ERF Policy Brief

Countermeasures for the COVID-19 Outbreak in Egypt:

This Time is Really Different

Sarah El-Khishin

About the author

Sarah El-Khishin is a Lecturer in Economics, the British University in Egypt.

In a nutshell

- *Egypt's ability to sustain the outcomes of recent reforms to the economy is under threat given the anticipated global and domestic growth slump – particularly since the causes, complexities and economic consequences of the coronavirus outbreak indicate that this crisis really is different.*
- *Accommodative countercyclical monetary-fiscal-financial measures, which are inevitable at the moment, need to be timely yet cautiously handled.*
- *Institutions matter now more than ever: sound monetary-fiscal-financial institutions will act as a safeguard against the misuse of countermeasures after the crisis.*

Introduction

In their book *This Time Is Different*, Carmen Reinhart and Kenneth Rogoff argue that although policy-makers usually believe the opposite, crises in recent history are generally initiated by similar causes – such as investment euphoria, financial innovations and easy monetary policy, as well as overconfidence in the economic outlook – all of which end up in financial deleveraging that is then transferred to the real economy. But an initial assessment of the COVID-19 pandemic and the consequent onset of a global slump show that this time might *really* be different!

The unique characteristics of COVID-19 outbreak are profound. The outbreak initiated in the economic sector, resulting in both supply and demand shocks that were rapidly transmitted to financial markets. Moreover, COVID-19 came with an already fragile global outlook and a slowing of economic activity. And it aggravated pre-existing global and regional panics involving oil price disturbances, trade war tensions and distracted supply chains, as well as intense Middle East political disruptions.

For Egypt, it is further complicated as part of this puzzling global and regional scene by being a very vulnerable economy:

- The country is currently undergoing a radical programme to reform longstanding monetary and fiscal problems as well as persisting structural imbalances.
- This crisis involves many vulnerable sectors, such as tourism and foreign financial flows, as well as a manufacturing sector that is highly dependent on imported raw materials and deeply involved in global supply chains.
- Egypt has been excessively exposed to continuing episodes of domestic political disruptions, starting from the 2011 revolution, through a set of successive political cycles and ending with the recently escalating Egyptian-Ethiopian tensions.
- The country is still struggling with fragile socio-economic and welfare status.
- And it continues to suffer from weak credibility and modest institutional performance that affect economic variables and public expectations, especially during times of abrupt uncertainty.

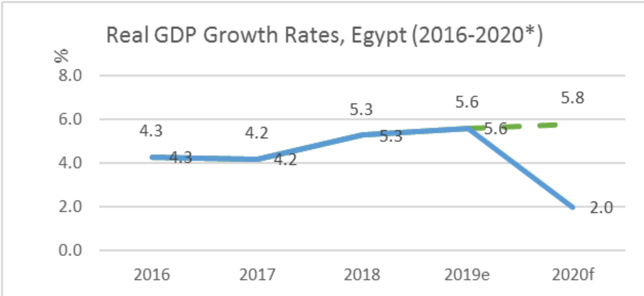
Potential economic effects of the outbreak on Egypt

Given the many uncertainties, it is difficult to quantify the likely impact of the COVID-19 outbreak on the Egyptian economy. But expected implications can be roughly sketched under three interrelated categories:

- First, direct effects of the domestic spread of the pandemic and the consequent threats to sufficient medical coverage, pressures on the budget, as well as the sharp deterioration in vulnerable sectors, such as tourism, logistics and civil aviation.
- Second, spillover effects of the global slump, especially in the manufacturing sector as a result of interrupted supply chains and lockdown in the global aviation industry. This is in addition to the implications of the global growth slowdown, declining oil prices, disturbances in global pharmaceutical sector and fallouts in financial markets.
- Finally, outcomes of increased uncertainty and risks and the so-called economics of fear, which can have serious implications for many macroeconomic aggregates, notably exchange rates, consumption trends and inflation rates and investment sentiments, as well as stock market performance.

Threats to the sustainability of IMF-supported reforms

The Egyptian economy has been undergoing a radical reform programme since 2016, supported by a $12 billion extended facility from the International Monetary Fund (IMF). Through a set of aggressive austerity measures, the reform has evidently resulted in remarkable fiscal and monetary developments and restored confidence in the Egyptian economy. But sustaining those short-lived outcomes of this reform is now under threat given the global and domestic hit of COVID-19. The World Bank has already announced a revised growth forecast for the Egyptian economy in 2020, from 5.8% to 3.7% (figure 1).



Source: WEO, 2020

Monetary-fiscal-financial policy responses to the pandemic

Egyptian post-COVID-19 policy packages are consistent with global advice and actions towards implementing conventional countercyclical toolkits in the form of accommodative monetary policy, fiscal stimulus packages and financial measures to ensure liquidity. This is in addition to targeted measures to protect vulnerable sectors and groups mostly hit by the pandemic.

Egyptian Countercyclical policy responses in the context of global practices and advice

Examples of monetary-fiscal financial practices and advice in response to the pandemic	Egyptian-announced policy measures in response to COVID-19
1. Increased emergency health spending	• 100 billion Egyptian pounds COVID-emergency budget financed through budget reserves
2. Targeted monetary-fiscal measures to protect vulnerable groups and sectors: • Widen social protection and extend social benefits for vulnerable groups • Urgent measures to protect small and medium-sized enterprises (SMEs) • Protect vulnerable economic activities: tax reliefs and VAT tax extensions	• Central Bank of Egypt (CBE) decision to expand term lending for SMEs loans six months • Tax reliefs: Egyptian Exchange tax relief, tax on dividends cut into half, real estate tax relief • Decreasing electricity and natural gas prices • Speeding up SMEs new Act and Real Estate tax Act amendments and incentives framework • Decreasing interest on mortgage loans, industrial initiatives and tourism activities to 8% instead of 10% • CBE extending the exemption of certain food products from cash cover requirements for one year • Minister of Social Solidarity announced the expansion in scope and coverage of the conditional cash program 'Takaful and Karama' by 60 thousand families. • Announced social transfer of 500EGP to irregular/seasonal workers for 3 months.
3. Accommodative monetary policy, financial measures to increase liquidity and broad-based fiscal stimulus to ease stress, boost aggregate demand and restore confidence	• CBE decreases policy rates by 300 basis points • Raising income tax exemption to 15,000 Egyptian pounds • CBE initiative on non-performing personal loans • $50 billion support package to mortgage finance.
4. Electronic means for basic services to ensure business continuity	• More e-banking activities are announced and incentivised • MCIT incentives packages announced for online payment of mobile and internet transactions

Countercyclical measures to accommodate the economic impacts of the pandemic in Egypt: how much is enough?

Countering the global and domestic economic slowdown is inevitable. Easier monetary policy and financial measures in Egypt are also wise and were expected given the global decline in interest rates, stability in domestic inflation rates and short-term expectations, leveraged foreign reserves and improved fiscal aggregates – all in addition to the need to move forwards to a growth-driven phase, to boost productive sectors and to decrease the public debt burden.

Fiscal stimulus measures are also necessary for the current phase and some of them need to be sustained after the crisis. Nevertheless, while it is uncertain and too early to anticipate when this crisis is going to end, whether it is temporary or will end up in a global recessionary wave, the question now is: how much is enough?

In other words, what are the safeguarding criteria against the excessive use of accommodative measures beyond the crisis? The answer lies simply in one word: institutions.

Institutions matter now more than ever

Reviewing policy packages in previous crises, there is much to be said about the importance of implementing countercyclical policies within a proper institutional framework. Nevertheless, the Keynesian conventional wisdom of countercyclical policies needs to be addressed with caution in developing countries usually suffering from:

- Prolonged recessions and short boom times – and hence, prolonged expansions in fiscal policy as opposed to short times of rationalised spending.
- Persistent structural fiscal problems regardless of the economic cycle.
- Weak multiplier effects.
- Poor budget processes and weak fiscal institutions where stimulus packages may become inefficient/abused/hazardous/inflated beyond limits.
- Poor political institutions: political influence over the budget and rent-seeking behaviours during booms are more prevalent in developing countries with loose fiscal rules and political Institutions.

Weak institutions allow the abuse of countercyclical discretionary interventions in order to alleviate underlying structural fiscal imbalances during pro-longed recession times. Hence, institutional measures are crucial to ensure efficient and contained countermeasures and to act as a safeguard against excessive misuse. For Egypt, this is even more essential.

To avoid repeating old mistakes, accommodative fiscal and monetary interventions should be done in a timely yet cautious manner and within a proper set of institutional guarantees. This is not only to ensure the sustainability of the realised fiscal and monetary outcomes, but also to avoid the exacerbation of structural imbalances that persist in Egypt regardless of cycles and crisis times.

In this regard, the following policy insights are recommended:

A proper commitment-based monetary-fiscal framework needs to be established and sustained, where discretionary interventions are temporary and minimal

Egypt's monetary and fiscal institutions are dominated by their discretionary nature, which has always resulted in undesirable outcomes especially during times of high political and economic uncertainties. A commitment-based framework would first, decrease time-inconsistency and lags that accompany discretionary interventions; second, limit politically motivated misuse of fiscal tools; and third, enhance credibility in monetary and fiscal authorities.

Monetary-fiscal coordination and active monetary policy top the realised gains of the recent reforms and continue to show through the current COVID-19 crisis; this needs to be sustained

While Egypt has established a de jure independent central bank framework since the early 2000s, de facto political dominance of fiscal and monetary tools has continued to dominate the scene, especially after the 2011 revolution where monetary policy was evidently passive.

The recent 2016 reform granted monetary policy a rather more active role, which needs to be sustained within a strong coordination framework. While liberalising exchange rates and leveraged reserves have lessened these vulnerabilities to some extent, the Egyptian public debt profile still remains at risk amid the onset of the current outbreak.

Sustained monetary autonomy will strike a balance between exchange rate policy and international capital movements while properly addressing debt vulnerabilities, not to mention the fundamental role of monetary policy in stabilising the economy and adjusting inflation levels.

Lesson learned the hard way from the Global Financial Crisis: financial policies and monetary easing ought to be governed with prudent supervision rules and regulations; exceptional measures should be loudly stated as being 'temporary'

Financial easing and liquidity injection are crucial for Egypt at this moment. Yet in light of the probable scenario of a global growth slump, easing might also result in relapsing financial complications, pressures on banking liquidity, debt rollover and threats to debt sustainability. Hence, proper prudential rules are necessary to tune financial vulnerabilities and maintain financial institutions' resilience and liquidity.

Relaxed financial terms and loan-terms restructuring policies need to be clearly considered as temporary actions and to be done in a transparent and well-supervised manner. If the crisis is to continue, macro-financial toolkits that involve Central Bank of Egypt macro-level operations and targeting sectors would be advisable.

Empowering sound political institutions

The Egyptian House of Representatives as well as the Central Auditing Organization need to work on supporting the sound operation of the monetary and fiscal policy frameworks, both in normal times as well as during outbreaks and crises. Ensuring the implementation of fiscal and monetary rules and commitments as well as quick and efficient enforcement of emergency measures during and after the pandemic is an essential role of the country's political institutions. Empowering political institutions need to be done through effectuating procedural rules that govern the House of Representatives role in the process of enacting and implementing the budget and fiscal policies. Moreover, improving the electoral process and switching to a party-based system is also expected to empower the Egyptian House of Representatives towards more efficient operation with regards to the budget process.

Further reading

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Contact Information

ERF Office
Address: 21 Al-Sad Al-Aaly St. Dokki, Giza, Egypt
PO Box 12311
Tel: 00 202 333 18 600 - 603
Fax: 00 202 333 18 604
Email: erf@erf.org.eg
Website: http://www.erf.org.eg

ERF Dubai
Dubai International Financial Centre (DIFC)
Premises: GV-00-1003-BC-42-0
Gate Village Building 10 - Dubai, UAE
PO Box 125115
Tel: +971 4 4011980