ARAB REPUBLIC OF EGYPT

Table 1	2018
Population, million	97.0
GDP, current US$ billion	242.8
GDP per capita, current US$	2503
Lower middle-income poverty rate ($3.2)[a]	16.1
National poverty rate[a]	27.8
Gini index[a]	30.0
School enrollment, primary (% gross)[b]	103.6
Life expectancy at birth, years[b]	71.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2016)

Macroeconomic stability improved, supported by fiscal consolidation, energy and currency reforms. Growth has been robust and broad-based. Private sector investment is picking up, albeit from low levels and remains hampered by the difficult business environment and tight monetary policy. Headline inflation still exceeds 12 percent and might face further upward pressure as energy subsidies continue to be phased out. Macro-financial vulnerabilities persist, due to the elevated debt levels and the country's exposure to emerging markets' turbulence.

Recent developments

Economic growth has been robust, averaging 5.3 percent in FY2017/18; a rate that was sustained through Q1-FY2018/19, driven by an expansion in the gas extractives, tourism, manufacturing, construction and ICT sectors. Private investment is picking up and net exports are improving. There is however evidence that non-oil private activities continue to be hampered by the cumbersome business environment, including non-tariff measures and poor institutional capacity at the borders that constrain trade. Consequently, job creation remains modest.

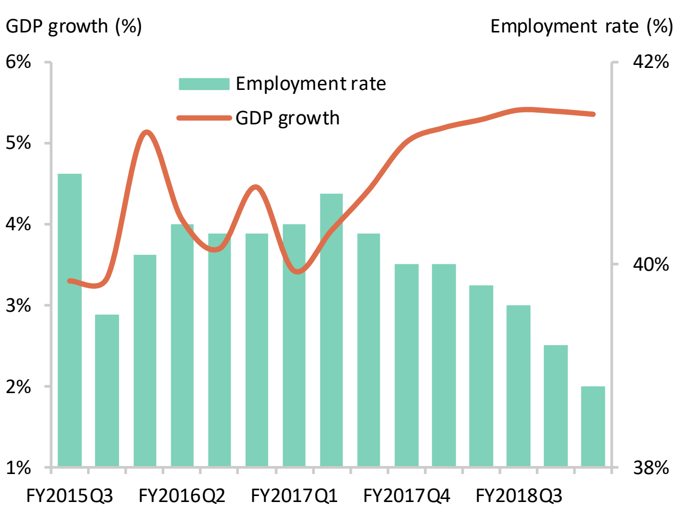
The tight monetary stance throughout 2018, manifested in positive real interest rates, has been a deterrent to private sector capacity expansion. During FY2017/18, the private sector and households received 23 and 8 percent of domestic credit, respectively, compared to 69 percent by the public sector. In mid-February 2019, the CBE cut key policy rates by 100 basis-points, the first adjustment since March 2018. While high and volatile headline inflation remains a concern, it has declined to 12.3 percent during December 2018—January 2019, from 15.4 percent in the previous six months. Additionally, core inflation has been consistently in the single-digits during July 2018—January 2019.

Fiscal accounts are improving, as the overall deficit continued its downward trend to reach 9.7 percent of GDP in FY2017/18, and the primary deficit shifted into surplus, thanks to reform measures on both the expenditures side (containment of civil servants' wages and energy subsidy reforms) and the revenues side (VAT, along with scaled up tax collection efforts). The debt-to-GDP ratio has also declined by more than 10 percentage points to 97.2 percent, although external debt has continued to rise. The primary balance ratio achieved a surplus of 0.4 percent in H1-FY2018/19, from a deficit of 0.3 percent a year earlier.

External accounts remain broadly favorable, as the current account deficit has narrowed to 2.4 percent of GDP in FY2017/18, from 6 percent a year earlier, driven by large remittances, a narrowing trade deficit -to-GDP ratio, as well as an improving services balance. However, net inflows in the capital and financial account have decreased, with modest and further declining FDI inflows and lower external borrowing. Net international reserves are at comfortable levels of US$42.6 billion in end-January 2019 (equivalent to about 8 months of merchandise imports). The Egyptian pound has started to show some appreciation after being steady for around 8 months.

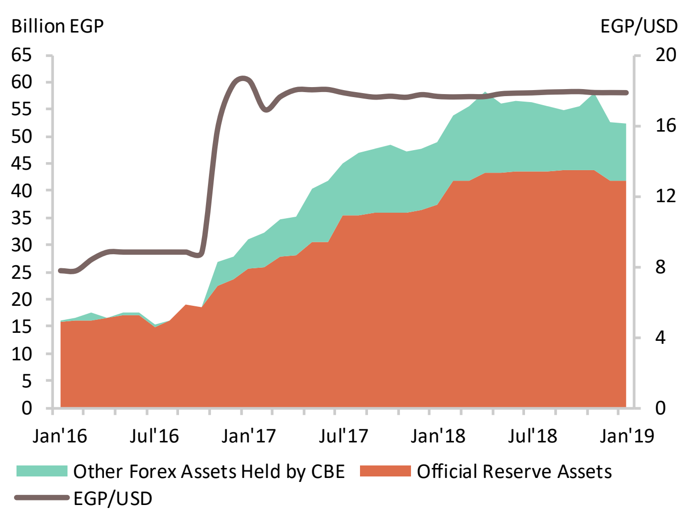
Social conditions remain difficult, as real income have been eroded by inflation, which has receded but spikes occasionally following energy and utility price adjustments or food price shocks. Participation in the labor market and formal employment rate have both been declining since 2010. Social protection programs have been stepped up (including the Takaful and Karama cash transfers and higher allocations of food subsidies). Yet, these mitigation measures remain limited, as the erosion of real incomes continues to be a concern. The national poverty rate was 27.8

FIGURE 1 Arab Republic of Egypt / GDP growth and employment rate, FY2014Q1-FY2019Q1



Sources: Authors' calculations based on Ministry of Planning & CAPMAS.
Note: Employment rate is number of employed divided by working age population.

FIGURE 2 Arab Republic of Egypt / Reserve accumulation and exchange rate, Jan 2016 – Jan 2019



Source: Ministry of Finance and Central Bank of Egypt.

percent in 2015, with most of the poor being concentrated in Upper Egypt and the frontier regions. Using an international poverty line of $3.2/day (2011 PPP), Egypt's poverty rate was 16.1 percent in 2015.

Outlook

Economic growth is expected to reach 6 percent in the medium term, as key economic sectors continue to recover. Fiscal consolidation will be helped by an expected increase in tax revenues with accelerating growth and the envisaged tax administration reforms, and as energy subsidy reforms continue. Yet, debt servicing is expected to remain a burden on the budget, therefore hindering larger social spending, notably on health and education.

The current account deficit is projected to stabilize over the medium term, but the capital and financial account may start declining, as the large financing related to the IMF program comes to an end by June 2019 and as declining yields on government debt instruments make Egypt less attractive to emerging market investors.

The poverty rate based on the $3.2/day (2011 PPP) international poverty line is projected to remain close to 15.7 percent in 2018 and 2019, consistent with the macro picture of growth in private consumption. However, households remain vulnerable to spikes in inflation from the envisaged phasing out of energy subsidies.

Risks and challenges

Several risk factors continue to impact macroeconomic stability, private sector growth and socioeconomic outcomes.

Macroeconomic fundamentals are vulnerable to exchange rate misalignment. The competitiveness gains are being gradually eroded with real appreciation, due to the cumulative inflation differential, at a time when the nominal exchange rate has been stable.

Notwithstanding the recent interest rate cut, domestic interest rates remain around 4 percentage-points higher than their levels prior to the policy rate hikes accompanying the 2016/17 exchange rate liberalization. High interest rates, in response to emerging market volatility, exert pressure on the budget through elevated debt servicing costs.

Fiscal risks originate from weak balance sheets of SOEs, the government contribution to the pension funds and large interest payments, in addition to low tax revenues. Fiscal consolidation is vulnerable to global oil price shocks or large movements in the exchange rate, although these may be relatively contained with the planned introduction of a fuel price indexation mechanism.

While the government has undertaken several important legislative reforms to ameliorate the business environment, private sector activity remains hampered by cumbersome and unpredictable regulatory framework, difficult access to key factor markets (land and skilled labor) and non-tariff barriers to trade. Additionally, State-led activities have a sizeable role in many sectors of the economy and enjoy preferential access to finance, land and procurement. There is a concern that this growing role of the state may be crowding out the unconnected private sector. Thus, the main challenge is to lift these binding constraints and create a level-playing field where competition can thrive.

On the socio-economic front, challenges emanating from the double-digit youth unemployment, declining labor force participation rates, and high level of informal employment are exacerbated by the accelerating population growth (to above 2.3 percent annually post-2011). The fast-growing population also exerts further pressure on natural resources (including water). Socio-economic hardship is exacerbated by poor public services, which suffer from low budget allocations, overstaffed government administration and insufficient transparency, citizen engagement and oversight.

TABLE 2 **Arab Republic of Egypt** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	4.3	4.2	5.3	5.5	5.8	6.0
Private Consumption	4.7	4.2	1.0	1.6	2.5	2.5
Government Consumption	3.9	2.5	1.6	2.7	3.9	3.1
Gross Fixed Capital Investment	12.0	12.4	8.1	13.3	13.0	14.0
Exports, Goods and Services	-15.0	86.0	32.2	11.8	9.0	8.5
Imports, Goods and Services	-2.2	52.5	11.3	4.0	4.0	4.0
Real GDP growth, at constant factor prices	2.3	3.6	5.3	5.5	5.8	6.0
Agriculture	3.1	3.2	3.0	3.0	3.0	3.0
Industry	0.2	1.8	4.8	4.5	4.7	4.7
Services	3.6	4.8	6.0	6.6	7.0	7.3
Inflation (Consumer Price Index)	10.2	23.3	21.6	14.5	12.5	10.7
Current Account Balance (% of GDP)	-6.0	-6.1	-2.4	-2.5	-2.6	-2.5
Fiscal Balance (% of GDP)	-12.5	-10.9	-9.7	-8.6	-7.5	-7.0
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.3	1.3	1.3	1.3	1.3	1.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	15.9	15.7	15.7	15.8	15.7	15.6
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	61.5	61.2	61.3	61.4	61.3	61.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2004-HIECS, 2017-, and 2015-HIECS. Actual data: 2015. Nowcast: 2016-2018. Forecast are from 2019 to 2021.
(b) Projection using point-to-point elasticity (2004-2017) with pass-through = 0.5 based on private consumption per capita in constant LCU.