ARAB REPUBLIC OF EGYPT

Table 1	**2017**
Population, million	95.2
GDP, current US$ billion	235.7
GDP per capita, current US$	2475
Lower middle-income poverty rate ($3.2)[a]	16.1
National poverty line[a]	27.8
Gini coefficient[a]	30.0
Life expectancy at birth, years[b]	71.3

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

Macroeconomic conditions are improving, as Egypt's twin deficits are narrowing and inflation has receded sharply in recent months. The Central Bank has cut key policy rates for the first time since the tightening cycle that accompanied the exchange rate flotation in November 2016. Economic activity is picking up, and unemployment rate has fallen below 12% for the first time since 2011. Socio-economic conditions remain challenging with the erosion of real incomes over the past year. The impact of key business environment reforms will depend on effective implementation.

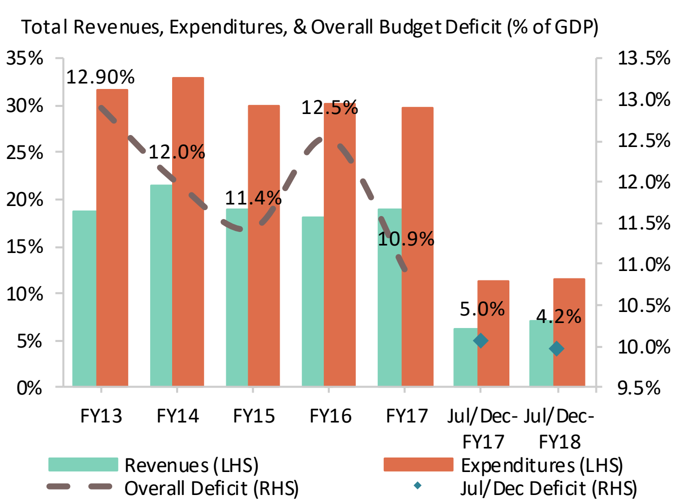
Recent developments

Egypt's economy grew by 5.2% in H1-FY18 (July/June), compared to 3.7% a year earlier, mainly driven by investment, exports and consumption. On the sectoral side, the gas extractives sector has been a main contributor to growth, notably since the recent operationalization of the large Zohr gas field. The improvement in energy supply is also starting to have positive spill-overs on other sectors, especially manufacturing. The tourism sector is rebounding gradually, helped by the effect of local currency depreciation. The nascent economic recovery has been accompanied by a steady decline in unemployment, which dropped to its lowest level since mid-FY10 to reach 11.3% in Q2-FY18. Annual headline and core inflation rates continued to decline for the sixth consecutive month in January 2018, reaching 17.1% and 14.4%, down from peaks of 33% and 35%, respectively in July 2017. This decline was supported by tighter monetary conditions, easing food inflation, in addition to the favorable base effect, as the impact of the exchange rate depreciation in November 2016 and the one-off energy price hikes are fading. The CBE has thus started to ease policy rates by 100 basis points in mid-February 2018. While nominal interest rates are still 600 basis points above their pre-exchange rate flotation levels, declining inflation has helped turn real interest rates positive in end-February 2018.

Macroeconomic imbalances are narrowing. The primary budget balance is close to surplus (-0.3% of GDP) for the first half of FY18. Tax revenues increased to 6.8% of GDP in H1-FY18, up from 4.8% during the first half of the previous year, driven mainly by the increase in revenues from the VAT, but also from corporate and personal income tax. Efforts continue to contain the civil servants' wage bill and energy subsidies, savings from the latter allowing the government to scale up the allocations to the food subsidy as well as the cash transfer programs. On the external side, the current account deficit narrowed to 0.7% of GDP in Q1-FY18, down from 2% a year before. This was supported by an increase in merchandise exports, tourism revenues, Suez Canal dues and remittances. Those, in addition to large portfolio inflows, contributed to an overall balance of payments surplus of 2.3% of GDP in Q1-FY18, up from a 0.8% in the same quarter of the previous year. Net international reserves achieved a new record high of US$42.5 billion in end-February 2018 (covering 9 months of FY18 merchandise imports), more than double its level prior to the exchange rate flotation in end-October 2016.

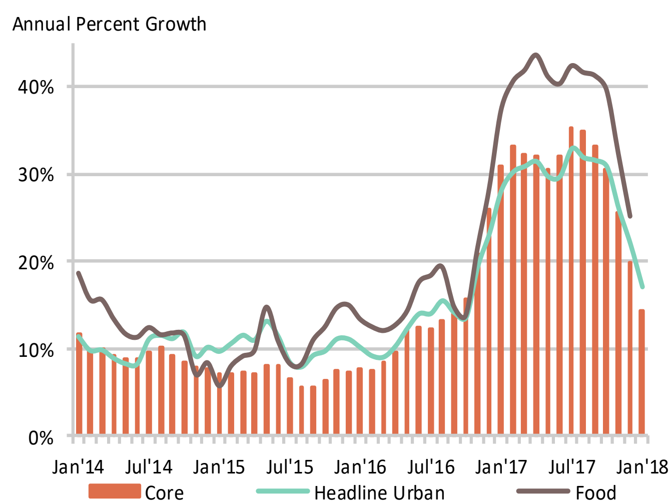
FDI remains weak (0.7% of GDP in Q1-FY18, down from 0.8% of GDP a year earlier), reflecting continuing concerns about business climate and the growing role of the State in economic activity. To enhance the business environment, the government has introduced a series of key legislative reforms, including a new industrial licensing law, investment law, bankruptcy law, and amendments to the companies law.

FIGURE 1 Arab Republic of Egypt / Real GDP growth, demand-side, FY2014Q1-FY2018Q1



Source: Authors' calculations based on Ministry of Planning data.

FIGURE 2 Arab Republic of Egypt / Inflation rates, January 2014 – January 2018



Source: Central Bank of Egypt.

Extreme poverty in Egypt is practically eradicated. Using the national poverty threshold, about a third (27.8%) of the population was below the poverty line in 2015. Moreover, the high inflation accumulated over the course of FY15-FY17 has lowered the purchasing power of households across the distribution, reducing the positive spillovers of economic growth; taking a toll on social and economic conditions. Regional disparities continue to be part of the country's landscape, with Upper Rural Egypt showing poverty rates three times as high as Metropolitan Egypt. Recent increases in allowances of the main social programs have helped weather the effects of inflation, but imperfect coverage and targeting leave some groups unprotected.

Outlook

As reform momentum is sustained, economic activity is expected to improve and imbalances are projected to narrow further. Real GDP is forecast to grow by 5% in FY18, and to increase gradually to 5.8% by FY20. Growth is expected to be driven by resilient private consumption and investment, in addition to a gradual pickup in exports (notably from tourism and gas).

The budget deficit is expected to narrow to 9.8% of GDP in FY18. This is slightly higher than initially-budgeted, due to larger interest payments, higher international oil prices, and larger-than-budgeted exchange rate. The fiscal consolidation program is expected to rely on revenue mobilization, in particular the increase in VAT receipts, in addition to energy subsidy reforms. The current account deficit is expected to narrow to 4.9% of GDP in FY18, from 6.6% of GDP in FY17.

Consistent with the macro picture of resilient growth in private consumption, poverty rate based on the $3.2/day (2011 PPP) is projected to decline modestly to 15.21% in 2019 from an estimated 15.63% in 2017. However, the ongoing reforms, although beneficial in the long term, could reduce households' welfare in the short-term due to energy price increases and overall high inflation. The government's strategy to shift expenditures away from universal subsidies to targeted transfers and food smart cards is key in mitigating the effects and will help support private consumption. Social protection measures must be complemented with efforts to improve service delivery. Negative impacts on the vulnerable and the middle class may only be mitigated by ability of the private sector to create jobs, especially for the youth and women.

Risks and challenges

The absence of a level-playing field, especially in sectors where there are State-led activities, might stifle the private sector and job-creation. Additionally, regional and domestic security risks threaten the recovery of foreign investments and tourism.

Fiscal reforms slippage or unfavorable external conditions, for example in the form of sustained increases in global oil prices, pose risks that may negatively impact the consolidation trajectory. With a government debt ratio of 108.8 % of GDP in end-FY17, a combined macro-fiscal shock can threaten Egypt's debt sustainability.

Social conditions remain difficult with double-digit unemployment rate and the absence of a notable acceleration in employment. A better understanding of the impact on the population and their coping mechanisms will come from the results of the ongoing Household Consumption Survey 2017 which was launched in October.

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

	2015	2016	2017 e	2018 f	2019 f	2020 f
Real GDP growth, at constant market prices	4.4	4.3	4.2	5.0	5.5	5.8
Private Consumption	3.1	4.7	4.2	3.9	4.1	4.2
Government Consumption	7.0	3.9	2.3	2.0	2.9	1.9
Gross Fixed Capital Investment	13.8	12.0	12.4	8.0	8.2	12.1
Exports, Goods and Services	0.0	-15.0	86.0	4.0	9.0	8.0
Imports, Goods and Services	1.0	-2.2	52.5	2.0	4.5	5.0
Real GDP growth, at constant factor prices	3.4	2.3	3.6	5.0	5.5	5.8
Agriculture	3.1	3.1	3.2	3.8	3.5	3.8
Industry	1.1	0.2	3.1	3.8	4.1	3.7
Services	5.0	3.6	4.0	6.1	6.8	7.5
Inflation (Consumer Price Index)	11.1	10.2	23.3	22.1	14.0	12.0
Current Account Balance (% of GDP)	-3.6	-6.0	-6.6	-4.9	-4.4	-4.1
Financial and Capital Account (% of GDP)	4.3	7.2	6.5	4.9	4.4	4.1
Net Foreign Direct Investment (% of GDP)	1.9	2.0	3.3	3.3	3.5	3.7
Fiscal Balance (% of GDP)	-11.4	-12.5	-10.9	-9.8	-8.4	-7.3
Debt (% of GDP)	93.3	103.0	108.8	99.8	96.4	91.3
Primary Balance (% of GDP)	-3.5	-3.5	-1.8	-0.6	0.8	1.2
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	16.1	15.9	15.6	15.4	15.2	15.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2004-HIECS and 2015-HIECS. Actual data: 2015. Nowcast: 2016 - 2017. Forecast are from 2018 to 2020.
(b) Projection using point-to-point elasticity (2004-2015) with pass-through = 0.5 based on private consumption per capita in constant LCU.