Forbes Middle East

Cairo’s Road To Recovery

For the first time in years, most of the main economic indicators for Egypt appear to be moving in the right direction. Has the economy finally turned the corner?

When Subir Lall, the IMF’s mission chief for Egypt, sat down in late September to speak about the country’s progress, he struck an optimistic tone. The IMF agreed a three-year, $12 billion aid package for Egypt in November 2016, on condition that the government made some wide-ranging changes to its spending habits and its economic policies. Although Cairo has not hit all the targets set by the IMF this year, Lall seemed content to overlook a few shortcomings and instead focus on the “strong start” the government had made.

Since November last year, Cairo has adopted a flexible exchange rate regime for the pound, introduced several waves of energy subsidy reforms, imposed wage restraint on public sector pay and brought in a value added tax (VAT). These moves have had some painful consequences for locals—not least the soaring inflation rate—but public finances are now on a stronger footing and the indications are that the economy is starting to turn a corner.

“While it is still at an early stage, we have seen gathering strength in economic activity,” said Lall at a press conference in Washington DC on September 27. “If we look at the last fiscal year we have seen a clear pick-up in the economic activity… the drivers of this growth were manufacturing, construction, retail trade, transport and communication. So that suggests that broad-based growth is taking hold.”

It is a view that is shared by independent observers too, with Steffen Dyck, a senior credit officer at ratings agency Moody’s Investors Service, acknowledging that “reforms are showing positive results”.

Of all the changes made by the government, it is the foreign exchange regime which has arguably had the most dramatic effect. Dyck notes that the currency liberalization in November 2016—which lead to a rapid 50% fall in the value of the Egyptian pound—helped to “reduce the country’s balance of payment pressures and support the government’s external liquidity position.”

The signs of improvement are evident in many areas of the economy, not least the tourism sector which appears to be enjoying a new lease of life after a particularly torrid period. As well as the political upheaval caused by the 2011 revolution which ousted President Hosni Mubarak and the 2013 uprising which unseated his replacement Mohamed Morsi, the industry was badly hit by the bombing of MetroJet flight 9268 from Sharm El Sheikh in October 2015 and the crash of EgyptAir flight 804 in May 2016.

The fall in visitor numbers as a consequence of such events was dramatic, with just 5.4 million arrivals in 2016, compared to 14.7 million in 2010—a fall of 63%. Now, however, a recovery appears to be underway. According to the Middle East Hotel Benchmark Survey produced by consultancy firm EY, Cairo's hotels enjoyed the fastest growth in revenue per average room (RevPAR—a key industry metric) of any major city in the region, with a 101.7% increase in the first half of 2017 compared to the same time in 2016.

This is a notable indicator, given the importance of the tourism sector for the economy as a whole, but it is still too early to be confident that the upturn will be sustained. Official data shows that, on a fiscal year basis, the number of visitors in 2016/17 fell to 6.6 million, down from 7 million in 2015/16. Some observers caution that the recovery remains fragile and may not continue at the rate the authorities would like.

"Government hopes that the [tourism] sector can quickly return to its pre-2011 heyday are well wide of the mark, but a pick-up in tourist receipts should still help to narrow the large current account deficit and could contribute as much as 1 percentage point to annual real GDP growth over the next couple of years," says Jason Tuvey, Middle East economist at London-based research firm Capital Economics.

Adding to the sense of a recovery is the improvement in the inflation rate. This eased back from a 30-year high of 33% in July to 31.9% in August. That is still an uncomfortably high number, but the small fall suggests the worst may be over. The elevated level of inflation had been caused in part by the fall in the value of the pound, along with the subsidy cuts and tax increases, but as the comparative effects of those start to unwind inflation should start to reduce.

Egypt's budget deficit has also narrowed over the past year, which gives the government a little more room for manoeuvre. According to data from the Ministry of Finance, the deficit for the period from July 2016 to May 2017 was 9.5% of GDP, down from 11.5% for the same period a year earlier. The improvement came from a combination of spending restraint, with government expenditure dropping from 24.2% of GDP to 23.1%, and an increase in revenues from 13.2% of GDP to 13.8%.

The spending cuts are part of the IMF-imposed reform program, but they have not been quite as far-reaching as originally planned, due to the sharp fall in the value of the pound after it was floated. Although energy subsidies have been pared back, the increased cost of imported fuels in local currency terms has meant that government costs in this area have remained high. That in turn means Cairo is set to miss the deficit target set by the IMF by around 0.7% of GDP this year, according to Capital Economics

The IMF's Lall brushed off concerns around this, saying that missing the target was "due to factors outside the control of policymakers" and therefore "not a major issue". Even so, if the situation continues it could lead to some tension between Cairo and the IMF. "Further slippage would probably prompt the Fund to push for more austerity, which could test the government's resolve," says Tuvey.

The improvements made to Egypt's economy over the past year have certainly been important, but the country is only half way towards recovery. Unemployment remains extremely high at 12% and investor confidence remains fragile. The three big credit ratings agencies have yet to make any changes to their ratings for Egypt, and all still have the country firmly in 'junk' status.

However, in what could be an indication of things to come, one of the smaller agencies upgraded its sovereign rating for the country on September 1. Capital Intelligence Ratings promoted Egypt's long-term foreign and local currency ratings from B- to B, citing improved macroeconomic management, replenished foreign reserves and the smooth transition to the floating exchange rate, among other things. “Stronger signs of the restoration of investor confidence and increased macroeconomic stability have started to emerge,” said the firm’s sovereign analyst Dina Ennab.

That offers a note of optimism for the authorities in Cairo, but there are just as many reasons for caution. Public dissatisfaction at the subsidy cuts could yet lead to renewed political upheaval while events beyond Cairo’s control such as a sharp rise in international oil prices or a renewed wave of terrorist attacks, could easily send the nascent economic recovery off course. Security threats have certainly not disappeared, as was shown on September 11 when an attack by Islamic State militants on a security convoy in the Sinai Peninsula left at least 18 dead and others injured.

As Lall noted at his press conference, “I will caution, it’s still very early days.”

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