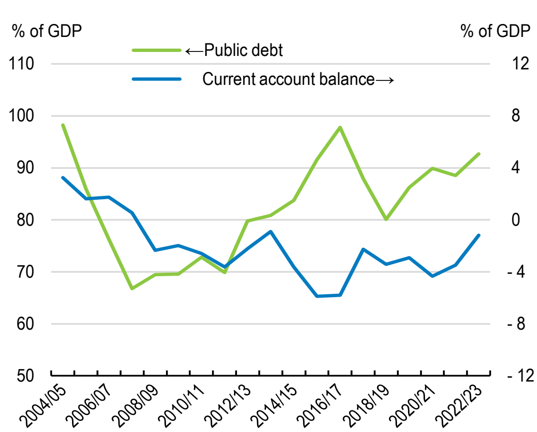
Executive Summary

Growth has weakened amidst economic challenges

Growth has held up better in Egypt until recently than in neighbouring countries in the face of a series of major exogenous shocks, and reform efforts have been stepped up in several areas. However, growth slowed in 2022, as inflation surged and massive capital outflows occurred, which led to foreign currency shortages and devaluations of the Egyptian pound.

Egypt was hit hard by the surge in global food prices. Inflation took off, even though energy prices were kept in check via price controls. It has become broad-based and, coupled with currency depreciation, reached very high levels in 2023. Fiscal support, including the expansion of targeted cash-transfer programmes, has sustained private consumption. Business activity has weakened due to tightened financing conditions, limited access to foreign currency, and increased uncertainty, following large-scale capital outflows of around USD 20 billion (4.7% of GDP). Egypt was particularly vulnerable to such outflows, due to its large current account deficit and high public debt (Figure 1), which had been increasingly financed from abroad. IMF financial assistance was put in place in late 2022, the fourth package in six years. Under this IMF programme, Egypt has expanded the scope of policy reforms to reduce public debt and macroeconomic imbalances.

Figure 1. Macroeconomic imbalances are large



Source: Central Bank of Egypt; Ministry of Planning and Economic Development; IMF World Economic Outlook October 2023 database.

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GDP growth is projected to decline to 3.2% in FY 2023/24 but to pick up thereafter (Table 1). Provided inflation subsides, consumption will recover despite gradual withdrawal of fiscal support. The recovery of investment is set to be subdued as financing conditions will remain tight for some time. Exports are expected to regain momentum if the disruptions to tourism and Suez Canal traffic end. The risks surrounding this outlook are substantial and skewed to the downside. They include, among others, further losses in investor confidence, which would result in further depreciation and deeper foreign currency shortages, and lead to additional tightening in financing conditions. The geopolitical tensions in the region, if prolonged, would further affect tourism and Suez Canal receipts.

Table 1. The economy will gradually recover

Annual growth rates unless noted	FY 22/23	FY 23/24	FY 24/25	FY 25/26
Gross domestic product (GDP)	3.8	3.2	4.4	5.1
Private consumption	3.8	3.0	4.2	4.7
Gross fixed capital formation	- 24.1	- 1.4	1.5	3.2
Exports	31.4	5.4	6.5	7.1
Imports	1.1	2.9	4.1	4.5
Consumer price index	25.1	32.0	15.9	7.5
Core consumer price index	29.3	30.7	16.8	7.9
Fiscal balance (% of GDP)	- 6.0	- 7.8	- 7.0	- 6.5
Central government debt (% of GDP)	95.7	92.0	86.9	80.7
Current account balance (% of GDP)	- 1.2	- 0.8	- 0.8	- 0.7

Note: Data refer to fiscal years from July to June of the following year.
Source: Update of the OECD Economic Outlook November 2023; Ministry of Planning and Economic Development; Ministry of Finance; Central Bank of Egypt.

The government faces large near-term financing needs. International market funding has been limited since early 2022, although the government has sought to diversify its debt portfolio and instruments. Restoring investor confidence in the public finances is essential to bring down debt service costs, with 10-year government bond yields having risen to close to 27% in early February 2024. This would facilitate fiscal adjustment and help achieve the Medium-Term Debt Strategy objective to reduce the debt-to-GDP ratio to around 80%. Although the initial Budget FY 2023/24 aimed at increasing the primary surplus to 2.5% of GDP, the overall budget deficit will remain large due to high interest payments.

Commitment to fiscal consolidation over the medium term is key, as is improving public financial management. Fiscal support targeted to those most in need should continue, but untargeted energy subsidies should be gradually reduced, which would also contribute to reducing emissions. Public investment has expanded substantially since the early 2010s. The government has recently limited new projects by Prime Ministerial decree. This should be complemented by a thorough review of the efficiency of public investment projects. Such spending cuts will not only help to reduce public debt but also create the fiscal space to finance priority policies including health and education. While pursuing the Medium-Term Revenue Strategy to enhance tax collection, the government should examine the numerous tax exemptions and eliminate inefficient ones. In this respect, it is key to abolish all preferential tax treatments granted to state-owned enterprises (SOEs) by implementing a 2023 law. Despite some recent initiatives, budget transparency is limited and large contingent liabilities and budget transfers to SOEs can endanger the sustainability of public finances. They should be scrutinised and reduced.

Monetary policy should continue to combat high inflation and bring it down towards the 7 ±2% target. Control of the exchange rate should be reduced gradually, while avoiding abrupt fluctuations.

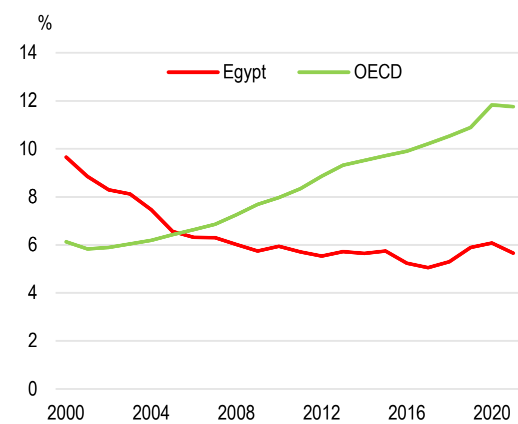
Speeding up Egypt's green transition

Egypt is highly vulnerable to the consequences of climate change and suffers from air pollution. Its updated Nationally Determined Contributions include some sector-specific emission reduction targets for 2030, subject to additional funding, and some adaptation measures, but efforts need to be stepped up.

Private investment and development partner support should play a key role in promoting green growth. Current efforts to scale up green investment need to be pursued. Renewables only accounted for just under 6% of total energy supply in 2021 (Figure 2). To achieve the National Energy Plan's goal to raise the share of electricity generation from renewable sources to 42% by 2030, major efforts are required, including mobilising financing, through the use of green bonds and concessionary loans, as well as attracting private investment with long-term power-purchasing agreements. The government has started to invest in transmission infrastructure and grid connections. Further private sector involvement is called for, notably in low-emissions industrial and green hydrogen projects, as well as in climate adaptation strategies, such as better management of scarce water resources.

Figure 2. Renewable energy has room to expand

Renewables as a share of total energy supply



Source: OECD, World Energy Balances database.

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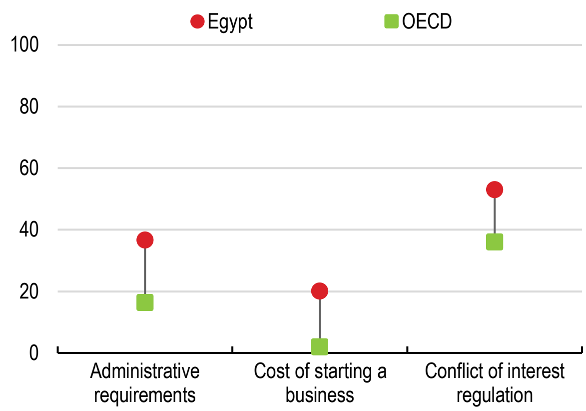
Unleashing private sector activity

Egypt has ample scope to increase private investment and productivity. Recent reform efforts should be intensified. Strengthening competition and reducing market distortions are key to reinvigorate productivity growth.

Regulatory barriers hindering firm entry and expansion should be reduced and external barriers lowered (Figure 3). The current efforts to reform the licensing regime, including steps to reduce approval times and the one-stop "Golden Licence" for investors, should be continued to further simplify procedures for all businesses. Digitalisation of invoices and tax returns should help ease administrative burdens, which are a contributing factor to informality and create opportunities for corruption. While openness to trade and FDI is essential to promote competition, trade barriers remain high, depriving Egypt of the full benefits of global trade. Tariffs should be lowered, simplified and streamlined while unnecessary non-tariff barriers should be removed.

Figure 3. Competition pressures are low

Scale 0 (not burdensome) to 100 (extremely burdensome)



Source: World Economic Forum, Global Competitiveness Index 4.0.

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Perceived corruption is high and undermines business activity, despite recent measures to improve public procurement. Fully implementing the 2018 Public Procurement Law, including removing procurement exemptions for SOEs, will reduce opportunities for corruption and build confidence to help attract more investment.

The domineering presence of SOEs has hindered private sector activity and investment. It has reduced business dynamism, reflected in low firm entry and low efficiency of resource allocation. The State Ownership Policy programme, aiming at cutting back overall government ownership across most business sectors and redefining its role in the economy, has progressed slowly since its announcement in December 2022. More clarity regarding its execution is needed, with a well-specified timeline and greater transparency in the choice of firms to be sold, the sequencing of sales and the future role of the state. As the state will likely remain a significant player in the economy, the principles of competitive neutrality need to be fully adhered to and implemented.

Expanding access to finance would support firm creation and expansion, while digital diffusion is necessary to boost productivity. This should be supported by, among others, liberalising the digital services market.

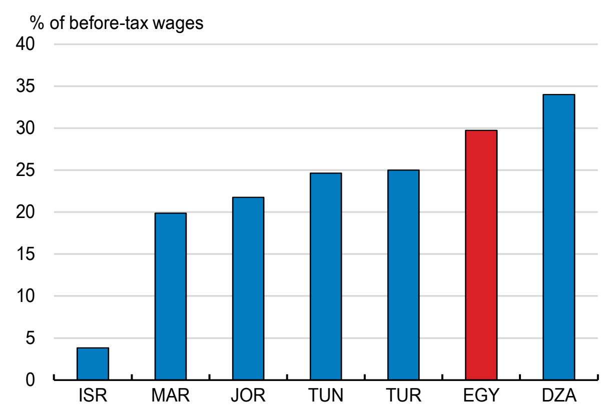
Creating more and better-quality jobs

The working age population is expected to grow fast, and educational attainment to rise further. However, the employment rate is low, particularly among youth and women, and the share of informal jobs is high. The poverty rate has trended up, with many working poor.

Job opportunities need to be expanded, while reducing informality. Still high social security contribution rates (Figure 4) are a driver of informality, depriving workers of benefit entitlement. The government should examine the effects of the 2019 reform and consider reducing business costs further, including compliance costs. While expanding targeted social benefits, job-ready beneficiaries should be encouraged to engage in paid work, by strengthening assistance for job search. Expanding childcare facilities and promoting flexible work arrangements would help raise female labour force participation.

Figure 4. Social contribution rates are high

Social security contribution rate



Note: 2022 for Egypt, 2019 or latest for other countries.

Source: International Social Security Association.

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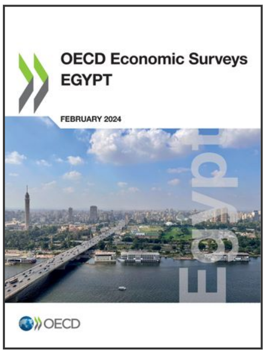
Education and skills are essential to ensure better job opportunities and boost productivity, and to facilitate school-to-work transition. EDU 2.0, an ongoing reform agenda to shift the focus from rote learning to developing critical skills, requires long-term strategic allocation of resources and support structures. The new qualification accreditation system should help to provide skills required in the labour market. To ensure better job-skill matching, identification of labour market needs should be developed further by improving the information system.

MAIN FINDINGS	KEY RECOMMENDATIONS
Achieving macroeconomic stabilisation	
Inflation reached very high levels in 2023. Initially driven by global food prices, it has become broad-based. The policy interest rate has been increased by 1 300 basis points since early 2022. Budget FY2023/24 features a primary surplus of 2.5% of GDP.	Keep a restrictive monetary policy stance until inflation approaches the target and raise the policy interest rate as needed. Achieve the primary surplus target and avoid adding to inflationary pressures.
The official exchange rate was devalued in steps in the course of 2022 but has remained almost unchanged since. Foreign currency shortages have endured, contributing to import backlogs.	Reduce the control over the exchange rate gradually, while avoiding abrupt fluctuations.
Energy subsidies had been significantly reduced over the past decade but were increased again following the rise in global energy prices. Food subsidies still reach the vast majority of the population.	Phase out energy subsidies gradually to fully reflect global energy price movements in domestic fuel prices. Target food subsidies strictly to those who are most in need.
Public investment has expanded considerably over the past decade, casting doubts on the quality of some projects. A public investment management assessment was conducted with the IMF in 2022. In February 2024, a governmental decree curtailed the public investments foreseen in Budget FY2023/24.	In the short run, ensure the recently-decreed curtailment of public investment is implemented. Undertake spending efficiency reviews of public investment and rationalise infrastructure projects accordingly.
The green transition requires fast and concerted action	
Tackling climate change requires large investments in adaptation and mitigation, including new infrastructure and clean technologies, to achieve sustainable growth.	Pursue climate efforts, especially in the oil and gas, and transport sectors where targets can be reached more easily. Strengthen capacity to monitor and report greenhouse gas emissions. Continue efforts to leverage private financing with green bonds and concessional loans, and earmark green projects clearly for investors. Step up adaptation measures, such as water and irrigation management, and natural sea defences.
Improving the business climate to revive private sector growth	
High regulatory barriers stifle the opening and operation of businesses, and the overall burden of licensing imposed on firms is high.	Streamline licensing procedures for new and operational licences. Introduce the “silence is consent” principle for business registration.
Perceptions of corruption are high, affecting investor confidence. The 2018 Public Procurement Law does not apply to state-owned enterprises (SOEs) and allows direct awards for non-civil firms.	Fully implement the 2018 Public Procurement Law, and strictly limit exemptions for SOEs and direct awards for non-civil firms.
Egypt is not well integrated into global value chains. Tariff and regulatory barriers to imports are high.	Lower, simplify and streamline tariffs. Eliminate routine requirements to obtain pre-export authorisations for products exported to Egypt that meet domestic standards.
No single entity is clearly mandated with planning and designing investment policy.	Consolidate investment policy in a single entity with powers to design and execute investment policy and provide the General Authority for Investment (GAFI) with sufficient resources to act effectively as Egypt’s investment promotion agency.
The corporate tax system remains riddled with exemptions. Overlapping legal texts increase the risk that incentives fail to attract more foreign investment.	Consolidate tax incentives into a single law under the Ministry of Finance. Tax incentives should be reviewed regularly to verify that they remain aligned with objectives.
The state footprint is large, with SOEs operating across most sectors of the economy. The full extent of the SOE sector is not known, and ownership is dispersed across numerous ministries, while financial transparency is lacking.	Fully execute the announced divestment programme with a clear timeline. Regularly publish a list of all SOEs and their ownership, and increase financial transparency.
The privatisation process requires greater clarity as to the objectives of the sales, the preferred method of privatising and the role of the state.	Increase transparency in the choice of firms to be sold, the sequencing of sales, the valuations of assets, and the future role of the state.
The state will likely remain a significant player in the economy.	Fully adhere to and implement the principles of competitive neutrality across all state entities and transactions.
Promoting better-quality job creation for inclusive growth	
Social security contributions remain high even after the 2019 reform, leading firms to often not register their employees or underreport labour earnings.	Evaluate the effects of the 2019 reform. Consider reducing the social security contribution rates for lower-paid workers.
Cash-transfer programmes targeted to the most vulnerable, notably *Takaful* and *Karama*, contribute to reducing poverty. However, the transition to paid work needs to be facilitated.	Register job-ready beneficiaries with public employment services to support them in finding an adequate job.
Women often withdraw from paid work due to household responsibilities, instead of taking maternity and childcare leaves and returning to work.	Accelerate the creation of nurseries and promote flexible work arrangements to allow women to reconcile work and family responsibilities. Further reform the regulation on workplace safety.
Education has been criticised for being repetitive and grounded in rote memorisation.	Provide necessary resources for schools and financial incentives for teachers to implement the EDU 2.0 reform, subject to monitoring and evaluation of its progress.



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