...

The pace of economic growth slowed in the final quarter of 2014 following the robust performance in the previous three months. The economy grew by 4.3% on an annual basis in the three months to December, following the expansion of 6.8% in the three months to September. However this left growth for the first half of the 2014/2015 fiscal year that began in July 2014 at 5.6%. This was a marked acceleration from the 3.7% GDP growth in the final quarter of the previous fiscal year. The finance ministry attributed the improvement to the government's reform measures adopted in July 2014 that aimed to improve the investment climate and curb unemployment and price rises. Growth now appears to be on a sustainable upward trend after three years of growth of around 2.0% in the wake of the Arab Spring. In April the International Monetary Fund upgraded its growth forecasts for 2016-2018 from below 4% to almost 5%.

## GDP Growth



Source: International Monetary Fund, World Economic Outlook database, April 2015

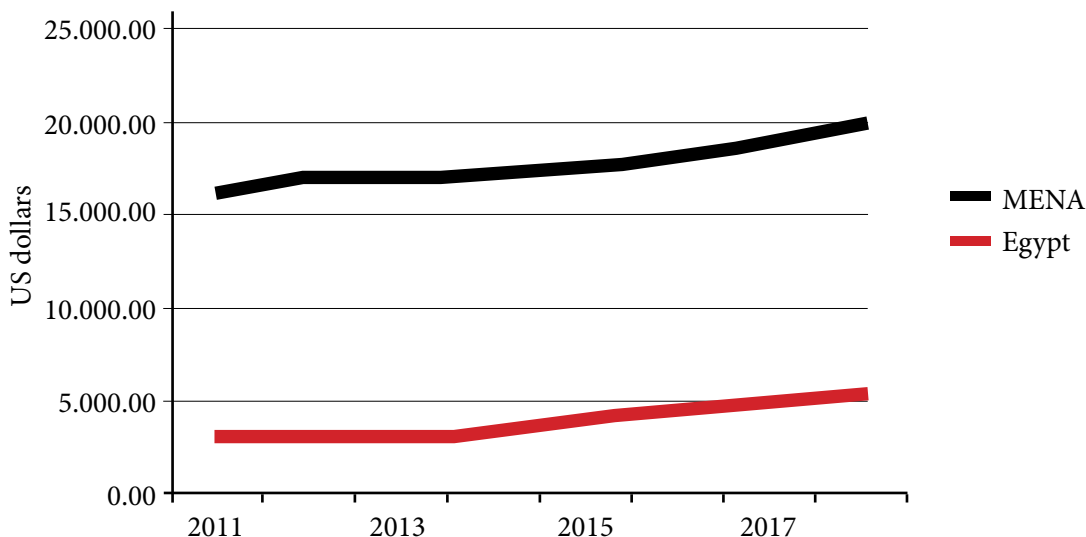
## ...as economic conference points to investor confidence...

The Egypt Economic Development Conference held in March 2015 indicated that investors had confidence in the medium term outlook. Representatives from 112 countries attended the event with 2,000 delegates including CEOs of multinational companies and senior officials from regional and international economic bodies. An estimated \$35bn of deals and memoranda of understanding were signed including British oil giant which signed an agreement to invest \$12bn to produce 3 billion barrels of oil equivalent and UK energy group BG saying it would invest \$4bn over two years. This builds on the benefits that Egypt gets from the sharp decline in oil prices since the middle of 2014 as a net oil importer. However GDP per capita continues to lag the region (Chart 2). It built on a solid base according to figures from analysts fDi Markets that showed that Egypt received almost \$3.8bn of inward investment from Gulf Cooperation Council countries in 2014, more than any other state worldwide.



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## GDP per capita, current prices



Source: International Monetary Fund, World Economic Outlook database, April 2015

## ...suicide attack and election delay dent political stability...

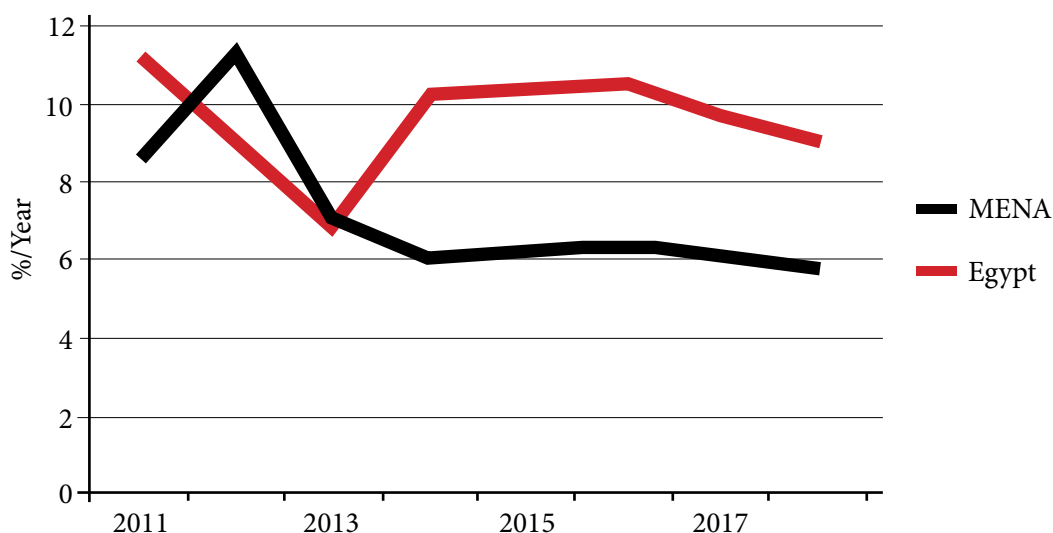
The political backdrop had improved since the chief of the armed forces, General Abdel-Fatah al-Sisi, ousted the country's elected Islamist president Mohamed Morsi. The government has initiated a series of reforms including: a reduction in energy subsidies; increases in public spending on education, health, and research; and the launch of a new cash transfer scheme and the reform of food ration cards. However the decision to delay the parliamentary elections again is a reminder that the political situation is still in transition. Furthermore a decision by a court in Cairo to uphold the death sentence imposed on Morsi over a prison breakout during the 2011 revolution attracted international opprobrium. The anger over this decision was highlighted by the assassination of the chief prosecutor, Hisham Barakat, in a car bomb in Cairo in late June 2015. Barakat has sent thousands of Islamists for trial since the overthrow of President Mohammed Morsi. A few days later, attacks by a group calling itself the Province of Sinai that has reportedly pledged allegiance to Islamic State killed 35 people in a series of attacks on military checkpoints and police stations in northern Sinai. These came just days after the murder of 38 foreign tourists in Tunisia in June 2015 and will severely heighten terrorism concerns. These attacks followed the suicide bombing in early June of the Karnak temple in southern Egypt, a key tourist destination, that injured four people.

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## Bank holds interest rates but further cuts expected...

Inflation hit a six-year high of 13.1% in May 2015, as prices of food accelerated sharply (Chart 3). The rise from 11.0% in April was driven by an acceleration in food inflation from an annual rate of 9.8% in April to 14.8% in May. Food accounts for 40% of the inflation measurement basket. Despite the spike in inflation the Bank of Egypt (BoE) decided to leave interest rates on hold in June for the third meeting in a row after its decision in January to cut its benchmark interest rate by 0.5 percentage points to 8.75%. Some analysts had expected another rate cut at the June meeting until the inflation rise made that impossible. However many expect the BoE to cut rates later this year if the food price rise proves temporary and the effects of last year's energy price hikes are set to unwind in July.

### CPI Inflation

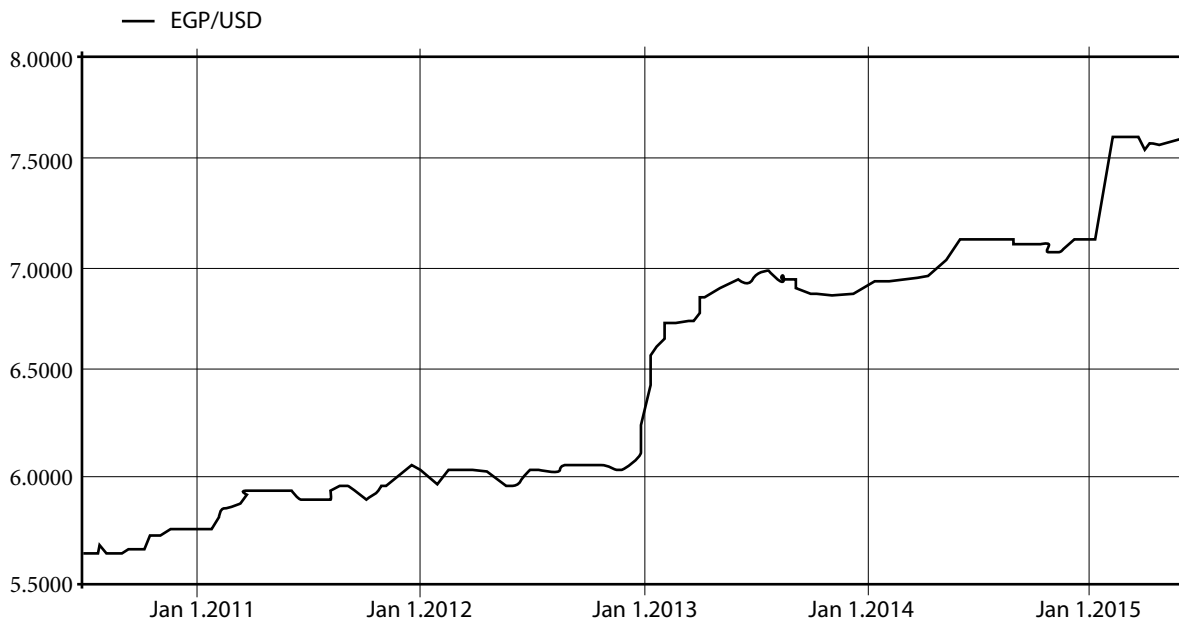


Source: International Monetary Fund, World Economic Outlook database, April 2015

## ...while authorities allow currency to depreciate

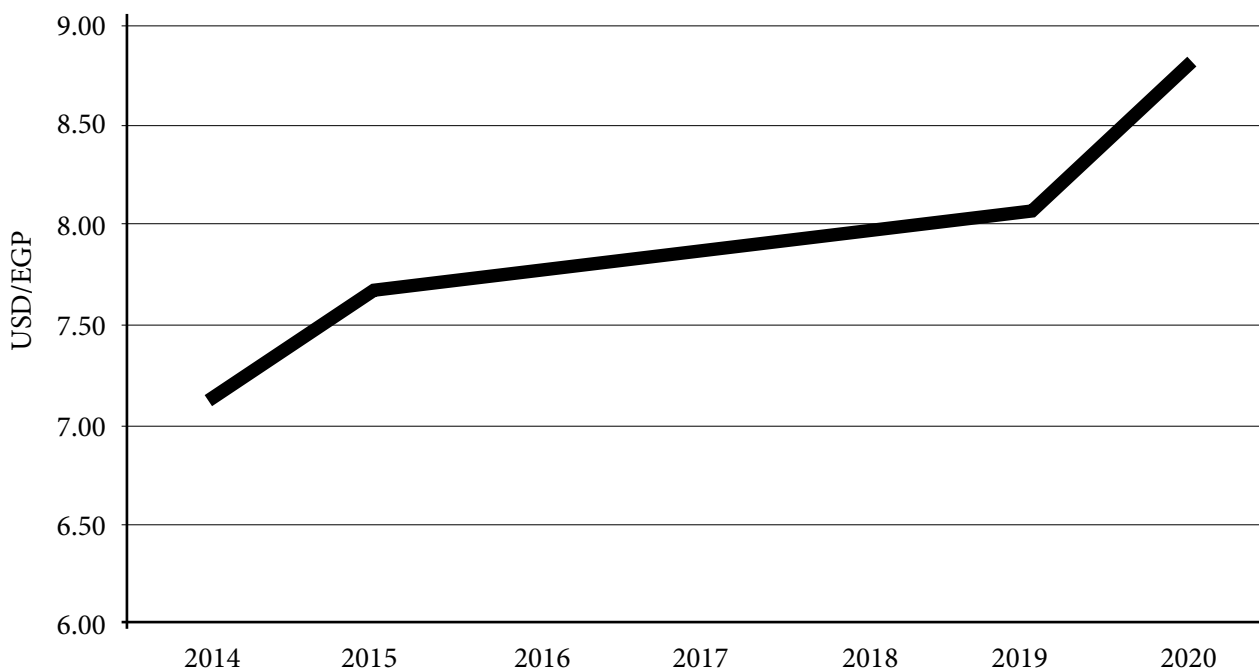
The central bank has held the official exchange rate unchanged for four months since letting the pound weaken at the beginning of 2015, when its value against the US dollar weakened from £7.15 at the beginning of the year to around £7.60 in February (Chart 4). At its June auction the BoE offered \$40m and sold \$37.8m at a cut-off price of £7.5301 per dollar. The unofficial exchange rate has been just below £7.70. The gap between the two rates has narrowed in the wake of the decision to allow the official rate to weaken and moves by the central bank to clamp down on unofficial transactions by capping on the amount of dollars that can be deposited in banks. The authorities are likely to allow the currency to weaken further over the coming five years to address concerns by foreign investors that the pound is overvalued. Forecasts from the Economist Intelligence Unit for nooz.com indicate a fall of some 17% to £8.81 by 2020 (Chart 5).

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Source: : [www.oanda.com/currency/historical-rates/](http://www.oanda.com/currency/historical-rates/)

### Exchange rate forecast



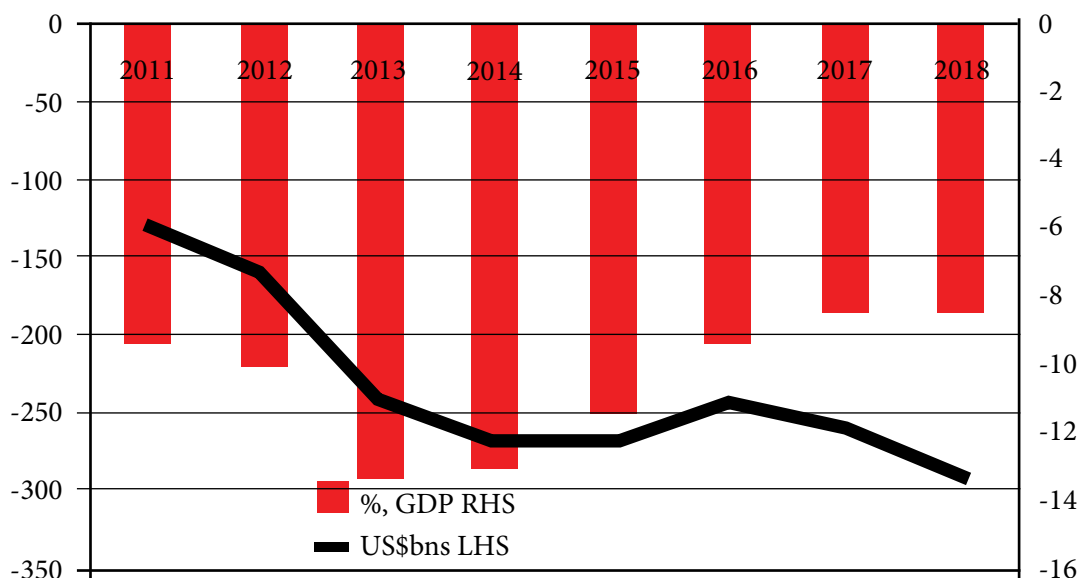
Source: EIU

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## Deficit and debt are still high...

The government finances received a separate boost from the March Economic Development Conference in the form of pledges of \$12.5bn in assistance from Egypt's allies in the Gulf Cooperation Council — \$4bn from each of the United Arab Emirates, Saudi Arabia and Kuwait and \$500m from Oman. This will meet the country's financing needs for the next 12-18 months against a backdrop of high debt and deficits. The government's fiscal consolidation plan aims to bring the budget deficit down below 8% of GDP by 2018/19 and reduce government debt to 80%–85% of GDP, and increase foreign exchange reserves to 3.5 months of imports, all within the next five years. The structural budget deficit is estimated to be 11.6% of GDP in 2014 down from 13.4% the previous year according to the IMF (Chart 6). Gross government debt is expected to remain high at just below 95% of GDP over the coming four years. Meanwhile fall in oil prices will benefit the government finances as Egypt spends around 7% of GDP on oil- and gas-based fuel subsidies.

## Government Budget Balance



Source: International Monetary Fund, World Economic Outlook database, April 2015

## ...and current account balance is in deficit...

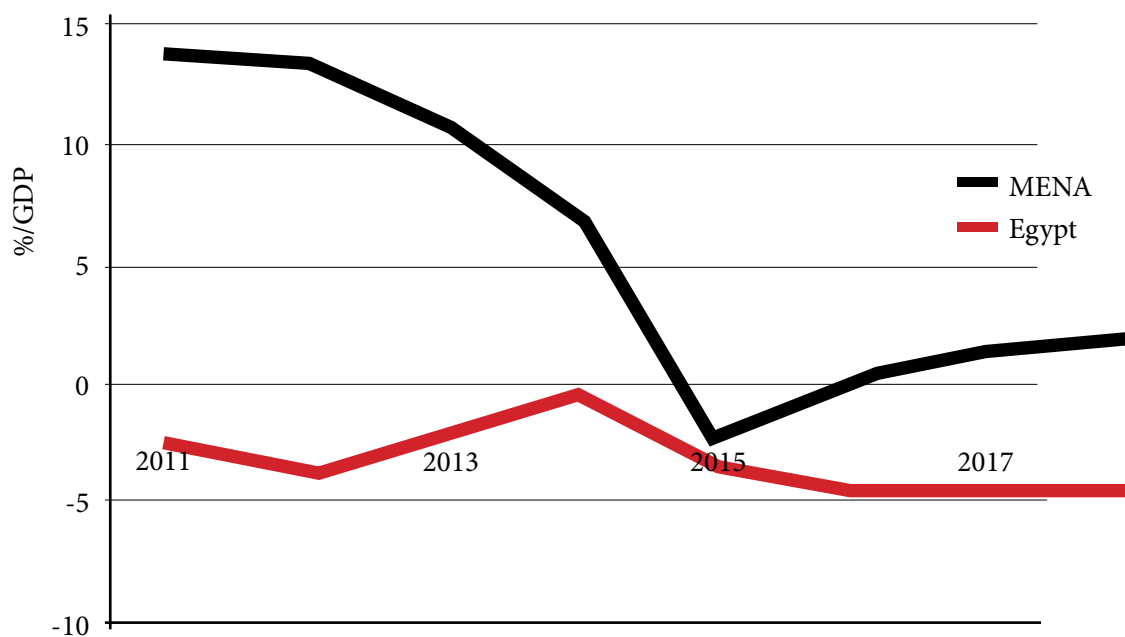
Egypt recorded a current account deficit of \$2.86m in the fourth quarter of 2014, its highest for two years and continuing a worrying trend. The underlying current account deficit widened massively in the 2013/14 fiscal year to \$14.3bn from the previous year's \$7.2bn (Chart 7). The main causes were a halving in tourist receipts in the wake of the overthrow of the government, which declined from \$9.8bn to \$5.1bn over the same periods, and a drop in non-oil exports below 5% of GDP. The impact was offset by \$20bn in Gulf aid in the form of grants, deposits, and oil shipments.



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Tourism has picked up but is vulnerable to continued tensions in Russia, which is a key market. Al-Sisi held talks with Vladimir Putin in February during the Russian President's two-day visit to Cairo. Remittances from overseas were flat at \$18.4bn in 2013/14 but are forecast to grow by 3-4% a year to 2018/19.

## Current Account Balance



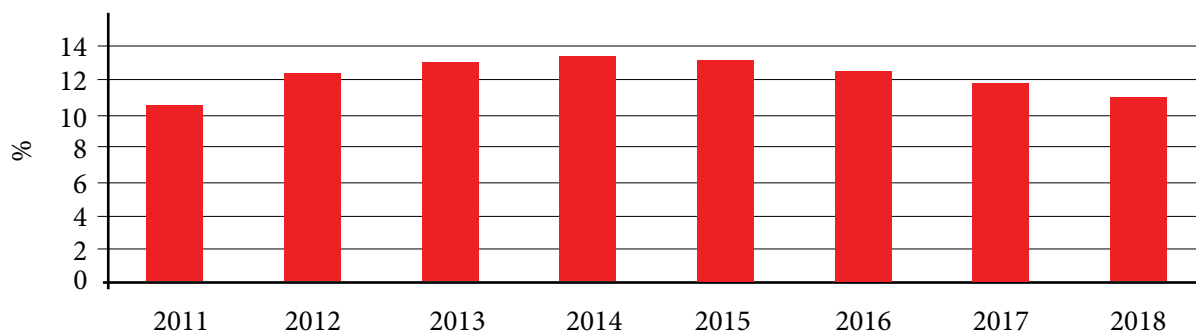
Source: International Monetary Fund, World Economic Outlook database, April 2015

## ...while the unemployment rate is high

The rebound in economic growth has translated into a fall in the unemployment rate, according to official figures. The jobless rate fell to 12.8% in the first three months of 2015, compared with 13.4% in the same period a year ago, the government statistics agency said. Unemployment has risen at a steady pace since the 2011 Arab Spring, when it was around 10%, to a peak of 13.4% in 2014 (Chart 8). The highest levels of joblessness are found among youth and women. The poverty rate rose to 26.3% in the 2012/13 fiscal year, with the IMF estimating another 20% of the population to be close to the poverty line. Al-Sisi has pledged to reduce the unemployment rate to 10% over the next five years. The government has taken action to create jobs and reduce unemployment but further rises in the jobless rate could add to social unrest.

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## Unemployment



Source: International Monetary Fund, World Economic Outlook database, April 2015

## Medium term outlook is upbeat...

In its first assessment of the Egyptian economy since the 2011 Arab Spring carried out in November 2014, the IMF said the policies aimed to reduce fiscal deficits, raise economic growth and create jobs had started to produce a "turnaround". The government is expected in August 2015 to inaugurate the \$8.6bn project to expand the Suez Canal to two-way traffic. The upbeat economic data for the second half of the 2014 calendar year appear to confirm that process is underway. The IMF is forecasting an acceleration in economic growth that will reach almost 5.0% in 2018. The World Bank has a similar outlook seeing growth at 4.0% in 2017. Inflation could decline faster than official forecasts if oil and food prices continue to fall. This could lead to further cuts in interest rates and a weaker currency.

## ...but risks are tilted downward

Egypt faces a number of downside risks. A deterioration in the political situation in the Middle East and continued tensions between Russia and the West over Ukraine could lead to a slowdown in global trade would affect Suez Canal revenues. Closer to home, the EU is Egypt's main trading partner thanks to a free-trade agreement in place and a Greek exit from the eurozone would have negative impacts for Egypt. The murder of 38 foreign tourists by a lone gunman in Tunisia and the suicide bombing in a Kuwait mosque in June 2015 have raised concerns about fresh Islamic State-inspired attacks across MENA countries. Meanwhile domestic instability around the parliamentary elections, and a weakening in the reform programme could deter investment. However there is potential for growth to surprise on the upside both from continued international and domestic stability and from the continued successful implementation of the reform agenda.