
**EX-POST EVALUATION of EXCEPTIONAL ACCESS
UNDER the 2020 STAND-BY ARRANGEMENT****IMF Country Report No. 22/237, July 2022****Background**

The IMF's financial support to the Egyptian authorities' policy response to the COVID-19 pandemic in 2020 included exceptional access to Fund resources. The Ex-Post Evaluation (EPE) assess whether program objectives under the 12-months arrangement were achieved, whether the macroeconomic strategy, program design, and financing were appropriate to address the challenges Egypt faced at the time.

In early 2020, the Egyptian authorities launched a broad policy response to address the immediate and severe economic disruption caused by the COVID-19 pandemic, which threatened to reverse Egypt's hard-won achievements in regaining macroeconomic stability. The overarching goal of Fund support was to maintain macroeconomic stability amid the crisis, allowing for the easing of fiscal, monetary, and financial policies to support the crisis response and for thus achieving health and social policy objectives during the pandemic. The Standby Agreement (SBA) aimed at safeguarding medium-term fiscal sustainability and at keeping the momentum in selected structural reform areas, mostly building on initiatives that began during the 2016-19 Extended Fund Facility (EFF).

The SBA, which expired on June 25 2021, achieved its primary objective of maintaining macroeconomic stability in the context of the disruption from the COVID-19 pandemic.

This allowed for the easing of fiscal, monetary, and financial policies to support the crisis response, including by increasing spending on health and social protection while safeguarding debt sustainability and preserving investor confidence. Momentum was kept on structural reforms in selected areas.

Policy implementation under the SBA was broadly in line with program objectives, even as exchange rate variability remained limited. While the Egyptian economy has successfully weathered the COVID-19 shock, the external and debt vulnerabilities that existed prior to the crisis remain high.

Success and Challenges after the Extended Fund Facility

Egypt's macroeconomic situation had improved markedly during the 2016-2019 EFF. Critical macroeconomic reforms implemented by the authorities to correct significant external

and domestic imbalances were successful in achieving macroeconomic stabilization (IMF, 2019b). This included the liberalization of the foreign exchange market and fiscal consolidation, underpinned by a fuel subsidy reform and the introduction of an automatic fuel price indexation mechanism. Growth accelerated, external and fiscal deficits narrowed, international reserves increased, and public debt was put on a downward trajectory. Inflation had come down from double-digits. Unemployment declined to its lowest level in over a decade, and social protection was strengthened, including via an expansion of targeted cash transfer programs, to ease the burden of adjustment on the poor.

The final review under the EFF in 2019 emphasized the importance of deepening and broadening structural reforms to sustain strong medium-term growth. Staff noted that progress on reform implementation had been uneven and underscored that the transition to a transparent market-based economy based on a more inclusive private sector-led growth model would require sustained implementation of structural reforms, particularly regarding long-standing problems of weak governance, rent seeking, vulnerabilities to corruption, and the heavy presence of the state in the economy. The final review also noted the importance of exchange rate flexibility to preserve the gains in real competitiveness during the program, and the need to allow the exchange rate to adjust downward should portfolio flows reverse (IMF, 2019b).

The last review of the EFF also found that despite the successful conclusion of the program, vulnerabilities remained. While the macroeconomic situation had improved since 2016, public debt remained high and interest costs accounted for a large share of public expenditures, with little fiscal space to meet important spending needs on health and education. Egypt had favorable access to external markets and steady inflows from nonresidents into local currency public debt, but remained vulnerable to a weakening of investor confidence or a shift in financing conditions given the still-high level of public debt and large financing needs.

The COVID-19 Pandemic

Looking at data until end-2021, COVID-19 infections peaked during the first wave, and began subsiding September 2020. Egypt's officially reported case numbers as share of its population have been relatively low, ranging in the 20th percentile globally. Vaccination of the population began in May 2021 but moved slowly initially due to difficulty in procuring supplies of vaccines. About 20 percent of the population was vaccinated by end-2021, rising to one-third in April 2022.

There was concern that the immediate and severe economic disruption from COVID-19 could reverse Egypt’s hard-won achievements in regaining macroeconomic stability if not addressed quickly. The pandemic resulted in an unprecedented and sudden stop in tourism, and large nonresident outflows from the local debt market. Foreign arrivals- tourism represents about 12 percent of GDP and 25 percent of exports of goods, services- came to a complete halt, and nonresident holdings of domestic debt plummeted, with more than \$15 billion of portfolio outflows in March and April 2020. Investors pulled money from emerging markets (EMs) in a flight to safety, and these outflows were, in relative terms, larger in Egypt than in other EMs. Like other EMs, Egypt saw a sudden spike in sovereign spreads, with the EMBI spread peaking above 900 bps (from around 500) in late March.

The authorities quickly launched a broad policy response to contain the economic and health impact of the shock. Fiscal, monetary, and financial sector measures were announced to increase health sector allocations, cushion the directly impacted sectors, and expand support to the poor and vulnerable (IMF, 2020b, Box 2). The Central Bank of Egypt (CBE) took measures to ease pressures in domestic liquidity and credit conditions, reducing the policy rate by 300 basis points and undertaking several initiatives to support borrowers.

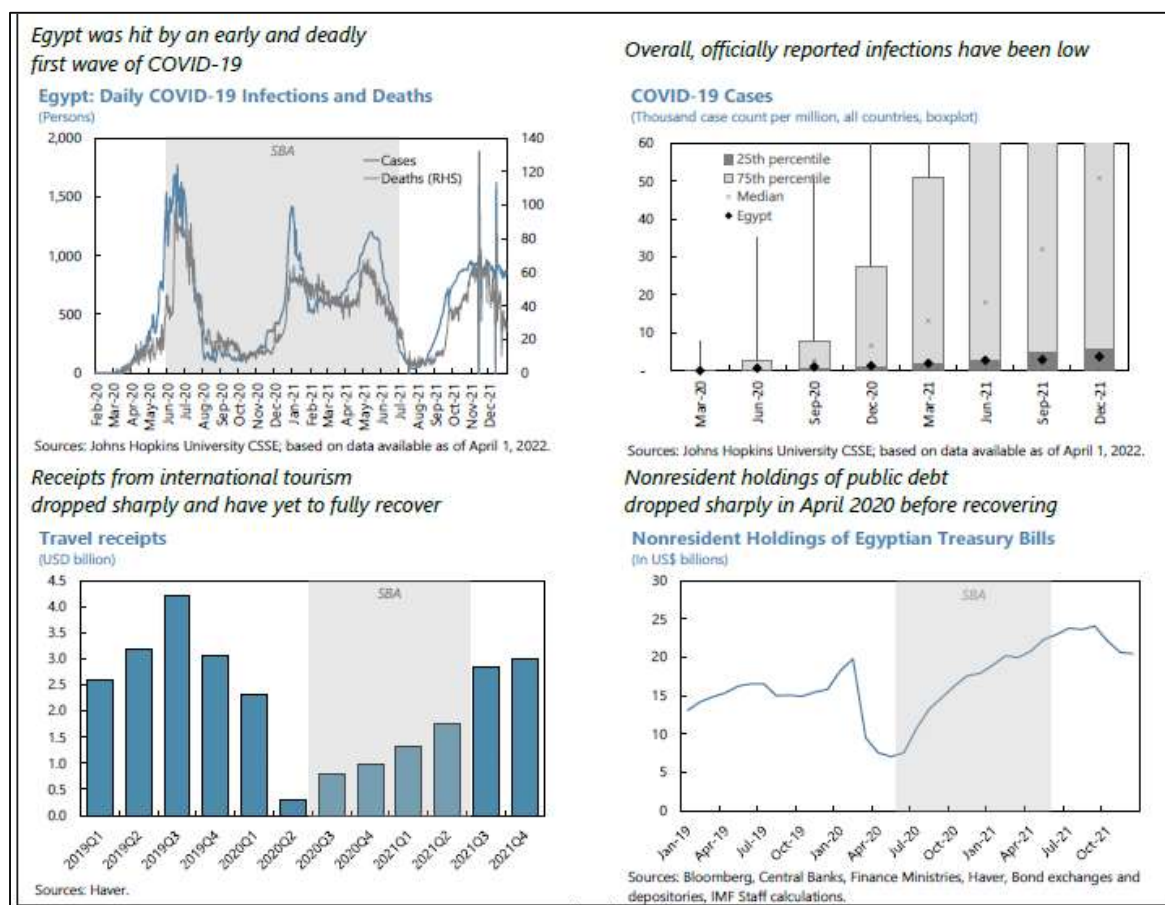


Figure (1): The Immediate Impact of the Covid-19 Crisis

Program Implementation and Performance

Macroeconomic outcomes were better than projected and domestic policies cushioned the impact of the pandemic. Growth rebounded in 2021 H1, reaching 3.3 percent for the full FY2020/21 compared to a projection of 2 percent at the approval of the arrangement. The tourism sector was hit hard, and as expected, by the sudden stop in international travel. On the other hand, remittances held up better than expected and the overall impact on domestic economic activity was not as severe as initially feared, including because COVID-19 restrictions were eased starting mid-2020. Fiscal and monetary loosening helped buffer the impact of the crisis, while measures to address health needs and support vulnerable sectors alleviated the impact of the shock on households. Construction activity, including on large national infrastructure projects, was able to continue, supporting employment.

External financial conditions recovered faster than expected. The authorities issued international bonds totaling \$10 billion by the end of the arrangement, including maturities of up to 40 years, while nonresident holdings of local currency debt recovered from \$9.5 billion in June 2020 to \$23 billion in June 2021. As a result, the CBE's total FX assets recovered from a low of \$39.5 billion in April 2020 to \$49.6 billion at end-June 2021, close to the pre-pandemic level of \$51.7 billion in February 2020.

Against this background, the program achieved its primary objective of stabilizing the economy; the reviews were concluded on time and all program conditionality was met. All quantitative performance criteria (QPCs) and structural benchmarks (SBs) were met, and the two reviews were completed on time. With inflation undershooting projections by a significant margin, the only significant and straightforward modification to the program design was the modification of the MPCC to reflect structurally lower inflation outcomes.

COVID-19 Response

The authorities' response to COVID-19 comprised measures to boost health spending, protect vulnerable households, mitigate the impact of containment measures on the economy, and support the tourism sector. The overall size of support and the related governance commitments were comparable to those of other countries that had Fund programs during the pandemic, although a significant share of measures was designed to be carried out by entities outside the budget sector. Health and social spending targets were met, as were some governance commitments. Reflecting robust oversight and targeted measures, the financial sector weathered the crisis well.

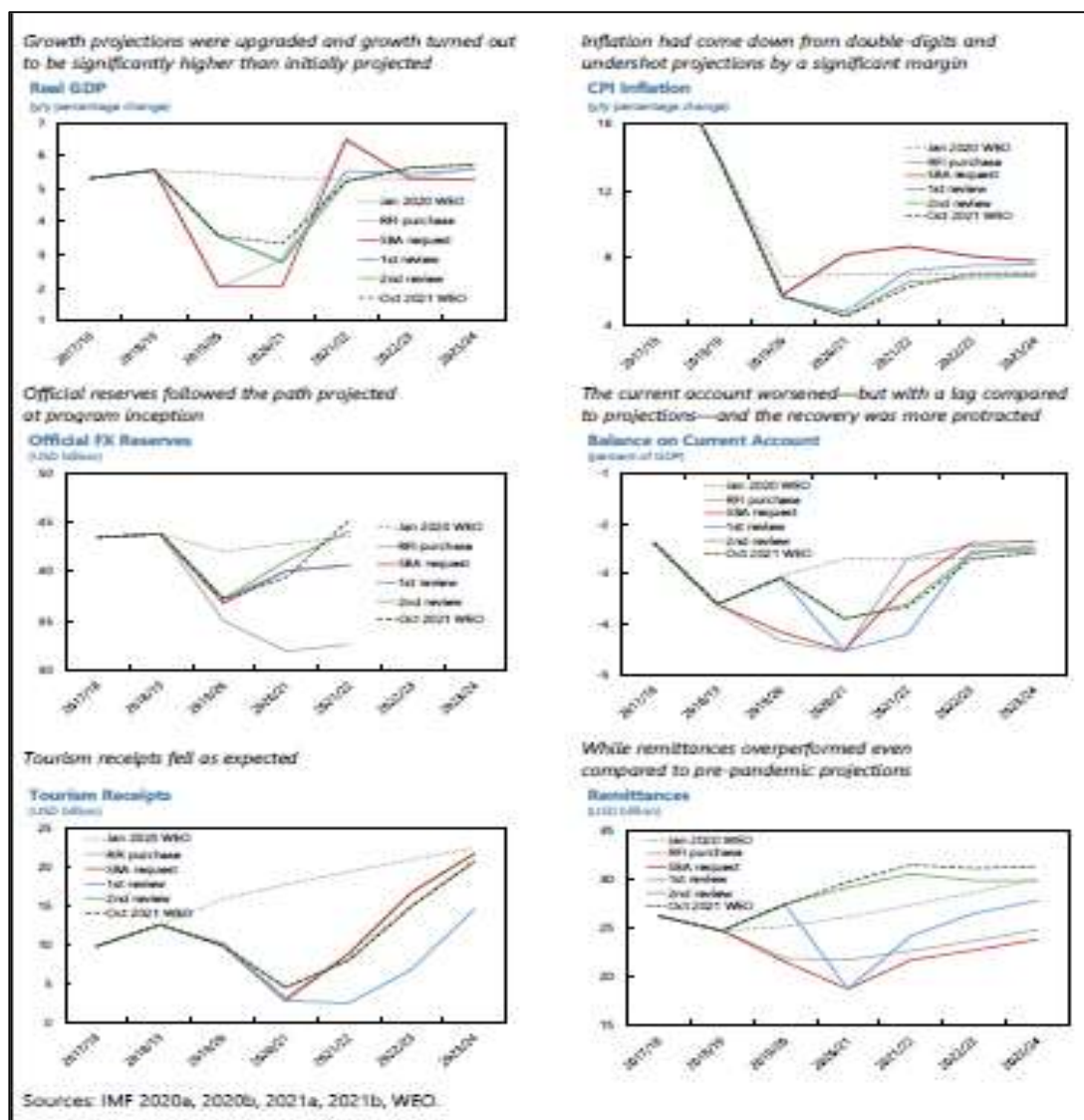


Figure (2): Macroeconomic Indicators and Program Performance

Fiscal Response

The authorities moved swiftly to announce a comprehensive fiscal support package to contain the health and economic impact of COVID-19. They channeled spending towards the health sector to fund the pandemic response and expanded social protection by increasing pension payments, introducing a new monthly cash subsidy for informal workers, expanding existing cash transfer programs (Takaful and Karama) to include new beneficiaries, and providing direct food and other basic commodities to vulnerable groups and villages. They also introduced various measures to support firms, some of which was targeted to firms that maintained employment levels through the early months of the lockdown, and extended assistance to workers in the most severely impacted sectors, particularly tourism and its related

activities. The size of Egypt's announced fiscal support package ranked close to the average of other countries, which entered Fund arrangements during the pandemic.

The additional budgetary spending by the central government in response to the pandemic appears small in part because of the role played by public entities. In contrast to other emerging markets, where overall primary spending generally materialized higher than had been expected before the pandemic, real primary expenditure in Egypt declined in both fiscal years covered by the program compared to pre pandemic projections.

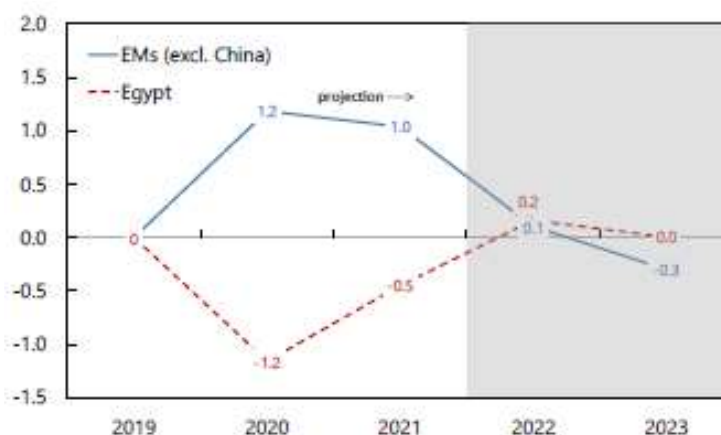


Figure (3): Deviation of Primary Expenditure from Pre-pandemic Projection
(in percent of 2019 GDP)

The Egyptian authorities made several commitments regarding the governance of COVID-19 related expenditures at the outset of the program, in line with best practices advocated by the Fund. All crisis-related budget spending was to be tracked and reported via published fiscal documents, and eventually audited by the Accountability State Authority after the end of the fiscal year, with the audit to be published and cover crisis-mitigating inflows and spending including ex-post validation of delivery.

Egypt met the social spending floor and executed health spending in line with commitments under the program, however, health and social outcomes cannot yet be determined. This difficulty stems largely from the limited availability of high-frequency data on health outcomes, income, and poverty – a challenge many countries face.¹¹ The public expenditure review to enhance social protection (completed as part of the SBA) and forthcoming reviews of health and education spending (supported by the World Bank) offer opportunities to explore how existing and new data systems might be leveraged to evaluate the social impacts of public policies going forward.

Financial Sector Response

The authorities also set out to provide relief for heavily affected borrowers, ensuring the flow of credit to the real economy. Measures included granting a 6-month repayment moratorium on existing credit facilities for all customers, which ended in September 2020, as well as urging banks to work with heavily affected borrowers to prudently and preemptively restructure their loans. The preferential interest rates on loans through the CBE's subsidized lending program was reduced; a credit guarantee backed by the CBE was introduced for lending to manufacturing, agriculture and construction; and two-year credit facilities with grace periods were provided for firms in the tourism sector for the payment of salaries and dues to suppliers. During the SBA, there was an initiative to require banks to provide at least 25 percent of their lending to SMEs, to assure financial inclusion in the credit flow to the economy.

The authorities also saw as a major priority to maintain financial stability in the banking sector. Providing a one-year waiver for additional risk-weights associated with portfolio concentrations was seen as an extraordinary and temporary measure. The authorities' continued supervisory vigilance allowed them to monitor any potential increase in risks that might degrade asset quality and profitability. Exemptions from calculating additional capital requirements for concentration risk would be unwound as soon as conditions allowed.

In addition to the short COVID-19 lockdown duration, the second review of the SBA credited the authorities' effective oversight of the banking sector for how well the banking system weathered the crisis. The banking sector remained liquid, profitable and generally well capitalized between the beginning of 2020 and end-2021. While there was a small increase in NPLs at the end of the repayment moratorium in September 2020, NPLs fell to around 3½ percent of total loans by end-2021 also due to income support of affected workers and businesses.

Structural Reforms

In line with the SBA's focus on macro stabilization, structural conditionality under the program was focused and parsimonious. Reforms concentrated on the priority areas identified during the EFF, including on improving public financial management, the business climate, and social protection, and important progress was also made in financial sector reform. While all structural benchmarks were met on time, the depth of the reforms, and with it progress towards private sector development and better governance, was more limited, reflecting the exceptional disruptions brought about by the pandemic and associated competing priorities.

The structural reform agenda was parsimonious and focused. Specifically, four structural benchmarks and one prior action focused on improving the sustainability of public finances, two

were aimed at improving the business climate, one was geared towards improving social protection and the final benchmark contributed to containing risks to both the public sector and the financial system.

The SBA struck a balance between the primary objective of macroeconomic stabilization while maintaining reform momentum in key structural areas. The parsimonious agenda focused on areas where ownership was high and where progress was possible despite the exceptional disruptions brought about by the pandemic and the short duration of the arrangement.

The SBA succeeded in taking forward the reform of the NIB, which was set in motion at the end of the EFF. NIB is a publicly owned development bank that was used to mobilize local savings by issuing retail certificates of deposit to finance national development projects, including a large portfolio of SOE loans.

A new Central Bank and banking law was ratified in September 2020, which provides a clearer mandate and stronger safeguards for the CBE. The law established price and financial stability mandates for the CBE, strengthened its governance arrangements as well as institutional and financial autonomy, and improved the legal framework for early intervention and resolution of troubled banks. The CBE was to cease subsidized lending schemes on the CBE balance sheet; henceforth, the government was to bear interest costs of these lending schemes; and limit short term lending to the government (to 10 percent of average revenues over previous 3 years) charged at market rates.

Impacts of Structural Reform

The SBA gave continuity to important reform initiatives. These included the financial sector reforms, updates to the medium-term revenue and debt management strategies, proposed amendments to the competition law, and passing of a new customs law. Ongoing technical assistance from the Fund is supporting implementation of the revised PFM law, which was submitted to Parliament during the SBA and ratified by the President in February 2022, and which sets the basis for a much-needed modernization of the budgeting process.

While all structural benchmarks were met on time, progress toward the broader objectives of supporting private sector development and improving governance appears limited. This is in part a reflection of the short program duration and the program's focus on economic stabilization.

Consistency with Fund Policies and Procedures

Regarding Finance, with the onset of the pandemic, an immediate and significant external financing gap was projected to develop in FY2019/20. In the last quarter of FY 2019/20 (April to June 2020) capital flows reversed abruptly before partially recovering, and tourism came to a near complete halt. The synchronized global downturn placed uncertainty over the future path of remittances. At the same time, the impact of measures to contain the spread of COVID-19 on domestic activity and significant volatility in commodity prices compounded uncertainty over trade flow projections.

The expectation of a weak economic recovery, paired with a still-challenging external financing environment, translated into an even higher projected financing gap for FY2020/21. The recovery of capital flows was expected to be slow. International reserves were projected to increase in line with program targets, and the remaining financing gap filled by Fund financing and contributions from other multilateral and bilateral creditors

The financing outturn reflected the evolving external and domestic environment. The financing outturn for 2019/20 was broadly, in line with what was envisaged at the time of SBA request, but for 2020/21 differed from projections more significantly. This was primarily because of the unexpected fast and strong recovery of portfolio flows (for 2020/21, net portfolio inflows were \$20 billion at the time of the second review compared to only \$3.5 billion envisaged at the time of the SBA request), which more than offset larger-than-expected debt repayments in FY2020/21.

The determination of financing sources and the phasing of disbursements were consistent with the diagnosis and the program strategy at the time of the approval of the arrangement. The purchase under the RFI contributed significantly to the financing of the urgent balance of payments need that emerged in the final months of 2019/20, with the first disbursement under the SBA contributing the remainder.

The provisions of the Exceptional Access Framework (EAF) are an important element in the Fund's financial risk management. This framework intends to enhance scrutiny for Fund financial assistance when it exceeds specific thresholds, while at the same time providing scope for flexibility and leaving room for judgment. The application of the EAF in the context of the Egypt 2020 SBA was consistent with Fund policies and involved carefully balanced assessments, especially with respect to EAC2 at the time of the SBA request, and, overall, resulted in reasonable safeguards to Fund resources.

The balance of payments needs facing Egypt satisfied Exceptional Access Criteria. Egypt was facing Exceptional balance of payments pressures arising from the unprecedented COVID-19 related disruptions to tourism, capital flows and potentially remittances, and it was proposed that the RFI and the SBA serve as a two-step approach to address the external financing needs. At the time of the RFI request, the combined financing gap for FY2019/20 and FY2020/21 was estimated to be about \$14 billion, before Fund support. The estimated financing gap increased to \$21.4 billion at the time of the SBA request, due to weakened projected private flows for FY2020/21 amid a weaker than initially expected global recovery, the need to rebuild reserves, and uncertainty regarding the future path of the pandemic.

Conclusions

The SBA achieved its primary objective and helped stabilize the macro economy in the context of the disruptions from the COVID-19 pandemic. Egypt's urgent external and fiscal financing needs resulting from the COVID-19 pandemic were supported by the Fund through a two-step approach. A purchase under the RFI addressed urgent financing needs and was followed by a 12-month SBA with the primary objective of stabilizing the macro economy. This two-step approach and the SBA's main features were characteristic of the Fund's approach to lending during the pandemic.

Policy implementation under the SBA was broadly in line with program objectives, even as exchange rate variability remained limited. The SBA was carried out against the backdrop of a better-than-expected domestic and external environment. Portfolio inflows resumed as Fund support materialized, allowing for reserve buffers to be rebuilt by more than initially expected. In hindsight, the program may have benefited from a strategy to capture these upside risks more systematically. More critically, while exchange rate flexibility was an important element of the policy mix, the exchange rate lacked substantive variation during the SBA, representing a missed opportunity to entrench greater flexibility. Fiscal policy was relaxed to accommodate emergency spending on health and social protection and commitments regarding the governance of COVID-19 related expenditures have been partially met.

The focused structural reform agenda supported by the SBA was fully executed, but deeper reforms were left for a later time. The SBA succeeded in taking forward several reforms that had been set in motion at the end of the EFF, including the reform of the National Investment Bank (NIB), and all structural benchmarks were met on time. However, reflecting the limited time frame of the SBA and the exceptional circumstances under which it took place, deeper reforms needed to achieve the broader objectives of private sector development and improved governance were left for a later time.

Main Lessons

With the benefit of hindsight, certain aspects of the program design could have been reconsidered. A broader definition of the FX reserves target—for example to include both official FX reserves and FX deposits with local banks—would have given a more complete picture of official FX dynamics. Related, as upside risks materialized, a careful recalibration of the NIR target could have strengthened the rebuilding of external buffers.

While having successfully weathered the COVID-19 shock thanks to the government’s program supported by the SBA, Egypt’s external sector vulnerability remains high. Notwithstanding some important progress in lengthening maturities of public debt under the SBA, Egypt continues to be reliant on nonresident portfolio flows, which expose the economy to persistent volatility from the ‘boom-bust’ cycles of capital flows, as well as global shocks.

Progress on deeper structural reforms is needed. Policies adopted in response to the pandemic (e.g., support to households and firms through fiscal and financial policies), as in many countries, intensified the role of the government in the economy, creating a more difficult environment for incentivizing private sector investment.

Specific design elements contributed to the successful completion of the program. A distinctive aspect of the SBA are the realistic—in hindsight even conservative—macroeconomic projections. In contrast to many other Fund programs, the SBA therefore did not require adjustments to meet growing financing needs, and instead ended with a general over performance relative to targets.

Authorities’ Views about the Report

The report gives adequate credit to the Egyptian authorities’ efforts to adhere to program objectives and even over-achieve program targets—that contributed to the overall success of the program.

The speed, size and frontloading of the Fund’s support under the Stand-By Arrangement (SBA), in combination with the Rapid Financing Instrument, and with the background of a successful Extended Fund Facility preceding it, were critical factors in the swift restoration of investor confidence and in catalyzing private capital flows.

The report mentioned that the program was successfully completed without any delays. This was achieved due to the realistic setting of economic projections and targets given the COVID pandemic context and associated high uncertainty. These targets were set and agreed upon jointly between the authorities and the staff.

The report appropriately highlights the CBE’s role in ensuring that monetary policy continued to be data-driven, as well as overachieving the reserve targets, securing low inflation

expectations, providing liquidity to affected firms which subsequently turned to be timely and adequate, and reaping the benefits from the continued effective oversight of the banking sector.

On the fiscal front, the report gives credit to the Ministry of Finance in maintaining fiscal discipline, overachieving the primary surplus targets, and carrying out agreed PFM reforms, as well as in lengthening debt maturities under the program with a more aggressive mode/speed than envisioned.

The outcomes and impact of the additional social and health spending should not be seen as missing despite possible time lags as one can relate this essential, targeted, and timely spending to the notable improvement in key indicators during the program period such as the ability to achieve positive inclusive and broad-based growth, to lower unemployment rates, to record relatively limited and reduced reported COVID cases and associated death rates, and to reduce poverty rates.

A well-designed structural reform agenda is needed to put the Egyptian economy on a more competitive footing and to further strengthen the Egyptian economy's resilience against shocks.