EGYPT

Highlights

- **Growth has picked up, but vulnerabilities remain.** Policy reforms, financial support from the Arab Gulf countries and a more stable political situation have boosted economic activity. However, fiscal and external vulnerabilities remain and unemployment continues to be high.
- **Significant reform progress has been made in the energy sector, following on from major subsidy cuts made in mid-2014.** Notable developments include the repayment of most arrears owed to foreign oil companies, the introduction of a comprehensive renewables law with attractive feed-in tariffs and the introduction of a new electricity law aimed at liberalising the power sector.
- **Some measures have been taken to improve the general business environment and attract investors.** Amendments to the investment law and competition law as well as a new microfinance law are helping to address some of the obstacles faced by firms in Egypt.

Key priorities for 2016

- **The low global oil price environment provides a window of opportunity to press ahead with energy subsidy reforms and reduce their fiscal burden.** Low global oil prices moderate the inflationary impact of subsidy cuts on consumers and also smooth the adjustment for energy-intensive sectors.
- **The state's role as regulator and competition enforcer needs to be strengthened.** Despite recent progress in bolstering the role of the competition authority, more needs to be done to ensure firms compete on a level playing field. Oligopolies and monopolies continue to dominate sectors such as mining, cement, steel and textiles.
- **Widespread regional disparities need to be addressed to ensure more inclusive growth.** To this end, the authorities need to modernise the agricultural sector to benefit rural areas, invest in regional infrastructure and address business environment obstacles at the governorate level.

Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	1.8	2.2	2.1	2.2	4.2
Inflation (average)	11.0	8.7	6.9	10.1	11.0
Government balance/GDP	-9.8	-10.5	-14.1	-12.8	-11.7
Current account balance/GDP	-2.6	-3.9	-2.5	-1.0	-3.7
Net FDI/GDP [neg. sign = inflows]	-0.9	-1.5	-1.4	-1.4	-2.4
External debt/GDP	15.2	13.2	17.3	16.4	15.0
Gross reserves/GDP	7.4	5.5	6.2	5.1	n.a.
Credit to private sector/GDP	29.7	28.0	26.3	25.8	n.a.

NOTE: All figures are for the fiscal year July-June, except gross reserves and private sector credit.

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Macroeconomic performance

Growth momentum has picked up thanks to policy reforms, financial support from Gulf countries and a more stable political situation. Annual growth accelerated to 5.5 per cent in the first half of the fiscal year 2014-15 – up from 1.2 per cent the previous year. Private consumption continues to be the main driver of growth, but investment is now the second-most important driver, after six continuous quarters of contraction from mid-2012. However, net exports continue to drag on growth, reflecting structural problems in Egypt's energy sector and eroding competitiveness. Unemployment remains high at 12.8 per cent in the third quarter of 2014-15. Youth unemployment is significantly higher at over 34 per cent in the latest available data.

The fiscal deficit is declining, but remains elevated. The fiscal deficit narrowed from 12.8 per cent of GDP in 2013-14 to 11.3 per cent in the first half of 2014-15, thanks to fiscal consolidation efforts. Egypt sold US$ 1.5 billion worth of US dollar-denominated bonds in June 2015 in a landmark issuance that was three times oversubscribed and marked a successful return to international capital markets after five years. High investor demand meant the bonds were sold at a better-than-expected yield of 6 per cent. The bond issuance, in addition to financial support from the Gulf Cooperation Council (GCC), is expected to meet the financing gap for this fiscal year but will fall short of covering the expected financing gap for 2015-16.

Egypt's current account deficit has widened recently, putting pressure on international reserves. After registering a current account deficit of 1 per cent of GDP in 2013-14, the current account deficit widened in the first half of 2014-15 to 2.7 per cent of GDP. Although goods exports struggled over the period, the main driver of the deficit increase was a fall in net official transfers as Egypt made a number of repayments to creditors over that period. As a result, international reserves have been under pressure. Despite combined deposits of US$ 6 billion in Egypt's central bank by Kuwait, Saudi Arabia and the United Arab Emirates in April 2015 and the sovereign Eurobond issuance in June, foreign exchange reserves remain only slightly above the critical threshold of three months of imports.

Despite significant recent exchange rate depreciation, foreign currency shortages continue. Between June 2013 and early January 2015, the exchange rate against the US dollar had remained broadly unchanged, which led to a decline in competitiveness, a backlog of demand for foreign currency and a parallel market for foreign exchange. As of October 2015, the central bank has allowed the Egyptian pound to weaken by a cumulative 11 per cent against the US dollar. This has helped reduce pressure on international reserves and support competitiveness. In addition, a number of administrative measures have been taken by the central bank to safeguard reserves and stem the parallel foreign exchange market, including rationing the supply of US dollars in official auctions to priority sectors and placing caps on US dollar-denominated deposits in banks. However, these measures have compounded the problem of lack of foreign exchange liquidity.

Egypt's economic recovery is expected to continue in the short term. Growth is expected to rise from 2.2 per cent in 2013-14 to 4.2 per cent in 2014-15 and 4.3 per cent in 2015-16 as reforms continue, confidence improves and the recovery in investment is entrenched. Security concerns are a downside risk to the outlook.

Major structural reform developments

Major new amendments to the country's Investment Law have been approved and ratified. One key feature of the amendments is an improvement to investor protection in case of legal disputes. In addition, the amendments streamline investment procedures by authorising the General Authority for Investment (GAFI) to act as a one-stop-shop for investors in certain sectors to deal with all licences and approvals needed to establish and run their businesses. The new law also aims to attract new investments into Egypt through tax and non-tax incentives. These include cutting corporate tax to 22.5 per cent from 25.0 per cent; trimming sales tax on equipment and machines used for production to 5 per cent from 10 per cent; cutting customs duties on imports of production inputs; and offering non-tax incentives on labour-intensive projects or investments in key sectors or locations.

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Other reforms to improve the business environment and expand access to finance have advanced. Investor dispute resolution efforts have been stepped up, with more than half of the disputes coming before Egypt's two main dispute resolution committees having been resolved as of April 2015. In addition, the Competition Law has been amended to strengthen the independence and effectiveness of the Egyptian Competition Authority (ECA), although the latter is still not completely independent and the full extent of its enforcement authority and mechanisms is unclear. Meanwhile, Egypt's first microfinance law was issued in November 2014 to address regulatory gaps and allow microfinance institutions to expand their outreach by increasing their leverage and diversifying their funding base.

Significant and much-needed reforms have been passed to encourage investment in the energy sector. Following on from major fuel subsidy overhauls initiated in July 2014, several steps have been taken to tackle the chronic under-investment in the energy sector, which had led to declining production, energy shortfalls and power blackouts. The government has made significant headway in the repayment of arrears to international oil companies – between December 2013 and December 2014, nearly US$ 5 billion in arrears was repaid, reducing the sum of outstanding debt to US$ 3.1 billion. There has also been significant progress in incentivising renewables uptake in order to tap into Egypt's significant potential in solar and wind. A comprehensive Renewable Energy Law was passed in December 2014 that introduced feed-in tariffs for purchasing electricity from renewable sources, guaranteeing attractive prices for investors.

Major plans are also under way to liberalise the power sector. In February 2015, a new Electricity Law was approved that would gradually liberalise the electricity transmission market with the aim of moving away from the single-buyer model with government-subsidised prices to a competitive market where private sector producers can sell electricity directly to consumers at market prices. In line with the authorities' plans to bring electricity prices to cost recovery levels over the next five years, prices for mid-to-high-use household users were raised by an average of 19 per cent in July 2015.

Fiscal structural reforms are ongoing with some delays. On the revenue side, taxes on cigarettes and alcohol have been raised but the planned introduction of a modern, broad-based VAT as a replacement to sales tax has been repeatedly delayed and the decision to introduce a tax on dividends and capital gains in July 2014 has since been suspended. On the expenditure side, there have been significant cuts to subsidy spending, helped both by cuts to regulated prices and by lower global energy prices. Reforms are also in the pipeline to address the public wage bill, which accounts for over one-fifth of Egypt's total budget. A ceiling on public sector wages was set in 2014. In addition, amendments to the Civil Service Law that overhaul salary, hiring and promotion systems were published in March 2015 and came into effect at the start of the new fiscal year in July. Although the new law has met with opposition by civil servants, the authorities have insisted it will be implemented.