Egypt: From macroeconomic stabilisation to sustainable growth

Pascal Devaux

Through economic consolidation measures implemented since 2016, Egypt has corrected its macroeconomic imbalances and regained the confidence of international investors. Foreign currency liquidity has returned to satisfying levels, the public account deficit is narrowing, although debt service is maintaining the fiscal deficit at a high level. Inflation is still relatively high but easing. Economic prospects are favourable. So far, the macroeconomic recovery has failed to trigger new momentum capable of accelerating growth and creating jobs. The weight of public sector and a large informal sector reduce the economy's responsiveness to positive macroeconomic signals. Structural reforms are necessary to preserve the achievements of ongoing reforms.

Since 2016, economic reform measures and massive external financial support have helped lift the Egyptian economy out of a very tight situation. The most substantial progress was made in terms of external imbalances, while public finances are recovering gradually. Although vulnerabilities persist, the economy is once again poised to enter a new phase of the reform process, one that should stimulate private investment and create jobs. Looking beyond the reduction of macroeconomic imbalances, structural changes will be needed to face up to hard-to-curb demographics and to preserve the economic achievements of the past three years.

External accounts recover

Egypt's foreign currency liquidity is no longer in the alarming zone thanks to the reduction in the current account deficit, financial support from international donor funds and the renewed confidence of foreign investors, who have returned to the local bond market.

Sharp decrease in the current account deficit

The most significant outcome of the reform process initiated in 2016 is the improvement in the external accounts. In 2017/2018[1], the current account deficit narrowed significantly to 2.4% of GDP, down from more than 6% in the previous two years (Chart 1). The main sources of this improvement were the services, revenue and transfer accounts (the so-called invisibles) (Chart 2). Tourist activity rebounded, thanks notably to the depreciation of the Egyptian pound (EGP) and a more stable political environment, and tourism revenues rose to USD 9.8 bn (13% of current account revenues), compared to USD 4.4 bn in 2016/2017 (7% of revenues) (Chart 3). Remittances from expat workers are still a major source of external revenues. They accounted for 35% of revenues in 2017/2018 (USD 26 bn) at a time of rising oil revenues in the Gulf countries, which employ more than 5 million Egyptian expats. High oil prices also bolstered Suez Canal revenues (+15% y/y).

Egypt: current account balance

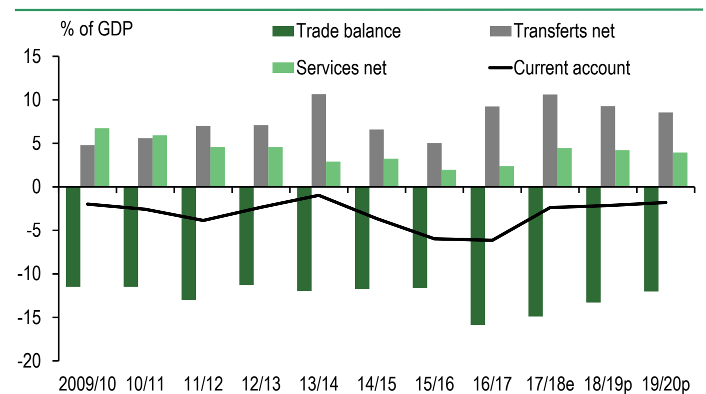

Chart 1 Source: Central Bank of Egypt, BNP Paribas

Egypt: main sources of external revenues

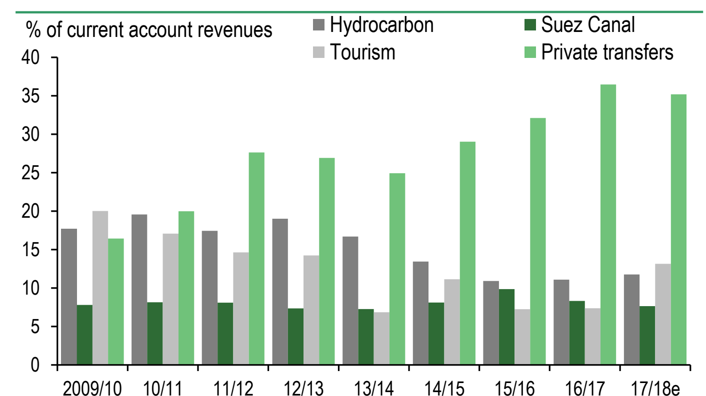

Chart 2 Source: Central Bank of Egypt, BNP Paribas

[1] The fiscal year ends in June.

Egypt: tourism activity (1 year rolling sum, '000)

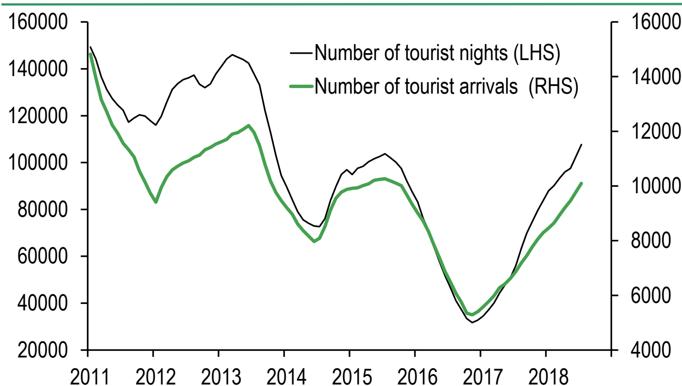

Chart 3 Source: Central Bank of Egypt, BNP Paribas

The results were more mixed for the trade balance than for the "invisible" balance. The hydrocarbon deficit (oil and gas) narrowed to USD 3.7 bn in 2018 from USD 5.4 bn in 2016/2017, thanks to virtually stable imports (+3.9% y/y). This is due to the decline in liquefied natural gas (LNG) imports in volume, and the bigger-than-expected decline in the consumption of petroleum products, a priori due to the cutback in government subsidies, which encouraged more moderate energy consumption. The non-hydrocarbon trade deficit swelled to USD 33 bn from USD 31.8 bn in 2016/2017.

So far, the depreciation of the Egyptian pound has had only a limited impact on exports. On the one hand, winning export market share does not seem to be a priority for the companies (according to EBRD[2], only 5% of Egyptian companies are exporters). On the other hand, the shortage of investment hurts the competitiveness of exports. All in all, the trade deficit narrowed to 15% of GDP in 2018, which is still near an all-time high (16% of GDP in 2017).

Favourable outlook

Over the next two years, the current account balance should continue to improve, although it should remain in negative territory. The trade deficit should continue to narrow as the country temporarily becomes a net gas exporter. The energy deficit contracted sharply in the first half of 2018/2019 to USD 0.6 bn (vs USD 2.2 bn in the year-earlier period). The start-up of new refining capacity should also reduce imports of oil products. Non-hydrocarbon exports should continue to grow at a moderate pace, while the gradual acceleration in economic growth is expected to boost imports. We also expect private domestic productive investment to recover mildly as of 2020, which should boost capital goods imports.

At the same time, the tourism sector is expected to become the driving force behind the improvement in the external accounts. Although the strong rebound in 2018 is unlikely to be replicated, activity should pick up and benefit all of Egypt's tourist sites. The expected opening of the Grand Egyptian Museum as of 2020 will also provide the sector with an extra boost. Suez Canal revenues are unlikely to increase significantly at a time when oil prices are expected to be virtually flat.

The current account deficit is expected to narrow to 2.1% of GDP in 2019 and 1.9% of GDP in 2020. Thereafter, it could widen since Egypt is likely to become a net gas importer again in 2020/2021[3], and investment growth is likely to fuel imports. There are several risks that could have a negative impact on this scenario, notably a deterioration in the security situation, the application of more restrictive labour policies for expats working in the Gulf countries, and a significant increase in oil prices[4].

Slowing capital flows

In 2017/2018, portfolio investment flows and new external debt issues covered most of external financing needs (i.e. the current account deficit of USD 6 bn plus USD 2.3 bn in external debt amortisation) (Chart 4). Non-resident investors took advantage of high local interest rates, and counted on the stability of the exchange rate to invest massively in the market for Tbills in the local currency. Net portfolio investment flows slowed to USD 12 bn, from USD 18 bn in 2016/2017.

Egypt: net capital flows

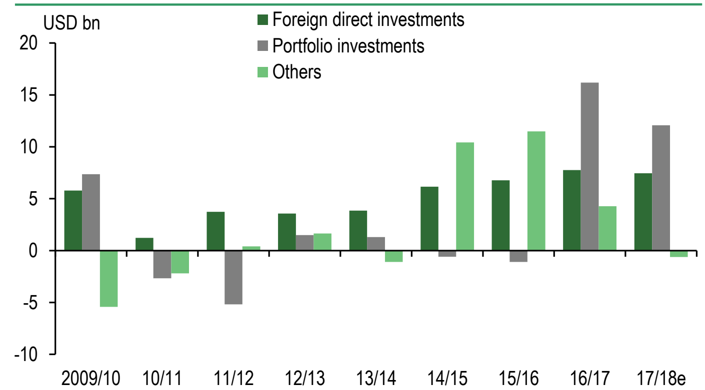

Chart 4 Source: Central Bank of Egypt, BNP Paribas

Similarly, flows of foreign direct investment (FDI) remained strong at USD 7.4 bn, although they are still concentrated in the hydrocarbon sector. Debt flows from bi-lateral and multi-lateral creditors were also high at about USD 10 bn.

[2] EBRD: *Private sector diagnostic. Egypt*. March 2017

[3] Only the start-up of new gas fields would enable the country to cover its domestic consumption needs, which are growing rapidly (+14% in 2017).

[4] Egypt has been a net importer of crude oil since 2009.

The outlook for capital flows is positive in the short term. After the slump in the emerging markets in 2018, the amount of local debt held by non-residents was slashed in half in Egypt. Since early 2019, international investors have returned to the T-Bill market in local currency, and net portfolio investment inflows have become positive again. They are expected to remain positive throughout 2018/2019 and 2019/2020. Even though the gradual decline in interest rates could reduce the yields on Egyptian sovereign debt instruments in the local currency, the risk/return couple will remain favourable thanks to the steady improvement in Egypt's sovereign rating and the appreciation of the Egyptian pound, at least in the short term. As to FDI inflows, we do not foresee a significant upturn outside of the hydrocarbon sector. With the end of the IMF support programme, external debt flows should diminish over the next two years, although they will continue to be supported by Eurobond issues.

Foreign currency liquidity is comfortable in the short term, but vulnerability to portfolio investment flows persists

External liquidity picked up in 2017/2018. The Egyptian Central Bank's official foreign reserves increased by USD 13 bn to a total of more than USD 44 bn, the equivalent of 7.2 months of imports of goods and services (Chart 5). Alongside these official reserves, there are also non-official reserves, also known as Tier 2 reserves, which are reported in a separate account on the central bank's balance sheet. They serve as a safety net in case of a massive flight of non-resident portfolio investment. At the end of 2017/2018, Tier 2 reserves amounted to USD 9 bn, equivalent to 54% of the amount of Treasury bills held by non-residents. Official reserves are expected to continue growing in 2018/2019, to USD 47 bn.

Egypt: Central bank foreign reserves

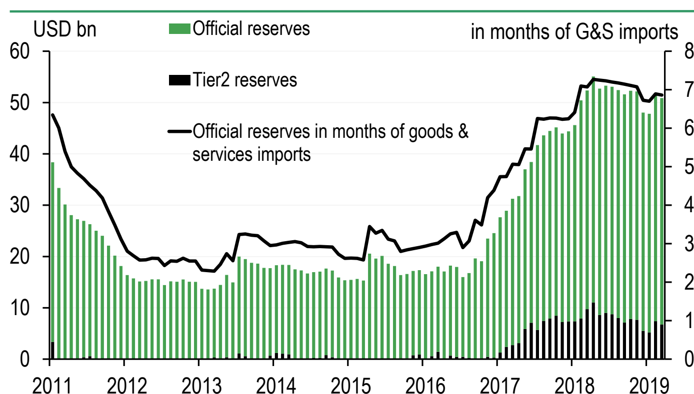

Chart 5 Source: Central Bank of Egypt, BNP Paribas

Yet this improvement in foreign currency liquidity was partially achieved to the detriment of the external position of commercial banks. In 2018, a big part of portfolio investment outflows were supported by the banks. The ending of CBE's repatriation mechanism redirected part of portfolio investment flows from the central bank's balance sheet to that of the commercial banks. Consequently, the banks' net external position deteriorated sharply as of mid-2018 and became negative. Net external liabilities amounted to USD 6.4 bn at the end of 2018. Yet thanks to the reduction in the current account deficit in the first half of 2018/2019 and renewed capital inflows since early 2019, the banks have virtually balanced their net external position since the end of February 2019 (USD -0.13 bn) (Chart 6).

Egypt: banking system net foreign asset and carry trade flows

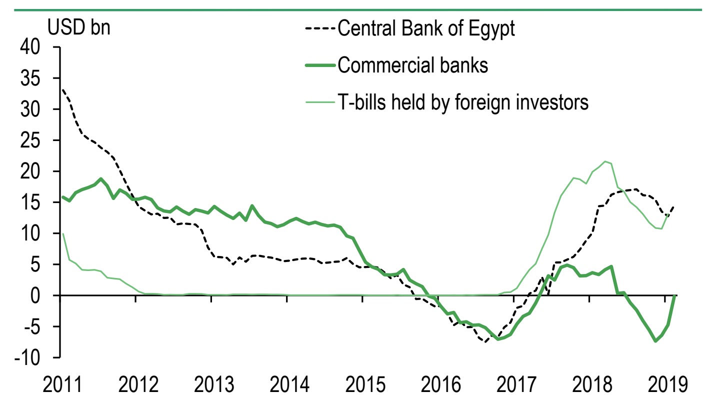

Chart 6 Source: Central Bank of Egypt, BNP Paribas

Moderate external debt

External debt has increased significantly since 2016 with the increase in official bi-lateral and multi-lateral loans, and the government's Eurobond issues (USD 20.5 bn). Yet this is still relatively moderate at 38% of GDP at year-end 2017/2018 (vs 17% in 2015/2016).

At year-end 2017/2018, the government external debt was 19% of GDP and 10.6% of GDP for the central bank (in the form of foreign government deposits). Banks and private companies have low external debt ratios of 2.4% and 5% of GDP, respectively. Government debt benefits from favourable financing conditions: the apparent interest rate on total public external debt[5] is low, at 1.1% in 2017/2018. The total external debt service (interest and amortisation) accounts for only 7% of current account revenues. This ratio is expected to remain stable over the next two years. As a consequence, external debt is not a source of vulnerability for external liquidity.

In the medium term, the external debt ratio should narrow to 30% of GDP in 2019/2020, assuming the fiscal deficit remains under control.

[5] External debt interest payment as % of external debt stock

The government has pledged to limit its use of external debt. Moreover, productive investment is not expected to pick up before 2020, and Egyptian companies are traditionally reticent to finance their development through foreign currency debt.

Public finances are gradually improving

Public finances are still the weak point of the Egyptian economy. Despite a sharp reduction in the primary fiscal deficit, the total fiscal deficit remains high due to a debt servicing charge that is difficult to manage.

Towards a primary surplus

Since 2011, political upheavals have disrupted the public finance situation, and the fiscal deficit has soared above 10% of GDP (Chart 7).

Reforms implemented since 2016 have significantly reduced the deficit. The gradual deregulation of energy prices was a key factor, thanks notably to cutback in subsidies (Chart 8). Subsidies averaged 6% of GDP between 2011 and 2014, but were trimmed to 5.3% of GDP in 2018. Concerning fiscal revenues, reform efforts were much more timid. Fiscal revenues amounted to only 14% of GDP. Non-tax revenues, which are mainly comprised of dividends distributed by state-owned companies, are less significant. These dividends are rather volatile due to their dependence on oil prices and Suez Canal activity.

Egypt: general government fiscal balance (% of GDP)

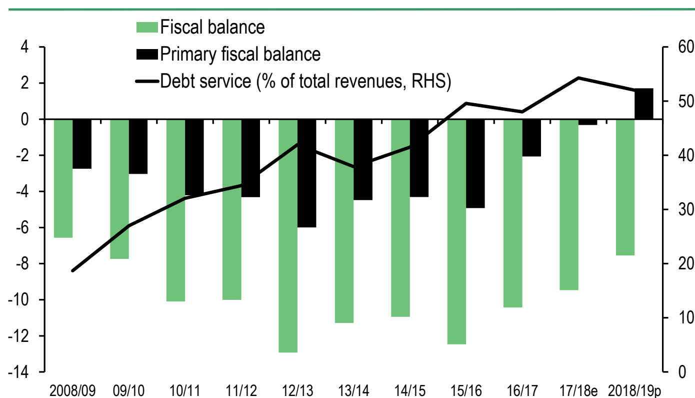

Chart 7 Source: Ministry of Finance, BNP Paribas

Total government revenues have not improved: they amounted to only 20.5% of GDP in 2018, compared to a 2012-2015 average of 22% of GDP. The most notable improvement in government revenues was the increase in the tax on goods and services, which is the easiest way to increase fiscal revenues. It is harder to increase government revenues via income and earnings taxes given the size of the informal sector (at least 40% of GDP) and efforts to attract foreign investment through lower taxes. It is also difficult politically to increase income taxes at a time of high inflation. All in all, despite stagnant revenues, the reforms significantly improved the primary fiscal balance (excluding interest payment on government debt). For the year 2017/2018, the primary deficit shrank to 0.3% of GDP, compared to an average of 4.3% of GDP for the period 2013-2017.

Over the next two fiscal years, the primary balance is expected to shift into positive territory again, at 1.7% and 3.3% of GDP, respectively, in 2018/2019 and 2019/2020, thanks to ongoing cutbacks in energy subsidies (the next reduction, programmed for 2019, will save EGP 37 bn) and a mild increase in tax revenues. Social expenditures (food subsidies, social transfers and civil servant wages) will increase to offset the decline in disposable household income. Initiated in 2016/2017 and continued in 2017/2018 for a total of 2.4% of GDP, investment efforts will be continued. The 2019/2020 budget proposal calls for investment in healthcare and education to be increased by more than 10%. Future oil price trends are the biggest uncertainty concerning the improvement in the primary balance. Over a given fiscal year, it is estimated that a USD 1 increase in the Brent crude oil prices increases spending by the equivalent of EGP 2.3 bn (about 0.04% of GDP).

Egypt: subsidies & wages

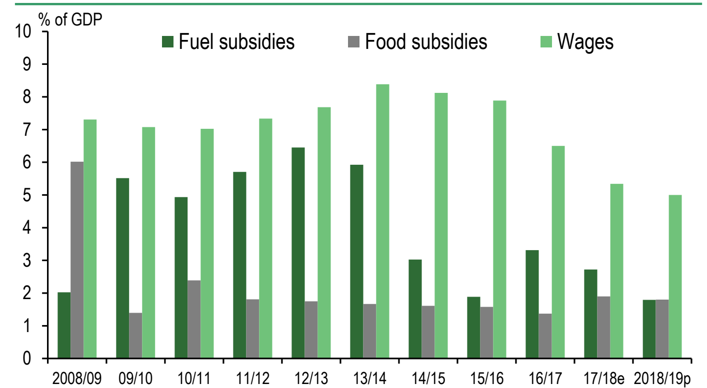

Chart 8 Source: Ministry of Finance, BNP Paribas

Debt service is hard to control

Despite the decline in the primary deficit, the total fiscal deficit will remain high due to swelling interest payment on government debt. As a percentage of GDP, interest payment hit a record high of 9.9% in 2018 and accounted for 54% of total fiscal revenues, by far the highest level among the middle-income emerging market economies. Unsustainable in the medium term, this debt service is notably due to the sharp increase in EGP interest rates after the pound's flotation. Since 2016/2017, the average interest rate on Treasury notes maturing within a year averaged more than 17%, compared to less than 13% in

2015/2016. Debt issues in the international markets have picked up again since 2015 and amounted to USD 20.5 bn. External debt as a share of total government debt rose from 7.4% in 2015/2016 to 21% currently. The average interest rate is 6.9% depending on the maturity. For the moment, the volume of new issues is not high enough to reduce the average interest rate on total government debt.

Egypt: interest rate on 1 year T-bills

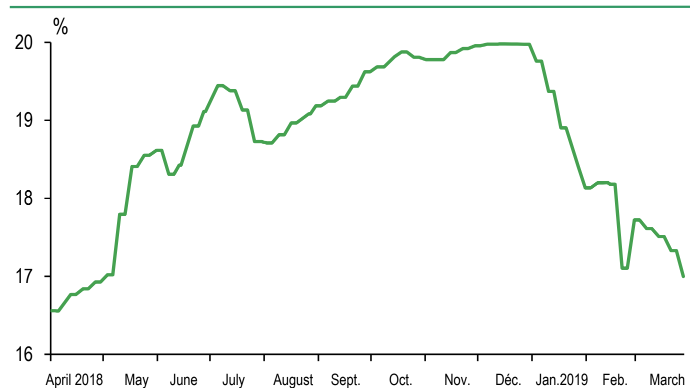

Chart 9 Source: Central Bank of Egypt

Interest rates on domestic debt issues have begun to fall significantly since the beginning of 2019. In the secondary market, interest rates on securities with a maturity of one year have fallen by more than 250 basis points (bp) since the end of 2018 (Chart 9). Falling interest rates will have a small impact on interest payment in the short term, notably due to the very high level of interest rates on issues in the first half of 2018/2019 (which averaged more than 19.5%). All in all, since interest rates are expected to decline very gradually, debt service will remain high in the short term. In the medium term, in contrast, the combination of lower interest rates and longer bond issues on the domestic market[6] should have a significant impact on debt service. In 2018/2019, we estimate interest payment at the equivalent of 9.3% of GDP and 52% of total fiscal revenues. After levelling off in 2019/2020, it should begin to decline as of 2020/2021, to reach 6.8% of GDP.

Though in decline, the fiscal deficit will remain high. From 9.5% of GDP in 2017/2018, it is expected to narrow to 7.6% in 2018/2019 and 6.3% of GDP in 2019/2020.

High government debt

Cumulative deficits since 2011 have swollen government debt, which rose to 93% of GDP in 2017/2018. With the gradual improvement in the public accounts, the debt ratio should narrow to 87% of GDP in 2020/2021 (Chart 10). Government debt is mostly comprised of local currency instruments with short maturities. At the end of September 2018, 45% of government debt issued in the local market was comprised of Treasury bills with a maturity of less than a year.

The share of debt denominated in foreign currency was equivalent to about 18% of the total (19% of GDP). About two thirds of the external debt benefited from favourable financing conditions (i.e. concessional loans), and the remainder was comprised of Eurobonds. If we include Treasury bills issued on the local market but denominated in foreign currency, total debt in foreign currency accounted for about 25% of total debt (26% of GDP).

In the medium term, the government's external debt is expected to continue to increase, albeit at a moderate pace. Given the government's commitment to limit Eurobond issues to USD 30 bn by 2022, the government's external debt is likely to reach 21% of GDP in 2020/2021.

Egypt: general government debt

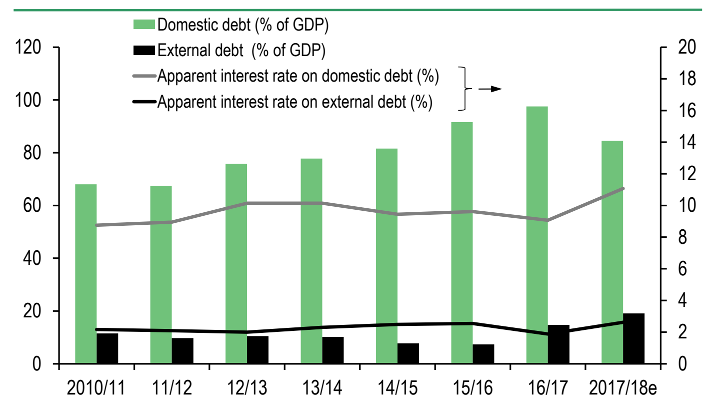

Chart 10 Source: Ministry of Finance, BNP Paribas

No short-term financing risk

After a few temporary difficulties in 2018 caused by an upsurge in risk aversion towards the emerging economies, the financing of the fiscal deficit seems to be assured in the short term.

The central bank's holdings of public securities should remain stable, while commercial bank loans to the government should increase by about 15%, in line with the growth of deposits (Chart 11). Non-resident investors returned to the local bond market in January 2019, and this trend is likely to be confirmed in the second half of 2018/2019. Non-resident investors are attracted by the improvement in Egypt's sovereign rating and by the appreciating trend of the Egyptian pound in the short term. Moreover, Eurobond issues will amount to at least USD 6 bn, and the IMF's last pay outs[7] will total USD 4 bn. There are also other sources of bilateral and multilateral financing. The main risk lies in the volatility of non-resident investors' appetite for Egyptian debt

[6] The Finance ministry wants to increase the share of domestic long-term bond issues from 5% to 70% by 2020.

[7] USD 2 bn was paid out in February after the conclusion of the fourth review, and another USD 2 bn after the fifth and final review in the first half of 2019.

in the local currency, which depends not only on their appetite to the Egyptian market, but also to the emerging markets in general as an asset class. In case of need, the commercial banks still have abundant excess liquidity, as illustrated by the Central Bank of Egypt's open market operations.

Egypt: government debt holders

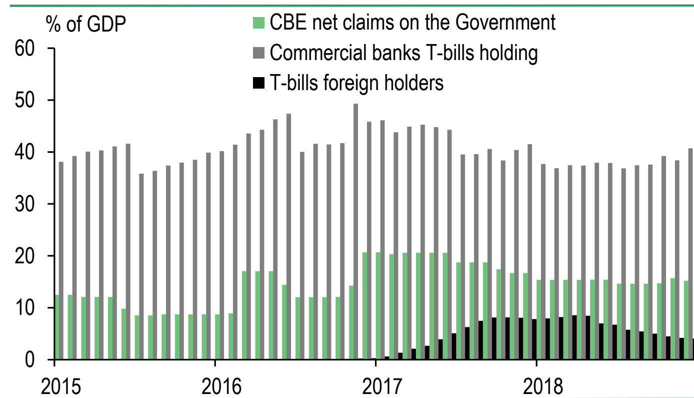

Chart 11 Source: Central Bank of Egypt, BNP Paribas

Persistent inflationary pressure

After rising sharply on the back of economic reforms, the inflation rate is currently declining. Yet with Egypt's external vulnerability and structural headwinds, inflation will remain high and hard to control.

Consumer prices decline gradually

The reforms implemented since the end of 2016 have had a big impact on inflation, which rose sharply in recent years. In addition to structural factors, several short-term factors are also maintaining Egyptian inflation at a high level, including the depreciation of the Egyptian pound, cutbacks in energy subsidies and the upturn in oil prices since 2017.

Yearly average consumer price inflation rose to an all-time high of 30% at year-end 2017. Since then, it has slowed to an average of 21.5% in 2017/2018, from 23.3% the previous year (Chart 12). Since the beginning of 2018, the stabilisation of the Egyptian pound and, to a lesser extent, the end of the monetisation of part of the fiscal deficit, has helped bring down inflation. It is hard to estimate the impact of monetisation of the deficit on inflation. The Central Bank of Egypt has reduced its holdings of public debt instruments (from 25% of M2 money supply in 2016/2017 to 21% in 2017/2018). Since May 2018, the headline and core inflation differential has widened at a time of lower energy subsidies. This points to a favourable trajectory for the core inflation rate, which absorbed the inflationary impact of economic reforms. Food prices are once again a key determinant of rising inflation. Core inflation has held below 10% since the beginning of 2018/2019.

We expect consumer price inflation to average 13.8% in 2018/2019 and 10.7% in 2019/2020. In the medium term, inflation is expected to remain relatively high (average annual rate of 8-10%) due to structural factors, including the rigidities of food supply (transport and marketing), the importance of traditional commerce as opposed to modern retailing, and the vertical integration of certain food producers, which gives them control over retail prices. In the medium term, the Egyptian pound is expected to follow a downward trajectory, a source of imported inflation.

Egypt: CPI inflation

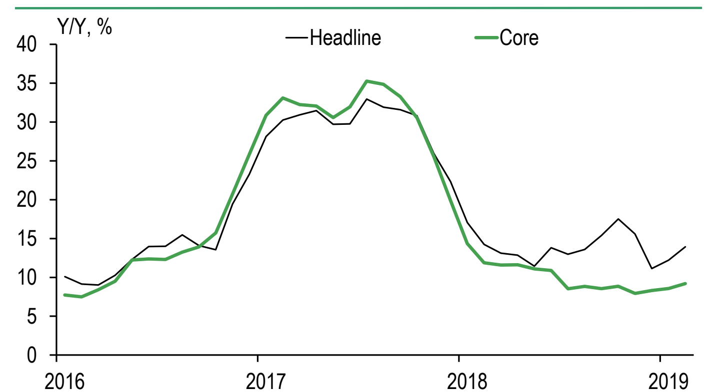

Chart 12 Source: Central Bank of Egypt, BNP Paribas

Monetary policy gradually becomes more accommodating

The central bank began easing its monetary policy in 2018. Yet faced with persistently high inflationary pressures, key rates will be lowered very gradually.

Gradual monetary easing

The central bank is conducting an inflation-targeting monetary policy that aims to bring inflation sustainably below the 10% threshold in the medium term, with a short-term target of 9% (+/-3% by year-end 2020). After the sharp rise in key rates following the pound's flotation, monetary policy was tightened regularly through February 2018 to counter strong inflationary pressures (Chart 13). Higher interest rates curbed private sector investment and drove up interest rates on T-Bills in the local currency. Starting in February 2018, the Central Bank of Egypt began easing financing conditions, with a cumulative 300bp cut in the key rate, to 16.75% at the end of February 2019. The central bank also launched open market operations in the form of deposit facilities for commercial banks, to better control the liquidity in circulation in the country. The amount of these open market operations is still high: the equivalent of 18% of M2 money supply at end-January 2019, down slightly compared to the November figure (23% of M2), but still

significantly higher than before the pound's flotation (less than 10% of M2).

Egypt: interest rates

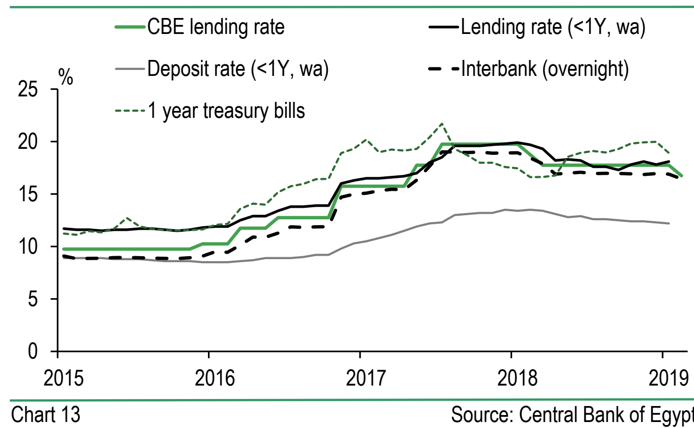

Chart 13 Source: Central Bank of Egypt

Currency liberalisation

The central bank does not have an official exchange rate management policy. Since November 2016, the price of EGP is determined by the foreign exchange market, in which the central bank does not intervene. Yet by setting up a repatriation mechanism, the central bank was implicitly able to influence the forex market.

This mechanism, which offers some guarantees to non-resident investors[8] intervening in the government bond market in the local currency, channelled these investment flows towards the central bank's balance sheet. Despite about USD 10 bn flowing out of the country in 2018 (compared to a maximum of more than USD 20 bn in non-resident portfolio investment stock), the Egyptian pound basically remained stable over the period. The central bank's official foreign reserves also remained stable, while Tier 2 reserves and the net external assets of commercial banks dropped off significantly.

The stabilisation of the exchange rate helped limit imported inflation and reassured foreign investors given the limited possibilities of hedging against currency risk. Both factors were priorities for the economic policy pursued since year-end 2016. At the end of 2018, the central bank halted its repatriation mechanism, and a growing share of foreign currency flows are now fuelling the interbank market in foreign currencies. Given the currently favourable trends in the external accounts, this has resulted in a slight nominal appreciation of the pound. Yet given the depreciation of numerous emerging market currencies since 2017 and Egypt's high inflation rate, the pound's nominal stability could potentially have a negative impact on the competitiveness of Egyptian exports.

Based on our estimates of the pound's real exchange rate, the country has lost competitiveness against the EUR and the USD. On average (in EUR and USD), the pound's real exchange rate has appreciated by 31% since year-end 2016, while it remained flat in Morocco and depreciated by 32% in Turkey (Chart 14). Even though Egypt is unlikely to become a major merchandise exporting country, certain sectors, notably food and textiles, are very sensitive to price competitiveness. Given this external trade policy challenge, we estimate that the pound appreciation is expected to remain limited.

Real exchange rate against USD

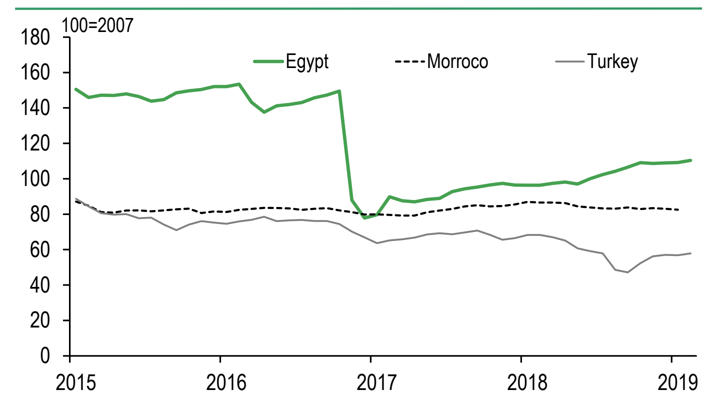

Chart 14 Source: IMF, BNP Paribas

An economic structure unfit for the demographic challenge

Economic growth has been relatively buoyant since 2015, but its capacity to absorb a fast-growing active population is still limited. This is notably due to the social impact of macroeconomic consolidation and the persistence of structural constraints.

Gradual economic recovery

The Egyptian economy entered a recovery phase in 2015, and real GDP growth has averaged 5% over the past three years, compared to an average of 2.6% for the period 2011-2014 (Chart 15). The positive contribution of net exports and the dynamic momentum of infrastructure and energy investment are the driving forces behind this recovery. Private consumption, which accounts for more than 80% of GDP, also made a positive contribution, but it was highly restricted by the impact of economic reforms on household purchasing power (Chart 16).

We expect growth to accelerate in the short term thanks to the steady improvement in household purchasing power as inflation gradually

[8] The availability of foreign currency is guaranteed to foreign investors when they repatriate their funds.

eases. Investment prospects are still favourable, notably in the energy sector, but on a smaller scale than in recent years (Chart 17). Similarly, infrastructure spending will remain high. In contrast, a significant rebound in investment in non-hydrocarbon manufacturing seems unlikely in the short term. Although high interest rates are hampering a rebound in investment, they are not the biggest constraint.

Egypt: real GDP growth

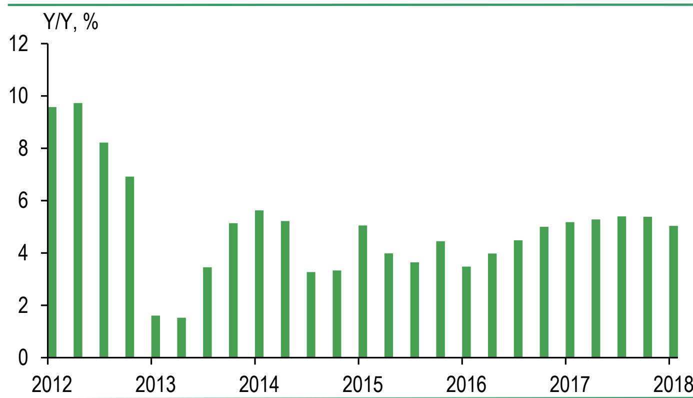

Chart 15 Source: Ministry of Planning, BNP Paribas

Egypt: contributions to real GDP growth (Y/Y, %)

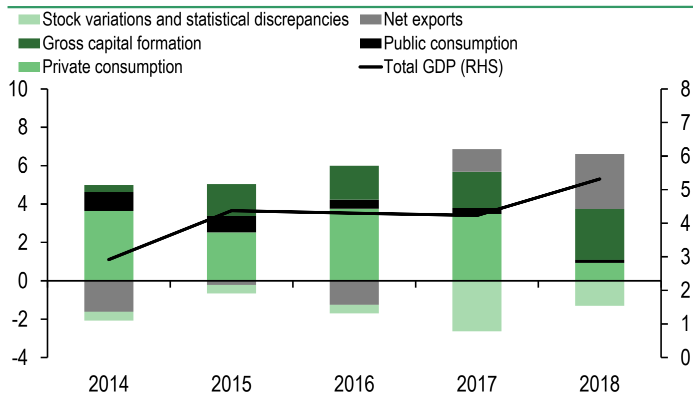

Chart 16 Source: Ministry of Planning, BNP Paribas

Real interest rates reach about 3.5-4%, which is comparable to the levels found in numerous emerging countries. They do not seem to be a major constraint for investment decisions in those countries. Other structural and cyclical factors are curbing investment momentum in the private manufacturing sector. Foreign trade is unlikely to be a growth engine. The increase in hydrocarbon output is a factor that reduces imports, but consumption and investment are highly dependent on imported goods, a trend that is likely to extend into the medium term. Moreover, export momentum is still mild, even though forex trends are rather favourable. Following the sharp depreciation of the pound in the foreign exchange market in 2016/2017, exporters did not significantly adjust their export sales prices in order to win market share. They preferred to use export gains to offset the decline in margins in the domestic market.

All in all, even in a steadily more buoyant economic environment, growth will not exceed 6% by 2020.

Egypt: implemented investments

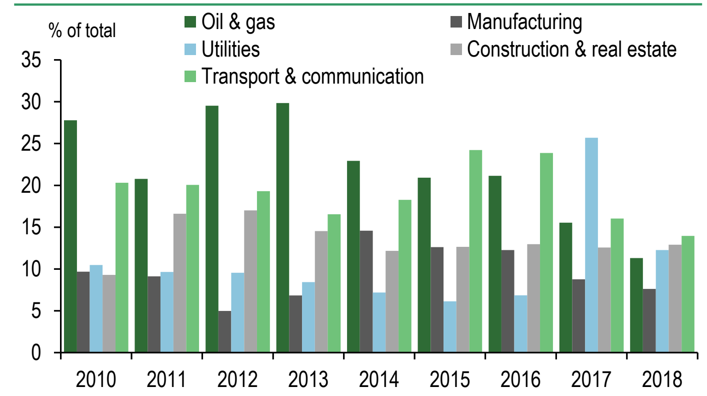

Chart 17 Source: Ministry of Planning, BNP Paribas

Insufficient job creation

Creating sufficient employment is the main challenge facing the Egyptian economy. Based on official figures, the unemployment rate does not really seem to be alarming. It has declined regularly to 8.9% at year-end 2018, from 11.3% the previous year. Yet the employment situation takes on another dimension if we integrate the share of the active population that is underemployed in the informal sector. Current demographic trends make this situation even more difficult.

Egypt has the region's highest population growth rate (about 2.5% a year) with roughly 600,000 new job market entrants each year. In recent years, however, economic growth has not been very job intensive. The main growth engines are in the energy sector, which is not very job rich, and in construction, a source of temporary employment. Companies that invest in the manufacturing sector tend to favour automation, notably in the food and consumer goods sectors. Yet tourism, a job-rich sector, rebounded strongly in 2018, and the government's policy in favour of SMEs could boost the job content of economic growth.

Growth headwinds

Structural factors

A recent study by the Institute of International Finance (IIF) [9] highlighted Egypt's long-term growth deficit relative to the average for the same category of emerging countries. Over the past thirty years, Egypt's per

[9] Abed G., Chun J., Markovic B., 2019: *Egypt: good progress to date, but sustainability requires deep, transformational change*, IIF, 20 February 2019.

capita GDP has increased by 50%, compared to a 6-fold increase for the emerging countries as a whole. The government's heavy weight in numerous economic sectors and a very centrally planned economic policy have not favoured the optimum allocation of resources.

Manufacturing value added per capita

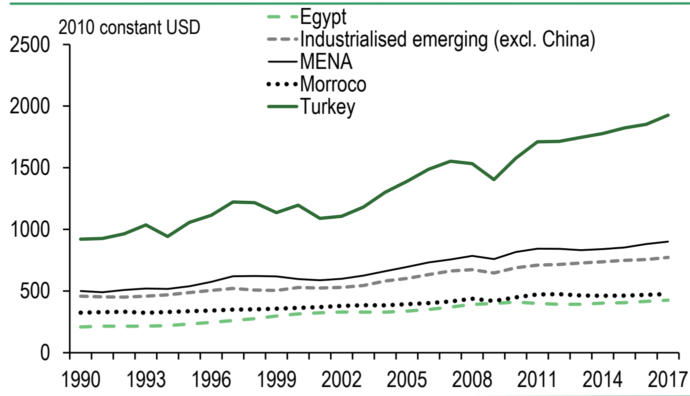

Chart 18 Source: ONUDI

This economic feature is a source of rigidity that favours rent-seeking. There are several obstacles to job-rich economic growth: a shortfall of private productive investment, a low-skilled labour force on average, and insufficient investment in research and development[10]. On the whole, Egyptian industry has not advanced much as far as global supply chains are concerned. According to the IIF, over the past 25 years, value added per capita is significantly lower in Egypt compared to the other emerging countries and the regional average (Chart 18).

Recent sector trends are unfavourable

A priori, recent structural changes in the economy do not favour a significant rebound in activity based on productive investment and job creations. The public sector accounts for about 40% of the official economy and a quarter of formal employment. For historical reasons, the public sector plays a very key role in the economy, and recent reforms have not changed this substantially. The public sector, in the broad sense of the term, remains active in numerous sectors, largely exceeding the perimeter of government functions. Access to land also remains tightly controlled. Although the public sector has been a key growth engine driving the economic recovery since 2015, the need to pursue fiscal consolidation reduces its manoeuvring room in the medium term.

The private sector is very heterogeneous. The vast majority of Egyptian companies are small businesses and micro enterprises (97% of the total according to EBRD). They account for 68% of total employment, which is much higher than for the other countries in the region (40% in Jordan and 34% in Turkey). Moreover, large-scale manufacturing companies in the consumer and capital goods sectors are focused mainly toward the domestic market. This over-representation of small and very small companies tends to curb investment. They are mainly active in the retail sector, which is not very capital intensive and does not require a high skills level.

A large informal sector

The informal sector accounts for between 40% and 50% of the economy. Traditionally, this sector is concentrated in agriculture, retail trade, craft industry and other small industry. Informal businesses require relatively little capital and training. Given the informal sector's economic vulnerability and the heavy dependence of family income on economic activity, producers tend to prefer short returns on investment and to limit high, irreversible fixed capital expenditures.

The deterioration in the broad economic situation of households almost automatically fuels growth by necessity in the informal sector. In a study by the American University of Cairo[11] on the motivation of Egyptian entrepreneurs in the formal and informal sectors, the later are especially driven by the necessity to generate income rather than by the pursuit of economic opportunities. Based on the analysis of a selection of 54 countries, Egypt has the highest proportion of entrepreneurs driven by economic need rather than seeking opportunities. Moreover, this proportion has increased significantly recently. This is due both to fewer job opportunities in the formal sectors (sharp slowdown in public sector hiring and a wait-and-see attitude in the private sector), and to the decline in economic opportunities for entrepreneurs. Ismail *et al* (2019) points out that entrepreneurs driven by necessity tend to develop business in the informal sector with low physical and human capital intensity, and very limited prospects for job creations.

All in all, the recent period of economic uncertainty and reforms eroding disposable household income have favoured the development of economic activities focused towards subsistence, to the detriment of economic opportunities, a source of productive capital accumulation.

A thriving platform economy

Alongside the traditional private/public and formal/informal dichotomies, the platform economy sector has rapidly developed in Egypt over the past few years. The platform economy is based on the formation of networks of individual "entrepreneurs" in a given economic sector, often in the services sector. The urban transport sector has been transformed by a vast, diversified development of the platform economy, ranging from motorized tricycles to bus services. Its development is having a significant impact on employment, although we do not have any precise figures[12] and it is hard to distinguish between net job creations and the

[10] Equivalent to 0.6% of Egypt's GDP, compared to 1.3% in Malaysia and Brazil and 4.3% in South Korea.

[11] Ismail A., Tolba A., Barakat S., Meshreki H., 2019: *Global Entrepreneurship Monitor. Egypt national report 2017-2018*, American University of Cairo.

[12] More than 200,000 drivers are now working for the Uber platform.

substitution of informal jobs for employment in the platform economy sector[13].

The development of a platform economy satisfies two needs: it corrects the shortcomings of Cairo's transport system and provides young graduates an opportunity to enter the job market. In terms of autonomy and flexibility, it is better alternative to the informal sector[14], but it does not provide the labour status or guarantees associated with formal sector employment. Despite its non-negligible impact on employment, the development of a platform economy does not, a priori, generate much productive investment or productivity gains, since it is mainly focused on service activities requiring relatively little capital or skills.

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Egypt has entered a new phase in the economic reform process. It is in the process of consolidating its main macroeconomic imbalances: external liquidity has stabilised at an acceptable level, and a fiscal primary surplus should be recorded at the end of the current fiscal year. Short-term prospects are positively oriented. Though narrowing, the imbalances still exist: the hard-to-curb government debt service entails a high fiscal deficit, and the decline in CPI inflation is slower than expected. Moreover the economy is exposed to exogenous factors such as commodity prices and investors' appetite for emerging market risk. Beyond that, the question of job-rich economic growth remains open. Alongside certain very dynamic sectors, notably in new technologies[15], a very large part of the economy is still geared towards rent seeking[16]. In recent years, economic policy has been characterised by a blend of old remedies (massive state interventionism) and macroeconomic consolidation. On its own, the later will not suffice to ensure a sustainable, job-rich economic recovery.

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[13] In the developed economies, to the contrary, the platform economy can be considered as a shift from formal employment to informal. Van WELSUM D., 2016: *Sharing is caring? Not quite. Some observations about 'the sharing economy*", World Development Report, World Bank, Background Paper Digital Dividend.

[14] Rizk Nagla, 2017: *A Glimpse into the Sharing Economy: An Analysis of Uber Driver-Partners in Egypt*, (22 February 2017). Available at SSRN: https://ssrn.com/abstract=2946083

[15] In 2018, Egypt reported the highest growth in investment in new technology start-ups in the MENA region. The country is the second largest destination for sector investment at the regional level (22%), after the UAE (30%). Magnitt, 2018 MENA Venture, Investment Summary.

[16] Devaux Pascal, March 2015: *Egypt: the need to reform a rent-seeking economy*, Conjoncture, BNP Paribas.

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