



EXECUTIVE SUMMARY

The Egyptian economy is performing at its strongest level since the beginning of the millennium, expanding at 5.1 percent in 2004/2005, compared to 4.2 percent over the previous fiscal year and 3.4 percent during 2000/2001. The solid recovery is pursuing its course into 2005/2006. Data for the first three quarters of the fiscal year (July - March 2005) reveal that growth has picked up to 5.8 percent compared to 4.7 percent during the corresponding period in 2004/2005.¹ Equal contributions from a sustained external impulse and a buoyant domestic demand underlined the recent growth.² Inflation rates continue their downward trend³ in spite of the robust economic performance and escalating oil prices. As a net exporter of oil, Egypt stands to benefit greatly from rising energy costs. Gains from underlying structural improvements, discussed in Section I.3 and presented briefly below, have also helped offset the negative impacts of higher petroleum prices.

Egypt's public finances remain under control,⁴ and its external position remains strong despite a small narrowing of the current account surplus and a slight widening in the trade deficit.⁵ The brisk growth experienced in major industrial countries and China, new trade agreements between Egypt and other countries (e.g., Qualified Industrial Zones (QIZs) with the US, free trade agreement with Turkey) and the deepening of already existing arrangements are all serving to uphold the external sector's healthy performance.

Looking ahead, the outlook for Egypt, as for many developing countries, will depend on developments in the world economy as a whole. Whether the outcome is positive or negative hinges on the challenges to the domestic economy by a number of external factors, including: (i) the rate of Chinese economic expansion; (ii) oil prices; (iii) world inflation and interest rates; (iv) the course of current account imbalances; and (v) the value of the US dollar. These challenges are the main focus of Section I.4.

However, the risks to the Egyptian economy appear balanced. With the economy in recovery mode and the fundamentals on solid ground, the risk of a significant slowdown is not a major concern. Market conditions in Egypt, notably domestic demand, macroeconomic policies, and the confidence of businesses and investors in the economy have become stronger over the past two

years — cushioning against the potential deterioration in the external environment — and should continue to produce growth in the medium term.

Concerning domestic demand, a number of important structural and institutional changes in the trade and fiscal areas⁶ are helping reinforce the domestic stimulus. Starting in September 2004, the Government initiated significant tariff reductions, adopted a number of trade facilitation measures and implemented large-scale improvements in customs administration. In addition, a new tax code that reduces personal and corporate taxes by 50 percent was passed in June 2005. The implementation of the new tax law is being supported by aggressive efforts to modernize Egypt's tax administration. All these reforms are expected to translate into faster growth and adequate employment. Thus, while external demand has played a crucial role in bolstering the economy during the past two years, the recent increase of domestic demand should help counter any negative external factors, and should make the economy more resilient to adverse global developments in the medium term.

Strong growth rates in 2005/2006 are also likely to depend on the effectiveness of macroeconomic policies and their capacity to (i) adapt to a more globalized environment and (ii) make the environment more favorable for the private sector to drive economic growth. The most recent data indicate that the private sector accounts for most of the growth in consumption demand.⁷

With respect to the confidence of entrepreneurs and investors, a major feature of economic developments in Fiscal Year 2004/2005 has been a pronounced revival of business confidence as the economy entered a period of rapid, healthy growth. Improved confidence quickly led to burgeoning foreign investment. This helped boost business investment and suggests that economic growth may exceed 6 percent in 2005/2006.

As we continue to improve the *Egyptian Economic Monitor*, we will gradually provide our readers with deeper economic analysis and a wider coverage of policy issues. We also hope that our readers will help us, through their continued feedback and in the spirit of a public-private partnership, to make this publication more useful and interesting.

¹ See Section II: Egyptian Economy Watch

² Ibid

³ See Section II: Egyptian Economy Watch

⁴ See Section II: Egyptian Economy Watch

⁵ See Section II: Egyptian Economy Watch

⁶ See Section I.3: Challenges and Opportunities Ahead, and previous issues of the *Egyptian Economic Monitor* available at www.mof.gov.eg.

⁷ See Section II: Egyptian Economy Watch