One of the key questions facing Egypt as it emerges from a three-year IMF reform programme is how resilient it will be to any future external shocks. The country’s deal with the IMF has yielded marked improvements to many of its main macroeconomic indicators, which should provide a platform for a sustained period of high growth, underpinned by inflows of foreign direct and indirect investment. However, many of the fundamental weaknesses in the economy persist.

Investment and growth in key sectors is rising but private consumption still constrained

By the metric of real GDP growth, the Egyptian economy appears to be in rude health. Since the IMF agreement was signed in November 2016, the growth rate has increased in every quarter, from 3.2% in July-September of that year to 5.6% in January-March 2019, according to government figures. In each of the past seven quarters, growth has been over 5%. The main drivers behind the expansion are increased investment, a narrowing trade deficit, surging natural gas production and strong performances in a few other sectors, notably telecommunications, the Suez Canal, construction and – since late 2017 – tourism.

However, closer examination of the GDP data presents a more nuanced picture of the economy. Private consumption, which accounts for more than three quarters of GDP by expenditure, has lagged behind the overall growth rate to a significant degree, reflecting the extent to which household spending has been constrained by high inflation and the limited increases in wages and benefits. In October-December 2018, the most recent period for which a full breakdown is available, private consumption actually contracted by 0.9%.

The net result is that the government can claim, with some justification, that the economy is thriving, but it doesn’t feel that way for much of the population. A recent statement from the World Bank that “some 60% of Egypt’s population is either poor or vulnerable, and inequality is on the rise” has lent credence to the view that living standards remain under pressure.

There has also been controversy over the delay in the government’s publication of an update of its own poverty assessment. A previous assessment by the state-owned statistics agency in 2015 put the national rate at 27.8%, based on a poverty line of $1.90 per day (at 2011 purchasing power parity). Since the devaluation of the currency at the end of 2016, the Egyptian pound equivalent of the poverty line has been adjusted upwards, but according to local media reports the assessment for mid-2017 showed the poverty rate rising to just 30.2%. The financial newspaper Alborsa reported in early May that the government had asked the statistics agency to revise its methodology. (Some commentators took the World Bank’s 60% figure as an indication of the rise of the national poverty rate, but the bank made clear that it was referring to a broader set of criteria.)

In the budget for the 2019/20 fiscal year, which starts on 1 July, the government has provided for an increase in the minimum wage for state-sector employees to £E2,000 ($119) per month from £E1,200 ($71.60), which was set in 2014. Pensions have also been increased, but consumers face hikes in electricity and fuel prices as the government takes further steps to reduce energy subsidies. Inflation has dropped to about 13% after averaging almost 30% in 2017 but is unlikely to fall to single-digits until mid-2020. This suggests that consumers will have marginally enhanced spending power in the coming period, but it will take a long time before significant improvements in living standards are reflected in the national data.

Strong Egyptian pound and foreign exchange inflows boost the country’s position

One of the most notable features of Egypt’s economic performance so far in 2019 has been the strength of the Egyptian pound, which has appreciated by about 7% against the US dollar since the start of the year. Following the currency’s floatation as part of the IMF deal at the end of 2016, the exchange rate fell by some 50% before settling at around E£17.90:$1.00 through much of 2017 and 2018. 2019 saw the rate firm to £E16.75 as of early June.

The reason for the appreciation is partly technical. At the end of 2018 the Central Bank of Egypt dispensed with a repatriation mechanism for foreign investors that it had used as a means to stabilise the exchange rate. At the same time, foreign exchange inflows have been strong, buoyed by the return of portfolio investors who pulled out of the Egyptian market in mid-2018 following hikes in US interest rates; rising income from tourism; and remittances from Egyptians abroad, which are continuing at a rate of almost $7bn per quarter. The balance of payments has also benefitted from the country’s shift from being a net importer of natural gas to a modest net exporter, following a surge in production from below 4bn cu feet per day in mid-2016 to almost 7bn cu feet.

Economic recovery remains vulnerable to potential shifts in investor sentiment and high external debt level

This sweet spot for Egypt’s foreign exchange position cannot last indefinitely. Foreign portfolio investors are notoriously fickle and will at some point decide to reduce their Egyptian exposure, whether because of their assessment of domestic risk or shifts in global sentiment. Prospects for further growth in tourism are promising, but vulnerable to setbacks from terrorism or political turbulence. Remittance flows have yet to be hit by Gulf Arab states’ moves to reduce reliance on expatriate labour, but that may yet become a factor for Egyptian workers. Natural gas consumption is rising at a similar rate to production, and some of the fields that have contributed to the recent surge – especially those in shallow waters in the Mediterranean – are prone to steep rates of decline. Finally, Egypt’s external debt has doubled over the past four years to $100bn, and the country faces a demanding repayment schedule in the early and mid-2020s, including the $12bn it owes to the IMF.

The central bank has built up sufficient foreign exchange reserves to defend the currency if necessary and deal with debt-service obligations. Yet a realistic assessment of Egypt’s economic prospects has to take into account this area of vulnerability, as well as the scale of the challenge to lift general living standards.

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