Arab Republic of Egypt—IMF Staff Visit
Concluding Statement
Cairo, July 16, 2009

1. **Egypt has weathered the impact of the global financial crisis relatively well.** Financial contagion was contained by limited direct exposure to affected products and low levels of financial integration, but Egypt has been more susceptible to the real spillovers of the global slowdown. However, sustained reforms since 2004 have reduced fiscal and monetary vulnerabilities, leaving some room to maneuver on the macroeconomic policy response.

2. **Fiscal and monetary policy actions helped cushion the impact of the global slowdown on economic activity in Egypt.** The government undertook a package of additional (mainly infrastructure) expenditures to help support economic activity. This is likely to be achieved within the 2008/09 budget deficit target of 6.9 percent of GDP, on account of revenue measures adopted before the crisis and careful budget execution in a difficult external environment. The Central Bank of Egypt (CBE) eased monetary policy appropriately, cutting policy rates four times by a cumulative 250 basis points since early 2009.

3. **Economic performance during 2008/09 was favorable.** Real GDP growth is expected to be 4–4½ percent, below the impressive 7 percent it has averaged in recent years, but still healthy given the global environment. Inflation fell from its August 2008 peak (24 percent) to below 10 percent in June 2009 as world food prices moderated. The current account will shift into a deficit of about 2 percent of GDP, driven by weaker exports, remittances, Suez canal traffic, and tourism receipts. Following the sharp reversal of portfolio flows in August-October, the financial situation has largely stabilized and, in recent months, the stock market has begun to recover ground lost in late 2008/early 2009. Reserve coverage remains comfortable at 6½ months of imports of goods and services.

4. **But, the economic environment will remain difficult in the year ahead.** Global growth is not expected to return to positive territory until 2010, and downside risks remain. Against this background, discussions focused on the near-term macroeconomic policy response, without losing sight of Egypt's medium-term reform objectives.

5. **Economic activity in Egypt is expected to continue to soften in 2009/10**, with real GDP growth will likely to remain below potential at around 4 percent. Private consumption is expected to be resilient, while some unwinding of the accumulation of inventories witnessed during 2008/09 could provide a small drag on growth. Near-term macroeconomic policies should continue to be geared toward supporting growth, while reducing inflation and maintaining a sustainable external position. In an uncertain global environment, the risks to the outlook remain tilted to the downside.

Fiscal Policy

6. **The expansionary stance of the 2009/10 budget aims to ease downward pressure on economic activity**. The deficit is targeted to widen to 8.4 percent of GDP, largely as a result of an expected cyclical deterioration in revenues. Given the remaining fiscal vulnerabilities and limited scope for additional stimulus, contingency plans in case of additional budget pressures should focus on postponing non-priorities while protecting social spending. On the other hand, any revenue over-performance should be used to reduce the deficit.

7. **The government's planned recourse to substantial domestic financing should be manageable, but poses risks to the rest of the economy.** With external debt relatively small, attractive opportunities to secure external budget financing should be carefully considered. Such financing would improve the debt profile, alleviate pressure on international reserves, and release resources for the private sector.

8. **For the medium-term, reducing fiscal vulnerabilities is be a precondition for achieving Egypt's growth potential.** Sustained high fiscal deficits and public debt could undermine investors' confidence and put upward pressure on the yield curve, with attendant risks to government financing costs, economic activity and the exchange rate. Government plans to resume medium-term fiscal consolidation as the global economy rebounds are well-placed. The authorities are aware that a credible fiscal consolidation strategy will be crucial to support investor confidence and foster private sector-led growth. This should be supported by policy actions to: strengthen revenues through introduction of a full-fledged VAT; and increase the efficiency and control of government spending with further rationalization of subsidies and decisive progress with financial management reforms. As plans for pension and healthcare reforms are finalized, it would be important to ensure that the potential fiscal impact is controlled.

Monetary, Exchange Rate, and Financial Policies

9. **With inflation continuing to fall and output growth below potential, there may be scope for an additional reduction in policy interest rates.** Recent cuts in rates have helped mitigate the impact of the global economic slowdown. However, monetary policy decisions in the near term will become more finely balanced, keeping a close watch on inflation trends. As 12-month inflation will continue to fall over the coming months due to a base effect, the focus should be on underlying inflation developments and prospects. In considering further rate changes, the CBE should also take into account the impact on the balance of payments.

10. **Exchange rate flexibility has increased in recent years and further moves in this direction would be appropriate.** This would help the economy adjust to the weaker external environment and provide scope for more independent monetary policy.

11. **The banking system appears reasonably well placed to withstand pressures arising from the global crisis.** Important reforms undertaken since 2004—including strengthened supervision, restructuring and consolidation, and a cleanup of NPLs—have helped make the banking system more resilient and liquidity remains ample. The CBE advised that, over the past year, NPLs have improved and provisioning is nearly complete. Nevertheless, some vulnerabilities remain, with the risk that a sharper slowdown could further erode the quality of banks' loan portfolios. The recently launched second phase of banking reforms, as well as close monitoring of financial soundness indicators, should help the authorities further reduce banking sector vulnerabilities.

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We would like to thank the Egyptian authorities for their warm hospitality and our productive dialogue during the mission's stay in Cairo.