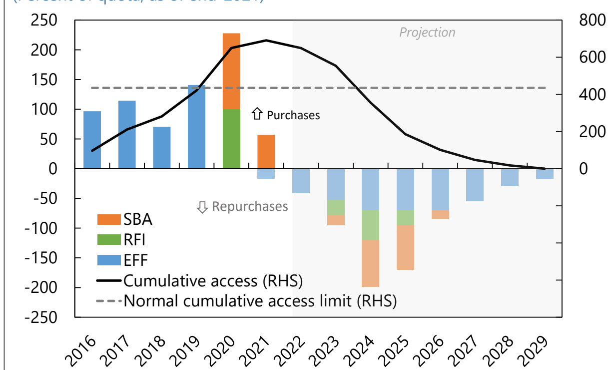
INTRODUCTION

1. This report evaluates Egypt's 2020 Stand-By-Arrangement (SBA) under the Fund's Ex-Post Evaluation (EPE) policy. In April 2020 the Egyptian authorities requested Fund financial support under the Rapid Financing Instrument (RFI) to be followed by an SBA. The IMF's Executive Board approved the purchase under the RFI on May 11, 2020 (at 100 percent of quota) and a 12-month SBA on June 26, 2020 (at 184.8 percent of quota). The SBA expired on June 25, 2021. With total disbursements of SDR 5.8 billion—$2.8 billion from the RFI and $5.2 billion from the SBA—Egypt was the largest recipient of new Fund support from the onset of the COVID-19 pandemic until end-2021. Annual access to Fund resources was within normal access limits ex-post, because the limits were increased during the crisis. However, due to Egypt's outstanding obligations from the 2016-2019 Extended Fund Facility (EFF, IMF 2017) (at 422 percent of quota end-2019), the cumulative access limits were exceeded resulting in exceptional access to Fund resources, which leads to this EPE of the SBA (Text Figure and Box 3).[1]

Purchases, Repurchases, and Cumulative Access
(Percent of quota, as of end-2021)



Sources: IMF Staff calculations.

2. The evaluation reviews the performance under the program with a view to drawing lessons for the Fund and for future Fund engagements with Egypt. In line with the Guidance Note, the EPE assesses whether performance under the program achieved program objectives, whether the macroeconomic strategy, program design, and financing were appropriate to address the challenges Egypt faced at the time, and if the program was consistent with Fund policies, including the justification of exceptional access (IMF 2010). The decision-making process behind the formulation of staff's views, the outcome of discussions with authorities, and discussions with the Executive Board are not subject to the scope of the EPE. As with any ex-post evaluation, EPEs have the benefit of hindsight.

3. The report is organized as follows. The next section describes the context of the 2020 SBA—Egypt's conclusion of the EFF in 2019 and the beginning of the COVID-19 pandemic. Against this background, the program's strategy and design are examined, and a detailed assessment of program performance against its objectives is undertaken. The report then evaluates whether the program was consistent with Fund policies and procedures, looking at program financing, application of the Exceptional Access Framework, and risks to the Fund, before the final section concludes and draws lessons for Egypt and the Fund. The views of the Egyptian authorities on this evaluation are presented in Appendix I.

[1] EPEs are not applicable to outright purchases under the RFI that involve exceptional access.

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CONTEXT

A. Success and Remaining Challenges after the EFF

4. **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.

5. **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).

6. **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.

B. The COVID-19 Pandemic

7. **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 (Figure 1). 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.

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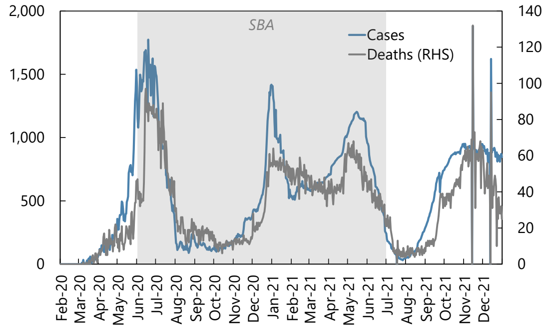
Figure 1. The Immediate Impact of the COVID-19 Crisis

Egypt was hit by an early and deadly first wave of COVID-19

Egypt: Daily COVID-19 Infections and Deaths

(Persons)

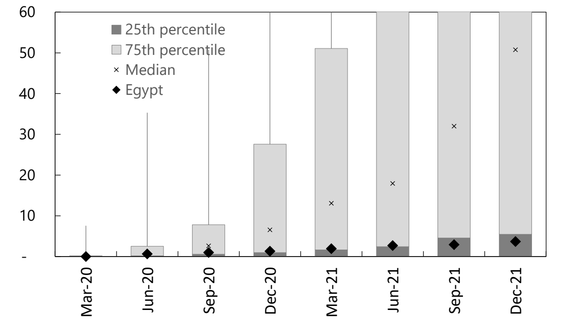


Sources: Johns Hopkins University CSSE; based on data available as of April 1, 2022.

Overall, officially reported infections have been low

COVID-19 Cases

(Thousand case count per million, all countries, boxplot)

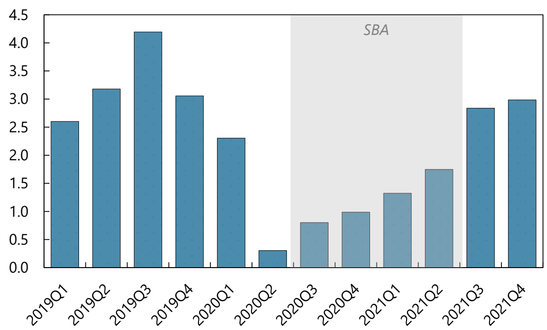


Sources: Johns Hopkins University CSSE; based on data available as of April 1, 2022.

Receipts from international tourism dropped sharply and have yet to fully recover

Travel receipts

(USD billion)

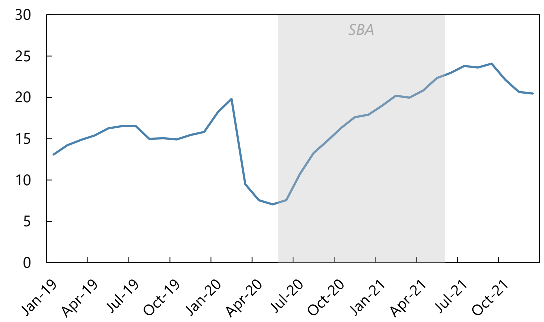


Sources: Haver.

Nonresident holdings of public debt dropped sharply in April 2020 before recovering

Nonresident Holdings of Egyptian Treasury Bills

(In US$ billions)



Sources: Bloomberg, Central Banks, Finance Ministries, Haver, Bond exchanges and depositories, IMF Staff calculations.

8. **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 and 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 (Figure 4, panel 4). 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 global nature of the Great Lockdown (WEO, April 2020) and disruptions in credit and commodity markets, raised the prospect that remittances would also be hit hard. Domestic activity was projected to slow significantly as a result of the containment measures to slow the spread of the virus.

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9. 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. Foreign exchange market interventions by the CBE kept the exchange rate stable despite large capital outflows, resulting in a decrease in the CBE's FX assets by $12bn.[2] A central element of the authorities' response to the crisis was a request for financial assistance from the Fund in April 2020.

STRATEGY AND PROGRAM DESIGN

10. The overarching goal of Fund support to Egypt in 2020 was to maintain macroeconomic stability amid the crisis. The global uncertainty prevailing at the time was exceptional. It included the course of the pandemic, the length and impact of lockdown measures, and was compounded by the prospect of an uneven and slow recovery. The authorities' request for a two-step approach, with the RFI followed by the SBA in quick succession, was aimed at dealing with this uncertainty by providing significant financing and helping to anchor economic policy making.

11. Egypt's urgent external and fiscal financial needs were addressed with the RFI. By design, Fund emergency financing takes the form of an outright disbursement that does not carry ex-post conditionality. Thus, Egypt's purchase under the RFI on May 11, 2020, served to quickly address the urgent external and fiscal financial needs. As such, discussions focused on prioritizing health measures to save lives and livelihoods, limiting the macroeconomic impact of the shock, addressing social needs, and ensuring that spending measures be timely, temporary, transparent and well-targeted. In the context of the RFI discussions, exchange rate flexibility was viewed as a critical tool to absorb shocks, with monetary policy aiming to ensure low and stable inflation. From the outset, the RFI was seen to serve as a bridge towards an Upper Credit Tranche (UCT) program and allow for more time for the finalization of a program (IMF, 2020a).

12. A strategy to maintain macroeconomic stability was set out in the SBA. The program discussions were able to build on the collaboration between Fund staff and the Egyptian authorities during the EFF, and the extensive discussions that had already taken place on the post-EFF policy agenda. Expanding on the diagnosis of the RFI, the SBA, approved on June 26, 2020, fleshed out a strategy to maintain macroeconomic stability while continuing to address the crisis needs. In particular, maintaining macroeconomic stability was seen as critical to achieving health and social policy objectives during the pandemic. The SBA aimed at safeguarding medium-term fiscal sustainability, anchoring inflation expectations, and implementing exchange rate flexibility, while

[2] CBE's FX assets comprise the CBE's official FX reserves and CBE's FX deposits with local banks; the latter are not included in official FX reserves because these are defined as claims on residents, but the two are often used interchangeably for reserve management purposes.

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keeping the momentum in selected structural reform areas already underway. The program design reflected the uncertainty about the magnitude and duration of the pandemic, which, at that time, was expected to fade in the second half of 2020 (WEO, April 2020). With a duration of 12 months and two semiannual reviews, it took a focused approach to conditionality. Specifically:

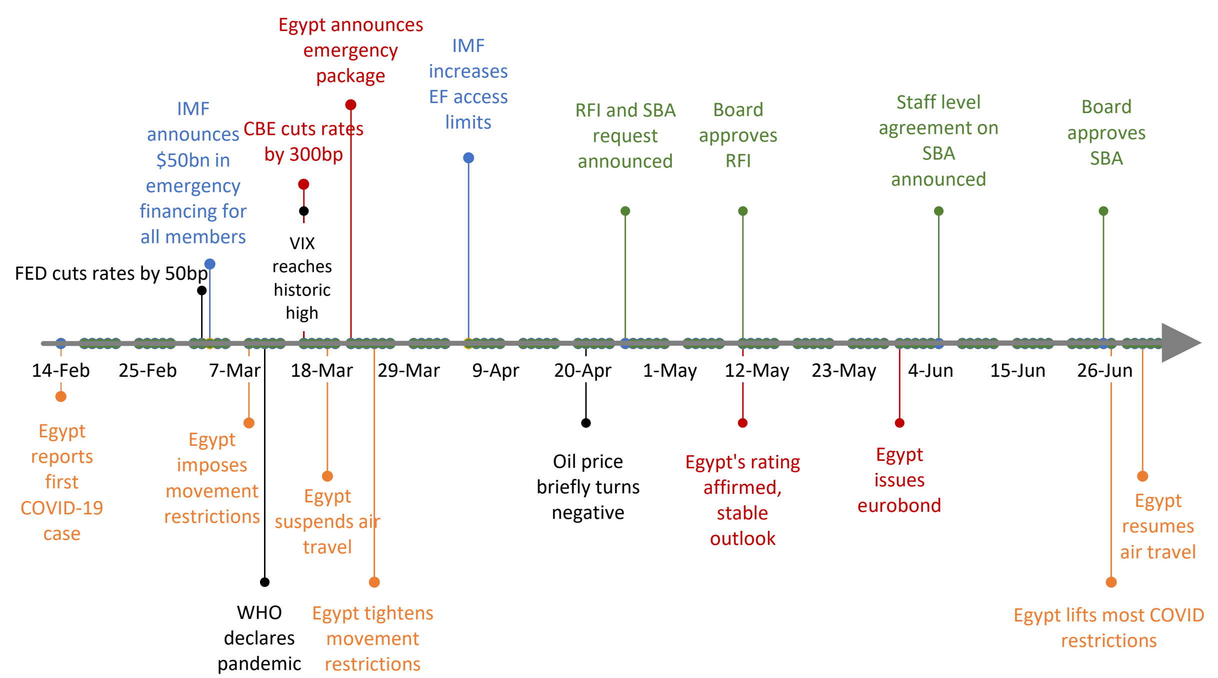
- The program was anchored in the accumulation of NIR to rebuild external buffers. The authorities committed to return to letting the exchange rate reflect market forces, limiting intervention only to instances of disorderly market conditions.

- Monetary policy would remain data driven to ensure inflationary expectations remained anchored. A monetary policy consultation clause (MPCC) was agreed to monitor inflation performance.

- Fiscal policy was eased to address crisis needs; the SBA targeted a reduced primary surplus of no less than 0.5 percent of GDP for FY2020/21 (the fiscal year runs from July to June), compared to the pre-pandemic baseline of 2 percent of GDP, to balance the need to accommodate crisis-related spending and avoid an excessive increase in public debt. Critically, a social spending floor was set to safeguard spending on health and vulnerable households.

- Eight structural conditions aimed at strengthening transparency, governance and competition through SOE reforms, including at the National Investment Bank (NIB), improving fiscal operations, and improving business climate while protecting the poor (Table 3).

Figure 2. Timeline of Events Leading Up to the SBA Approval



Source: IMF staff.

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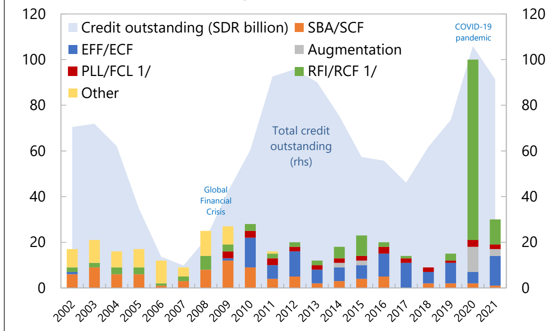
Box 1. Fund Lending During the Pandemic[1]

The COVID-19 pandemic was a crisis like no other, and the Fund's response was equally unprecedented in terms of the pace, amount, and the number of countries receiving financing. Since the beginning of the pandemic, the Fund approved 87 emergency financing (EF) requests (i.e., RFI/RCF) for 76 countries, of which over 80 percent were approved between April 1 and June 30, 2020.

Fund Financial Support

(2002- Nov. 2021, Number of arrangements and SDR billion)



Sources: MONA, Fund staff calculations. 1/ Including predecessor instruments.

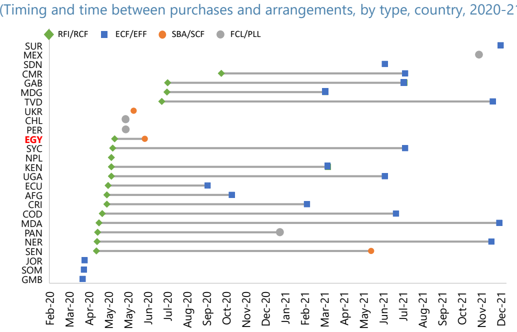
Fund lending in the early stages of the pandemic focused on containment, followed by emphasis on macroeconomic stabilization. A key concern was to finance priority spending to support health sectors, firms and households, while monetary and financial policies aimed to be as accommodative as possible. The general policy direction given to the membership was to "spend as much as you can, but keep the receipts." The Executive Board swiftly increased access limits on emergency financing (Box 3). Amidst an unprecedented demand for Fund financing, procedures were streamlined to ensure timely disbursements. The Fund recognized early on the challenges involved in providing financing through UCT programs given the unprecedented global health emergency and the resulting highly uncertain outlook, and moved to apply the existing toolkit in a flexible manner.[2]

About a quarter of the members that accessed the Fund's Rapid Financing Instrument transitioned to UCT programs. Preliminary analysis shows that access levels to General Resource Account (GRA) facilities during the pandemic was generally larger compared to pre-pandemic trends. Conditionality was more streamlined, with fewer quantitative targets and fewer structural benchmarks, and focused more on social spending.

Most UCT arrangements had a precursor in Emergency Financing.

Fund UCT Lending during the COVID-19 Pandemic

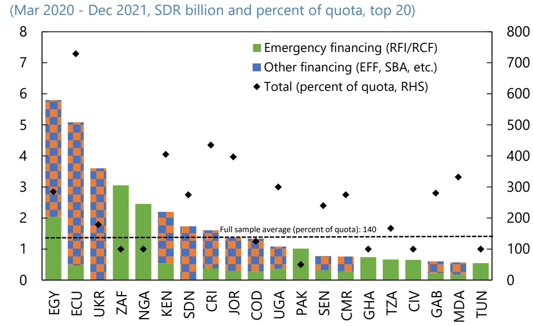
(Timing and time between purchases and arrangements, by type, country, 2020-21)



Egypt was the largest recipient of Fund financing in absolute terms, the tenth largest relative to quota.

Fund Financial Assistance during the Pandemic

(Mar 2020 - Dec 2021, SDR billion and percent of quota, top 20)



Notes: Excl. non-disbursing arrangements. Charts shows largest 20 arrangements and full sample average.

Sources: MONA databases.

1/ Based on preliminary staff analysis. A review of the IMF's Emergency Response to the COVID-19 pandemic is being conducted by the Independent Evaluation Office (IEO, 2021).

2/ See, for example, IMF Lending During the Pandemic and Beyond.

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13. Egypt's two-step approach and the SBA program design were an early example of the Fund's approach to lending during the pandemic (Box 1). Reflecting the severe impact of the crisis on Egypt, the transition from emergency financing to a UCT arrangement happened fast, and the choice of arrangement was an SBA of short duration. The SBA's focus on macroeconomic stabilization, with a focus on social spending and a parsimonious approach to structural reforms (see below), was an example of the flexible application the Fund's lending toolkit.

PROGRAM IMPLEMENTATION AND PERFORMANCE

14. Macroeconomic outcomes were better than projected, and domestic policies cushioned the impact of the pandemic (Figure 3). Growth rebounded in 2021H1, 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. Headline inflation remained well-contained at 4.9 percent (y/y) in June 2021, compared to a projection of 9 percent at approval of the arrangement. The anticipated pickup in inflation did not materialize as monetary policy eased and the exchange rate remained broadly stable. Relative to pre-pandemic projections and other EMs, output scarring in Egypt appears to have been lower (Text Table).

Growth during the Pandemic

	Real GDP (2019=100)	
	2020	2021
Egypt		
Pre-pandemic projection 1/	105.9	112.2
Outcome 2/	103.6	107.0
difference	*-2.3*	*-5.2*
EMs (excl. China)		
Pre-pandemic projection 1/	103.9	108.4
Outcome 2/	95.9	101.4
difference	*-8.0*	*-6.9*

1/ October 2019 WEO.
2/ January 2022 WEO.

15. 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.

16. 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 (Table 2), 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. The remainder of this section discusses the performance of the program in the various policy areas in detail.

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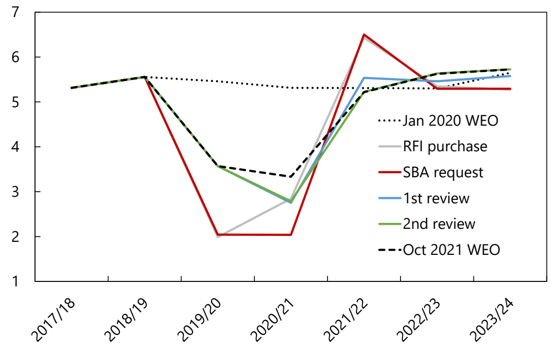
Figure 3. Macroeconomic Indicators and Program Performance

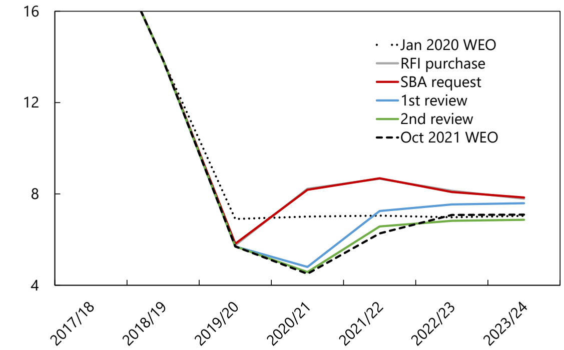
Growth projections were upgraded and growth turned out to be significantly higher than initially projected

Real GDP
(y/y percentage change)



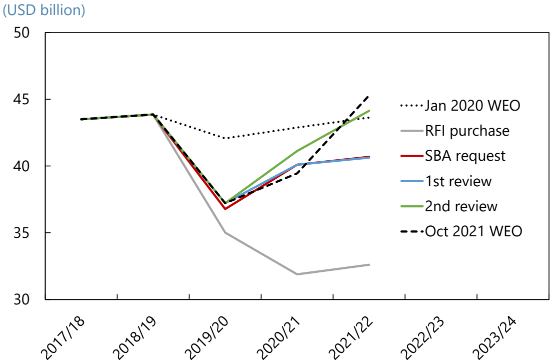
Inflation had come down from double-digits and undershot projections by a significant margin

CPI Inflation
(y/y percentage change)



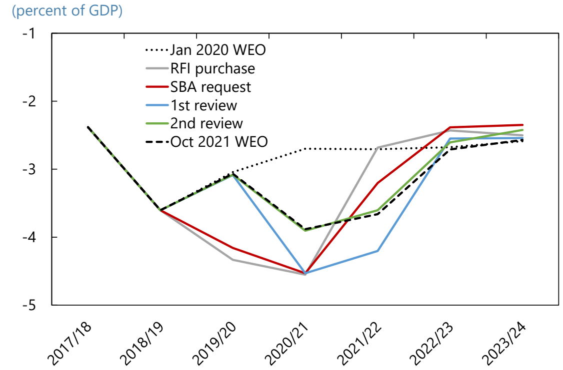
Official reserves followed the path projected at program inception

Official FX Reserves
(USD billion)



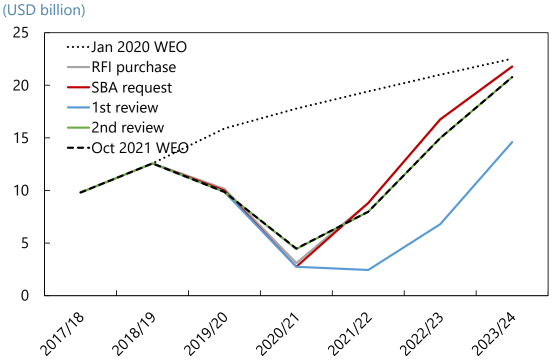
The current account worsened—but with a lag compared to projections—and the recovery was more protracted

Balance on Current Account
(percent of GDP)



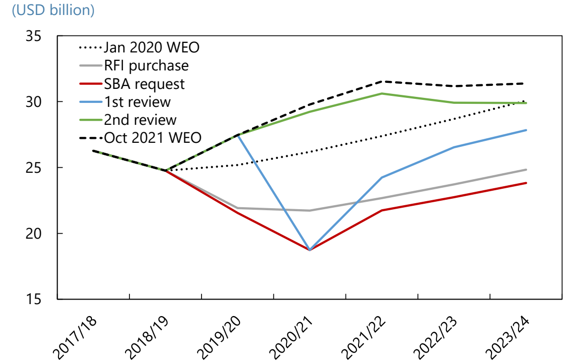
Tourism receipts fell as expected

Tourism Receipts
(USD billion)



While remittances overperformed even compared to pre-pandemic projections

Remittances
(USD billion)



Sources: IMF 2020a, 2020b, 2021a, 2021b, WEO.

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A. External Sector Policy

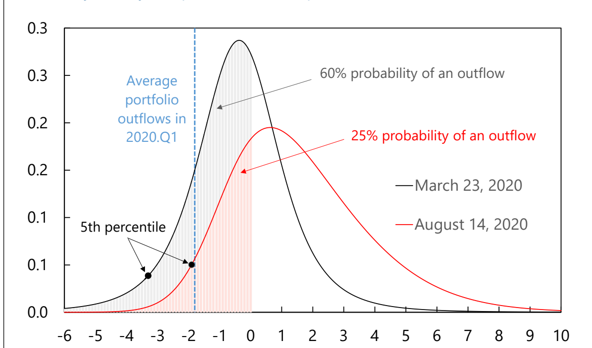
External sector policies under the program aimed at gradually rebuilding external buffers and restoring confidence, while allowing for exchange rate flexibility. A fast return of investor confidence and an improvement in external conditions increased the availability of FX in the market and contributed to an overperformance on the NIR target. The nominal exchange rate—after an initial period of flexibility—showed little variability as the program progressed.

Objectives and Anchor

17. External sector policies aimed at gradually rebuilding reserve buffers and using exchange rate flexibility. Against the background of the sharp decline in the CBE's FX assets during March-April 2020, the SBA aimed to gradually rebuild reserve buffers, with accumulation starting in 2021. Egypt's external position was assessed to be broadly in line with fundamentals, reflecting a modest expected increase in the current account deficit on import and export contraction, as the COVID-19 shock was expected to be temporary. The external financing projections of the SBA reflected the challenging external conditions prevailing at that time—capital flow reversal, a sudden stop in tourism, and risks to remittances. The authorities committed to limit FX intervention to addressing disorderly market conditions and to allow two-sided exchange rate flexibility reflecting market conditions, repeating a policy commitment made under the EFF.

18. A floor on the accumulation of NIR provided the external anchor of the SBA. A QPC set the floor for NIR accumulation to $3 billion, to be achieved by the second (and last) test date of the program (end-March 2021). The definition of NIR was based on the CBE's official FX reserves; reserve assets were defined to include claims on nonresidents in convertible foreign currencies, consistent with the Special Data Dissemination Standard (SDDS) and the definition adopted in the 2016–19 EFF; this did not include the CBE's FX deposits with local banks, which are claims on residents. The NIR accumulation target was set at a level deemed sufficient to build external buffers consistent with the expected conduct of exchange rate policy, while also accommodating the expected FX demand by public sector entities for imports of food and key commodities, with adjustors to reflect deviations in program disbursements, legal settlements, and possible repo margin calls. The NIR target was consistent with achieving 110 percent of the Reserves Adequacy (ARA) metric, which considers reserves to be broadly adequate for precautionary purposes for flexible exchange rate regimes when in the range of 100-150 percent.

Capital Flows at Risk: Near-Term Portfolio Flow Florecast
(Probability density and portfolio flows as percent of GDP)



Sources: October 2020 GFSR, Figure 1.17, Panel 3.

Outcomes and Exchange Rate Developments

19. External conditions for EMs recovered fairly quickly from the initial shock, even as uncertainty over new COVID-19 waves remained high. Following the extraordinary

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speed and level of portfolio outflows from EMs in early 2020, in 2020 Q2/3 flows had begun to recover. Overall, supported by the aggressive policy countermeasures in advanced and emerging economies, global financial conditions eased, and investors began differentiating across countries (GFSR, October 2020). Risks to external conditions remained high, however, and the pandemic did not fade towards end-2021 as initially expected. Instead, concerns about a new COVID-19 wave and new virus variants continued to weigh on sentiment, and the uneven pace of vaccination clouded the outlook for the recovery, in Egypt and abroad.

20. External conditions for Egypt improved along with overall sentiment and the authorities' program supported by the Fund. The announcements of the Fund's engagement with Egypt in late April 2020 coincided with a return of capital inflows starting in second quarter of 2020 (Figure 4, panel 3 and 4). The support provided by the Fund to the authorities' program underscored their commitment to macroeconomic stability and to gradually rebuild and maintain sufficient reserves, while strengthening foreign investors' confidence. The interest rate differential between global rates and Egypt's public debt remained despite domestic monetary easing. While tourism was hit hard —international flights were halted until July 2020, resulting in a decrease in tourism receipts of 80 percent (y/y) during the final three quarters of 2020 —a gradual recovery in 2021 resulted in a somewhat better than anticipated outturn for 2020/21. Remittances remained high throughout 2019/20 and 2020/21, compared to initial projections and even surpassing pre-COVID-19 estimates (Figure 3). While the determinants of remittance flows are complex and include domestic factors such as high-yield deposits in local currency, unprecedented support to labor markets around the world is likely to have played a role in the continued flows.

21. Against this background, the NIR target was comfortably achieved. The outlook and risk assessment at the time of the approval of the arrangement pointed to a very challenging external environment ahead, in the context of which any increase in reserves would have been considered a success. By the time of the first review, NIR accumulation had reached $4.3 billion, already exceeding the program target by a margin, and the overall increase until the second review was $6.3 billion. Moreover, there was a larger accumulation of foreign assets through the CBE's FX deposits with local banks, which registered a net increase of $6.6 billion from June 2020 through June 2021 (Figure 4, panel 1).

22. Flexibility in the nominal exchange rate was limited. After staying largely unchanged during the period of large capital outflows in March-April 2020, the nominal exchange rate depreciated by about 3 percent in late May (Figure 4, panel 2). This depreciation reversed during July and August, and the exchange rate returned to its pre-pandemic level by mid-September and remained broadly unchanged until the end of the program. It is worth noting that the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) has classified Egypt's de-facto exchange rate regime as different from its de-jure floating regime since 2017. Specifically, the arrangement was classified as "crawl-like" between March 17 and October 7, 2020 and as "stabilized" on October 7, 2020.

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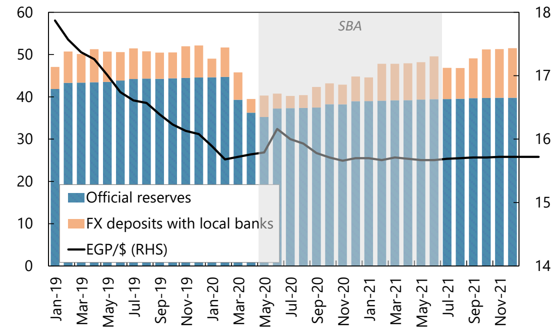
Figure 4. External Sector Developments

CBE's FX deposits with local banks fluctuated while CBE's official FX reserves increased gradually

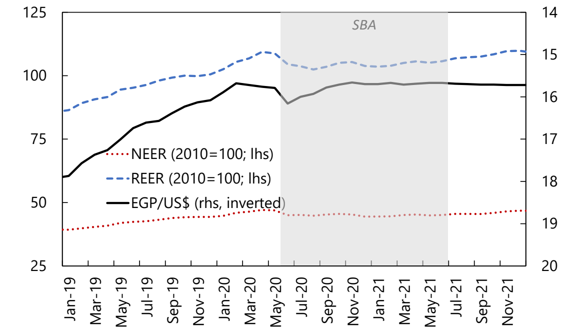
CBE Official Reserves and FX Deposits with Local Banks
(USD billion)



Sources: Central Bank of Egypt, Haver.

Exchange rates displayed little variation during the program

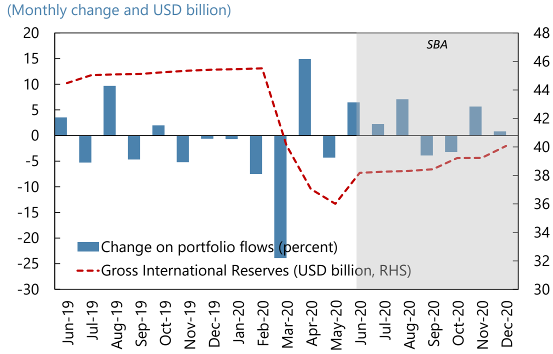
Exchange Rates
(Index and Egyptian Pounds/$)



Sources: Central Bank of Egypt; Information Notice System; Haver.

Portfolio flows displayed high volatility in early 2020

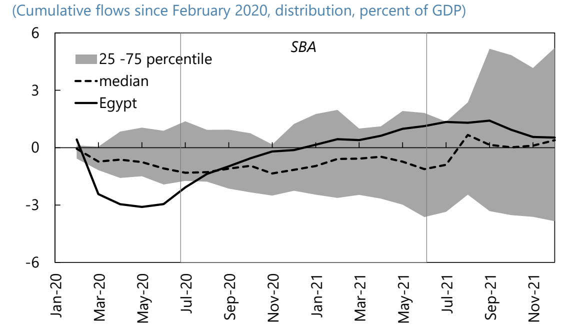
Portfolio Flows and Gross International Reserves
(Monthly change and USD billion)



Sources: Central Bank of Egypt, Haver.

Capital outflows were pronounced and followed by a gradual a sustained recovery

Net Capital Flows to Emerging Markets
(Cumulative flows since February 2020, distribution, percent of GDP)



Source: For Egypt, change in foreign T-bill holdings, CBE. For other EMs: IIF, covering Argentina, Brazil, Chile, China, Colombia, Czech Republic, Hungary, India, Indonesia, Korea, Lebanon, Malaysia, Mexico, Nigeria, Philippines, Poland, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine. IMF staff calcuations.

23. **A broader definition of the reserves target and a recalibration of NIR targets could have been considered.** The objective of the external anchor was to rebuild external buffers. The target was operationalized in terms of changes of foreign reserve assets, as is common in Fund programs (and as used in the EFF), relative to a cut-off date (May 31, 2020). As the program evolved, unexpectedly, reserve accumulation in excess of the program target was held with local banks rather than official FX reserves. In hindsight, therefore, a broader definition of reserve assets to include both official FX reserves and FX deposits with local banks would have given a more complete picture of reserve management operations and of the overperformance relative to the program targets. The likelihood for a better-than-projected increase in overall FX buffers became clear early in the program,[3] and was confirmed during the first and second review. The first review noted that the increased availability of FX in the market as portfolio flows returned had facilitated market purchases

[3] The $5 billion Eurobond issuance was completed on May 31, 2020. The initial impact of this issuance on NIR under the program definition was neutral, as the CBE recorded offsetting increases in foreign reserve assets and foreign reserve liabilities (reflecting government deposits in foreign currency). However, NIR increased in early June 2020 when the government deposit was converted into EGP (resulting in a decrease in the CBE's foreign reserve liabilities).

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by public sector entities, which meant that CBE FX sales to these entities was significantly smaller than originally programmed. Mindful of the still-prevailing significant uncertainty at that time, a careful recalibration of NIR targets reflecting these developments could have further strengthened external buffers.

24. The exchange rate could have helped to absorb the initial shock, however, the authorities considered a stable exchange rate an important factor to bolster domestic confidence. Arguably, the impact of the initial COVID-19 shock could have been more effectively absorbed by a combination of FX intervention and exchange rate flexibility, the latter also reflecting the commitment under the EFF to use the exchange rate to absorb external shocks. The SBA began after the period of FX intervention and when capital outflows had bottomed out. The decision not to pursue an exchange rate adjustment at the outset of the SBA was supported by the assessment of no significant misalignment, and by the fact that a depreciation at that point in time would have had limited impact on tempering the remaining forces that were driving the financing gap, in particular, the sudden stop in tourism.

25. In hindsight, the conduct of FX policy during the program seems to have been a missed opportunity toward entrenching greater flexibility. The SBA counted on the use of exchange rate flexibility. However, even as there was a significant rebound in portfolio flows after June 2020, there was limited variability in the nominal exchange rate. Staff reiterated the importance of two-sided exchange rate flexibility to absorb external shocks and maintain competitiveness during the first and second review. Even as the overall external position was assessed to be in line with fundamentals given available data at that time, greater flexibility could have been helpful; it could have prevented the secular appreciation trend of the real effective exchange rate, and counteracted investor expectations of a stable exchange rate.

B. Monetary Policy

Monetary policy helped to anchor inflationary expectations and successfully maintained inflation in the lower single-digits, supported by a data driven approach and revisions to the MPCC. Lower-than-expected commodity prices and exchange rate stability allowed for additional monetary easing, even as its transmission remained incomplete.

Inflation Anchor

26. The EFF made hard-fought gains in controlling inflation. Twelve-month inflation fell to single-digits in mid-2019 from a peak of 33 percent in mid-2017, as a tight monetary policy stance helped to contain second-round effects from the exchange rate depreciation and increases in domestic energy prices as a result of the fuel subsidy reform. Inflation continued to fall through early 2020, with headline inflation at 5.1 percent in March 2020 (Figure 5, panel 1). With inflation easing and expectations anchored within the CBE's target for headline inflation of 9 ±3 percent, the CBE had already reduced the policy interest rate by 350 basis points in the second half of 2019. This was followed by a further reduction of 300 basis points in mid-March 2020 to help support

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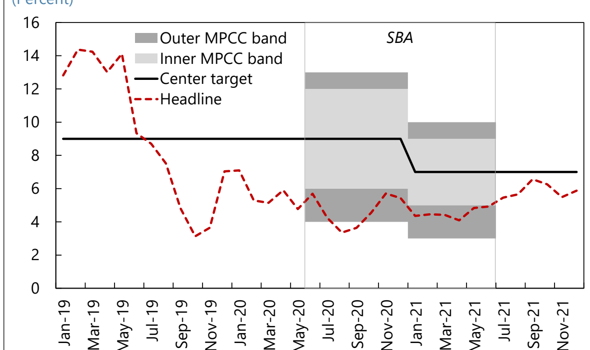
economic activity and alleviate pressures in domestic financial markets. Despite the sizable reduction in policy rates, real interest rates remained relatively high at around 4 percent.

27. A key objective of the authorities' program supported by the SBA was to keep inflationary expectations well-anchored and maintain single-digit inflation. Inflation remained susceptible to structural inefficiencies in the domestic agricultural sector that contribute to volatility in domestic food prices, while exchange rate movements were also expected to increase inflationary pressures in 2020/21. In order to align with the authorities' ongoing transition to inflation targeting, the SBA introduced a monetary policy consultation clause to monitor inflation performance, rather than the reserve money targeting framework that had been used during the EFF. The inner band of the MPCC was set at 9 ±3 percent corresponding to the CBE's target range, and with an outer band of 9 +4/-5 percent. A deviation of the inner band would trigger a discussion with staff on the policy response, while a breach of the outer band would require a consultation with the Executive Board.

Inflation Outcomes and MPCC Discussions

28. The projected pickup in inflation during FY2020/21 did not materialize, with twelve-month headline inflation remaining around 4-5 percent throughout the program. Headline inflation stood at 4.9 percent (y/y) in June 2021, little changed from March 2020, compared with a projection of 9 percent at the approval of the arrangement. Lower-than-projected inflation reflected the stability of the exchange rate while usually volatile domestic food prices consistently surprised on the downside, against the background of low commodity prices.

Inflation and MPCC Bands
(Percent)



Sources: Central Bank of Egypt, Haver.

29. Lower-than-expected inflation resulted in breaches of the MPCC bands at both the first and second review. Headline inflation fell below the lower outer band of the end-September MPCC at the first review. The CBE reduced the policy rate by a cumulative 100 basis points in late 2020 in response, while the MPCC midpoint was revised from 9 to 7 percent for the second review test date in end-March to reflect near-term expectations of moderate inflation.

30. Staff agreed that a pause in lowering rates was appropriate at the second review. Despite the downward revision of the target, and headline inflation breaching the revised lower inner band at the second review in March 2021, the CBE opted against further rate reductions, citing the sizable interest rate cuts that had taken place earlier in the year. The CBE also pressed the need to be vigilant against possible upside risks from rising commodity prices. Staff was also of the view that global increases in commodity prices would pass through to Egypt, putting upward pressure on inflation.

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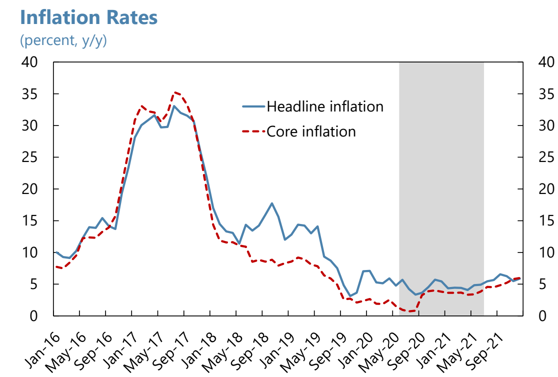
31. Overall, inflation expectations appear to have remained well-anchored during the program even as headline inflation fell below the CBE's target range. Under the MPCC framework, monetary policy was eased in response to persistently lower inflation, and the data-informed approach taken at both reviews to further easing appears appropriate in view of emerging inflationary risks, which later proved to be correct.

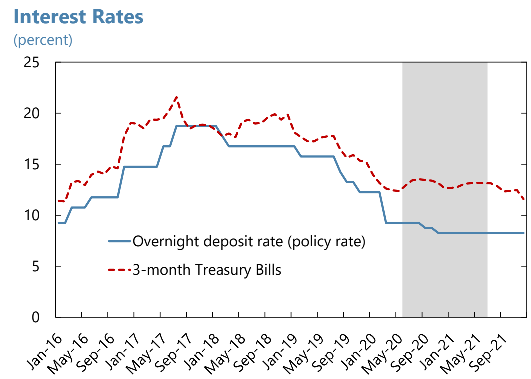
Figure 5. Financial Sector Developments

Inflation stayed within single digits



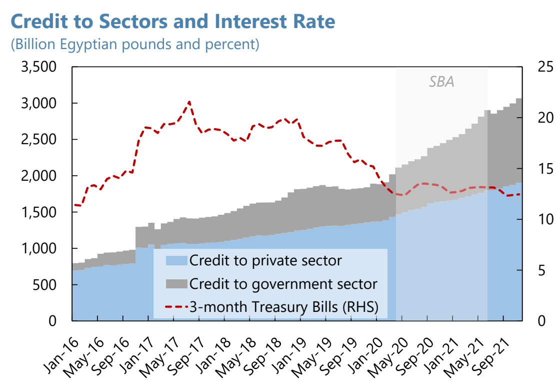
Sources: Central Bank of Egypt.

While overnight rates came down, 3-month rates remained high



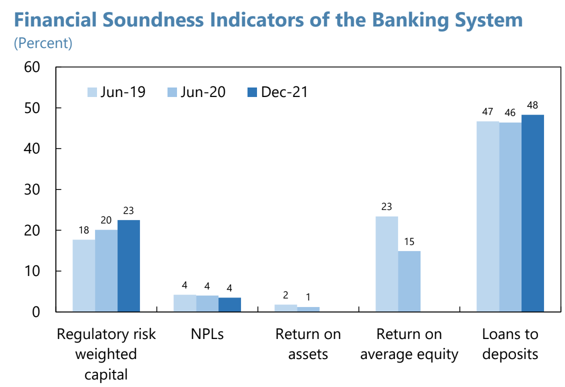
Sources: Central Bank of Egypt

Government borrowing increased, and with the support of subsidized lending schemes, so did private credit



Sources: Central Bank of Egypt

Overall, indicators suggest the banking system weathered the pandemic well



Sources: Central Bank of Egypt.

32. However, the transmission of monetary easing remained incomplete. The cuts in the policy rate in the second half of 2020 were not reflected in the overnight interbank rate (the CBE's operational target pursued by Open Market Operations), which remained outside the target corridor, nor in the three-month treasury bill rate. While this incomplete transmission is likely to have had a limited impact on inflation outcomes during the program, given the lags in monetary policy transmission, this somewhat muted the effect of lower policy rates on financial conditions and the impact on the domestic economy. At the same time, subsidized lending through the schemes introduced by the CBE prior to the COVID-19 outbreak amounted to nearly EGP 200 billion, boosting private sector credit growth to 25 percent (y/y) in January 2021 from 12 percent in

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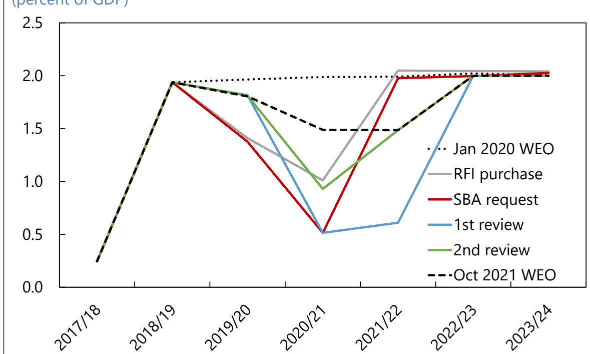
February 2020. The incomplete transmission together with high public debt and large public borrowing needs also implied that yields on public debt did not fully reflect the lower policy rate.

C. Fiscal Policy

The SBA aimed to give Egypt sufficient space to temporarily ease the fiscal stance and accommodate additional health and social spending to save lives and livelihoods and buffer the impact of the pandemic, while avoiding an excessive increase in public debt. These goals were met to a large extent as, despite accommodating COVID-19-related expenditures and constituting a somewhat looser fiscal stance, the primary balance in FY2019/20 and FY2020/21 outperformed program targets. However, the resulting higher fiscal balances did not translate into a lower debt-to-GDP ratio due to offsetting factors.

33. **A main objective of the authorities' program supported by the SBA was to enable countercyclical fiscal policy that accommodated the necessary spending on health and protection of vulnerable households and firms.** Prior to the pandemic, Egypt was expected to record a budget sector[4] primary surplus of 2 percent of GDP in FY2019/2020 and maintain similar primary surpluses over the medium term, allowing for a gradual decline in debt. Coming into place at the end of June 2020, the program had little scope to influence the primary surplus for FY2019/20. The projected primary surplus of 1.4 percent of GDP, corresponding to a moderate fiscal easing of about ½ percent of GDP, reflected emergency measures announced earlier that year and was considered appropriate. For FY2020/21, the program targeted a primary surplus of at least 0.5 percent of GDP, followed by a return to 2 percent in FY2021/22 (or at least 1.4 percent of GDP if economic recovery were to take longer). The programmed fiscal easing of about 2 percent over two years was small compared to that expected in other countries at the start of the pandemic, as was the outturn (Text Table).

Primary Fiscal Balance
(percent of GDP)



Sources: IMF 2020a, 2020b, 2021a, 2021b, WEO.

Public Debt and the Primary Balance (PB) during the Pandemic

	Debt (percent of GDP)		PB (percent of GDP)	
	2020	2021	2020	2021
Egypt				
Pre-pandemic projection	82.9	80.9	2.0	2.0
Outcome 2/	89.8	91.4	1.8	1.5
difference	*7.0*	*10.4*	*-0.2*	*-0.5*
EMs (excl. China)				
Pre-pandemic projection	53.0	53.1	-1.2	-1.1
Outcome 2/	62.0	60.3	-5.6	-3.2
difference	*9.0*	*7.2*	*-4.4*	*-2.0*

1/ January 2020 WEO.
2/ October 2021 WEO.

34. **All fiscal QPCs and indicative targets were met (Table 2).** As real and nominal growth in 2020 and 2021 surprised on the upside, tax revenue was higher than expected in both FY2019/20 and FY2020/21. The gain in tax revenue was, however, outweighed by weaker performance of non-tax revenue. At the same time, the authorities disciplined current spending, leading to lower-than-expected expenditure on wages and other remunerations, goods and services, and fuel and

[4] Defined as General Government less Social Insurance Funds and NIB, see IMF 2020b, MoU.

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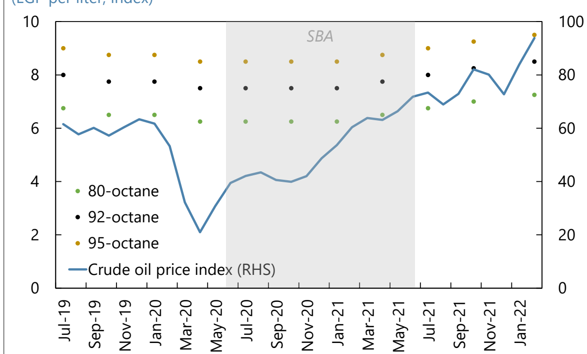
food subsidies (taking advantage of lower-than-expected commodity prices). Social spending was maintained above program targets. As a result, primary balances of 1.8 percent of GDP and 1.5 percent of GDP were achieved in FY2019/20 and FY2020/21, respectively, translating into overall balances of -7.8 and -7.4 percent of GDP (see Figure 6). The deficits were financed by a mix of domestic and external sources, broadly in line with projections. Moreover, the authorities reduced the issuance of short-term debt, bringing the share of short-term net new domestic treasury issuance well below program targets and reaching 3 percent of total domestic issuance for FY2020/21 as a whole. As a result, average time to maturity of Egypt's debt increased from 2.74 years at end-June 2019 to 3.26 years at end-June 2021.

35. **The authorities implemented most tax measures foreseen under the program.** Specifically, the program included a floor on tax revenue, supported by several revenue measures that were planned for the FY2020/21 budget before the pandemic, as well as an additional, temporary 1 percent "solidarity tax" on wages and 0.5 percent tax on pensions which was levied during FY2020/21 to support the pandemic response. Most of these revenue measures were successfully implemented and the floor on tax revenue was met by a comfortable margin.[5]

36. **Meanwhile, the automatic fuel price mechanism introduced during the EFF[6] was not fully applied**. This resulted in relatively muted movements in fuel prices between February 2020 and the end of the SBA, despite large swings in international oil prices during this period. The sharp decline in oil prices in early 2020 was not fully passed through to retail prices, with a reduction in pump prices by only about 3 percent (25 piastres) in April 2020, below the 10 percent maximum adjustment allowed for by the mechanism. As global oil prices recovered, the authorities kept pump prices steady and only reversed the initial reduction in April 2021. This reflected in part the introduction of a green tax on gasoline and diesel of 30 piasters per liter in FY20/21 but also discretion in the application of the fuel price mechanism. Further increases of 25 piastres each followed in July and October 2021 (after the expiry of the SBA), as global oil prices continued to rise. All in all, the imperfect pass-through of

Fuel Prices
(EGP per liter; index)



Sources: GDS live dataset; Fuel Automatic Pricing Committee; staff calculations.

[5] Amendments to the VAT law to charge VAT on digital services, e-commerce and online trade were foreseen at the time the FY20/21 budget was prepared. The amendment was sent to parliament in June 2020 but ultimately was approved only in December 2021. The budget also foresaw additional revenues from revisions to the bank secrecy law to comply with rules set forth by the Global Forum on Transparency and Exchange of Information for Tax, but these revisions ultimately did not take place during the program period.

[6] Under the EFF, the Egyptian authorities raised retail prices of fuel to reach full cost-recovery and implemented an automatic price indexation mechanism with the aim of maintaining prices at cost-recovery levels and safeguarding the budget from unexpected changes in the exchange rate and global oil prices. Under the mechanism, prices are adjusted every three months to reflect changes in global fuel prices and the exchange rate, with adjustments capped at +/-10 percent per quarter.

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lower oil prices in the early months of the program led to budget savings in FY2020/21, although the amount was relatively modest at about 0.25 percent of GDP.[7]

37. The public debt outturn for FY2020/21 was in line with projections at the time of arrangement approval, as the overperformance of the primary balance was offset by a revision to the FY2019/20 outturn. The FY2019/20 public debt outturn was about 1½ percent of GDP higher than expected (Figure 6, panel 4 and 5), reflecting changes in the accounting of financial relations with some public entities under the program definition of public debt.[8] In addition, inflation materialized significantly lower than expected, raising the real effective interest rate (Figure 6, panel 6). Despite these two factors, at the time of the second review, debt was projected to end FY2020/21 at 92 percent of GDP, below the initial projection of 93.3 percent of GDP, supported by the overperformance of the primary balance. However, larger-than-projected transactions in the last quarter of FY20/21, including for pre-existing arrears settlements between the EGPC and the electricity sector (1.3 percent of GDP) and payments and bond issuances to the CBE related to losses incurred in 2016 (0.5 percent of GDP), resulted in a public debt stock of 93.5 percent at the end of FY2020/21. During the SBA, all indicative targets on debt accumulation (at end-September 2020, end-December 2020 and end-March 2021) were comfortably met.

38. Public debt continued to be assessed as sustainable throughout the program, though not with high probability. The factors discussed above did not alter the bottom-line assessment, even though at the time of the second review, medium-term debt projections had been revised up compared to the SBA request. On the other hand, successful lengthening of average debt maturities during the program contributed to strengthen risk mitigating factors and the reduction in Egypt's EMBIG spreads led to an upgrade in the DSA heatmap (¶64 and Figure 7).

39. A 15-month SBA program would have allowed for test dates to cover the full fiscal year 2020/21. When the final review was completed on 23 June 2021, the 2020/21 fiscal year was not yet complete, and data was available only for the first three quarters of the fiscal year, consistent with the test date of end-March 2021. A test date of end-June 2021 would have allowed the program, and, notably, targets on the primary balance and debt accumulation, to cover the entire fiscal year of 2020/21. This could have been considered given the program's dual objectives of supporting temporary fiscal easing while safeguarding medium-term fiscal sustainability. That said, given the commitment of the authorities to fiscal discipline and strong ownership of the fiscal program, the shorter horizon did not prove to be detrimental to the fiscal outcomes.

[7] This includes revenues raised by the new green tax on gasoline and diesel of about 0.1 percent of GDP.

[8] Under revised accounting, assets and liabilities are treated separately leading to changes in gross and net debt.

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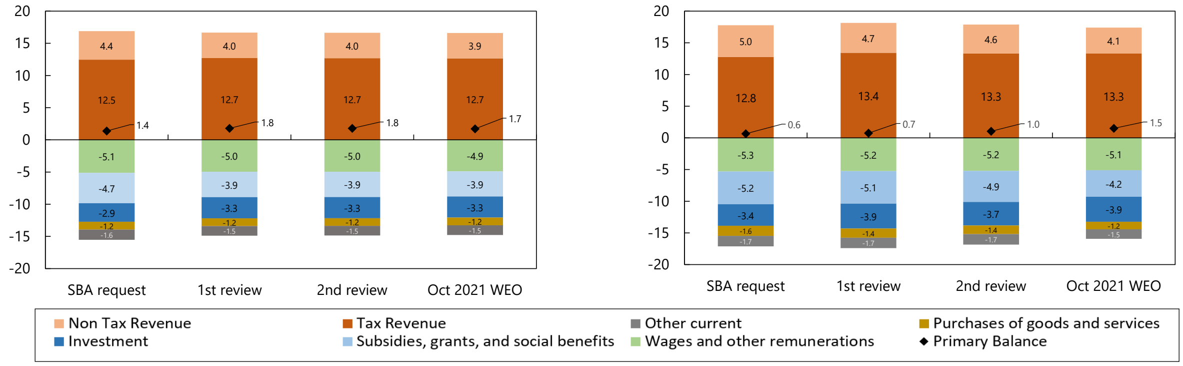
Figure 6. Fiscal Developments

Lower-than-expected food and oil prices kept primary spending on subsidies contained in FY19/20, improving the primary balance despite lower non-tax revenues.

Primary Balance, FY2019/2020
(percent of GDP)

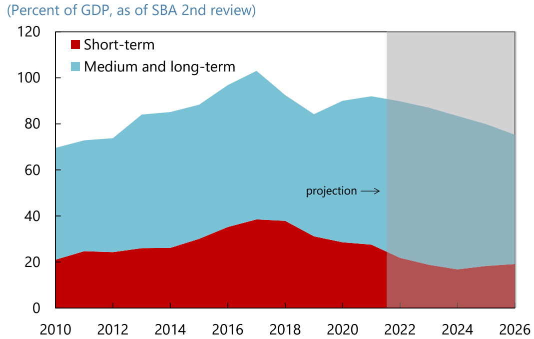
Continuing to benefit from lower commodity prices, the primary balance in FY20/21 similarly overperformed program expectations.

Primary Balance, FY2020/2021
(percent of GDP)



Strict limits on issuance of new short-term debt lengthened average maturity of debt over the program…

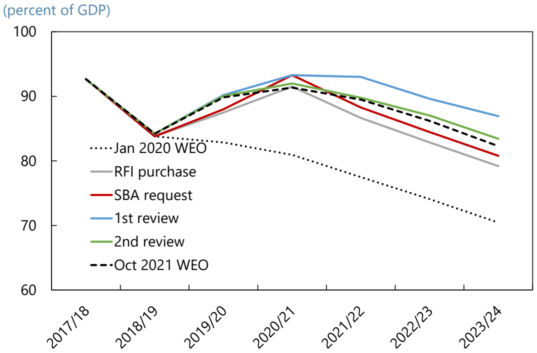
Public Debt Maturity
(Percent of GDP, as of SBA 2nd review)



Sources: IMF 2021b.

…and despite an upward revision to outstanding debt in FY2019/20, the public debt-to-GDP ratio ended FY2020/21 broadly in line with program projections.

Public Debt
(percent of GDP)

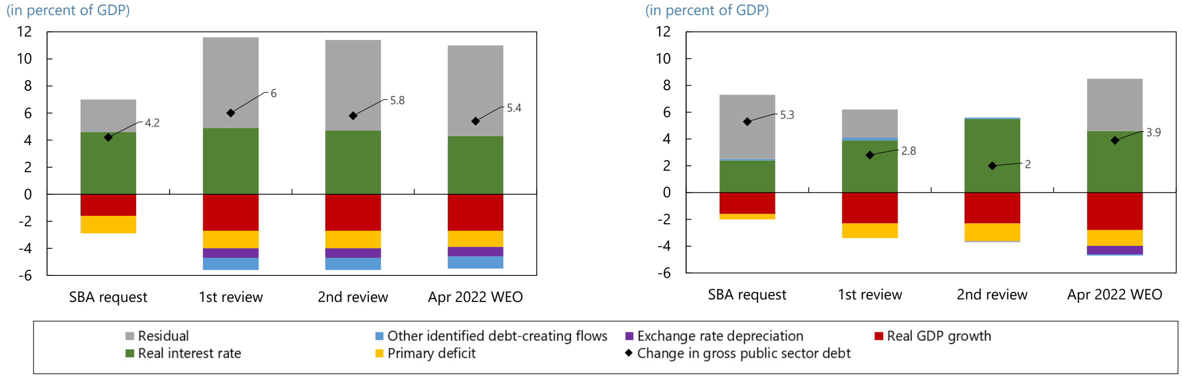


Higher residual debt-creating flows outweighed stronger real growth in FY2019/20…

Debt-Creating Flows, FY2019/20
(in percent of GDP)

…and materialized anew for FY2020/21 after the final program review.

Debt-Creating Flows, FY2020/21
(in percent of GDP)



Sources: IMF 2020a, 2020b, 2021a, 2021b, WEO.

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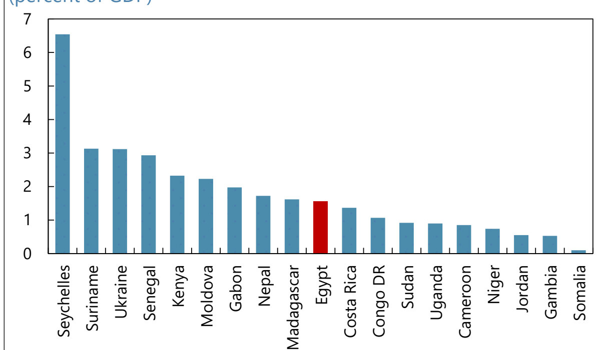
D. COVID-19 Response

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.

Fiscal Response

40. 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. Total estimated cost of announced support measures, including both on- and off-budget measures, reached 0.2 percent of GDP for health, 0.6 percent for support to households and 1.0 percent for support to firms cumulatively across FY2019/20 and FY2020/21 (IMF 2021a, Annex III). The size of Egypt's announced fiscal support package ranked close to the average of other countries which entered Fund arrangements during the pandemic (Text Figure).

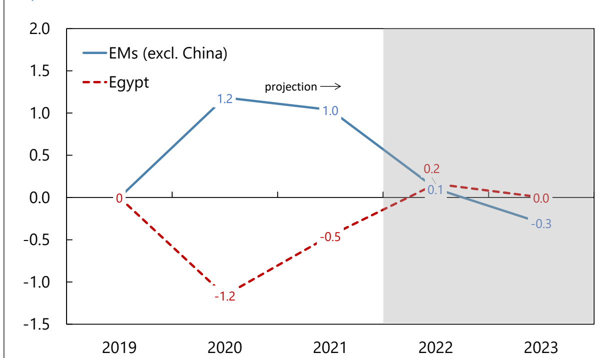
COVID-19 Related Fiscal Support in Fund UCT Arrangements
(percent of GDP)



Source: IMF COVID Dashboard and IMF staff calculations.

41. 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 (Text Figure). The uncharacteristic overall decline in real spending reflects fiscal savings from lower-than-budgeted

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



Sources: IMF 2021b, WEO.

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food and energy prices and containment of other current spending, but also the significant role of off-budget entities in administering the COVID-19 response. Of the 1.8 percent of GDP of support announced by Egypt during FY2019/20 and FY2020/21, only about 0.6 percent fell to the budget.[9]

42. 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. Moreover, public procurement plans as well as awarded contracts for the emergency response were to be published, including the names of awarded companies and information on beneficial ownership, in accordance with the applicable law (IMF 2020b, LOI).

43. The authorities have implemented some of these commitments. Detailed information on procurement contracts up to February 2021 was published, including the names of the awarded companies.[10] Three-month ahead procurement plans for COVID-19 related spending for the March-June 2021 and July-October 2021 periods were also published. Procurement regulations were adjusted in June 2021, shortly before the final SBA review, to allow for the systematic collection and publication of beneficial ownership information. While the Ministry of Finance published a list of COVID-19 support measures on its website, it has yet to make available information on execution for most of these measures. A special financial audit report covering health expenditures related to COVID-19 was published for the periods March-June 2020 and July 2020 to early May 2021; however, other budgetary expenditures announced as part of the COVID-19 response package (e.g., higher subsidy pay-outs for exporters, an EGP 500 monthly cash subsidy for irregular workers, and the expansion of the cash transfer programs Takaful and Karama) were not covered, and the report did not discuss ex-post validation of delivery. To date, the regular annual audits of the government's financial statements carried out by the Accountability State Authority have not been made available to the public.

44. 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

[9] Comprehensive data on spending execution is not yet available. Regarding public entities, measures to support firms included reductions in electricity and gas prices for all industries. The reduction in electricity tariffs was absorbed by the EEHC, while reductions in gas prices were absorbed by GASCO. Meanwhile, bonuses and an annual raise for pensioners were carried out by the National Organization for Social Insurance (NOSI). Some measures were carried out by the central government and took the form of public guarantees (e.g., EgyptAir's borrowing from domestic banks).

[10] The staff report for the 2021 Article IV Consultation and Second Review under the SBA included links (here, here, here and here) to contracts awarded from December 2020-February 2021 as well as to information on contracts awarded prior to December 2020.

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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

45. 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.

46. 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.

47. 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 (Figure 5). 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.

E. 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

[11] Few countries publish timely, high-frequency data on poverty. The April 2022 Fiscal Monitor presents such data for the U.S. and Brazil, where there is evidence of an absolute decline in poverty rates in 2020, owing to the large temporary expansion of social protection schemes.

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better governance, was more limited, reflecting the exceptional disruptions brought about by the pandemic and associated competing priorities.

48. 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 (Table 3). Almost all structural benchmarks built on reform initiatives that began during the EFF. In the case of the social protection expenditure review, the benchmark built on ongoing work of the World Bank. A comparison with pre-pandemic exceptional access programs suggests that structural conditionality in the Egypt SBA was well-focused on areas of Fund expertise, even if the number and depth of conditions was slightly lower (Box 2), reflecting the short duration of the program and the Fund's approach to lending during the pandemic (Box 1).

49. 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. This approach was appropriate given the large degree of uncertainty prevailing at the time of the approval of the arrangement and the primary program objective of macroeconomic stabilization. The adoption of a focused structural reform agenda also reflects recommendations of the 2018 Review of Conditionality which called for further prioritization of reforms critical to specific program objectives.

50. 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. NIB did not have a banking license and was not subject to banking supervision. Under the EFF, the authorities created an inter-agency committee to undertake an operational and financial review and develop a plan for reforming NIB and hired an international auditor to evaluate NIB's assets and liabilities. The SBA included as a structural benchmark the preparation of a reform plan, to be approved by the Prime Minister, with a clear plan and timebound actions for implementation of the strategy. The plan was approved in January 2021 and the authorities further set in motion the winding down of the bank, with the cessation of all lending and deposit collection activities in the same month.

51. 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.

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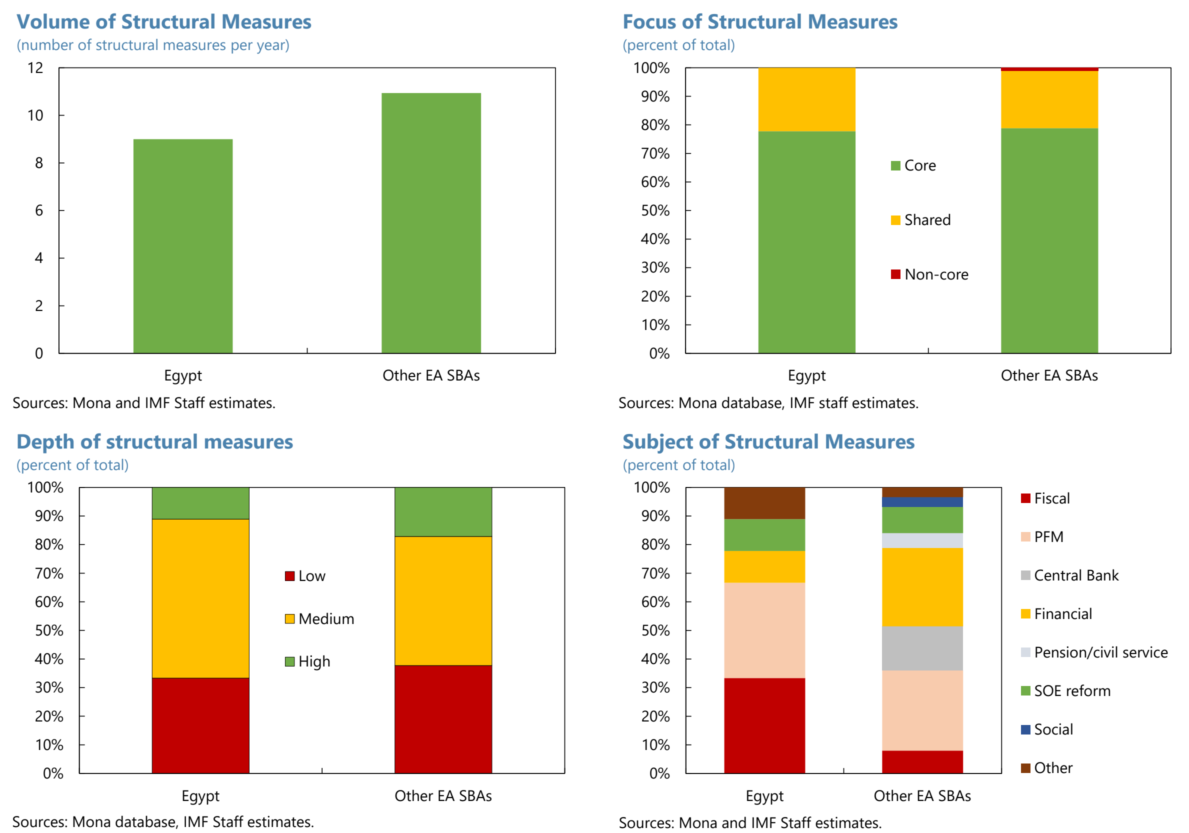
Box 2. Structural Conditionality Under the 2020 SBA in Perspective

Egypt's 2020 SBA was of short duration and characteristic of Fund lending during the pandemic, with implications for the structural reform agenda (Box 1). Accordingly, a comparison with other exceptional access (EA) SBAs approved between 2008 and 2020 shows that Egypt's SBA was both the shortest (the only 12-month arrangement) and had slightly fewer structural conditions than other programs, measured per program-year. The same comparison finds that the focus of structural conditions was comparable to other EA SBAs, with close to 80 percent of conditions falling in the core areas of Fund responsibility, 20 percent in shared areas, and no conditions in non-core areas. Within the core areas, Egypt's SBA put relatively more focus on fiscal and PFM reforms and relatively less focus on financial sector reforms than comparators. Finally, the comparison shows that the SBA had a slightly lower proportion of high-depth structural measures compared to previous EA SBAs.

Structural Conditionality in Perspective



<u>Note</u>: This comparison follows the methodology applied in the 2018 Review of Conditionality (IMF 2019a), where conditionality is assessed by volume, depth, and focus. In all dimensions, the assessment is based on the design of the conditionality at the time of the approval, not implementation. Volume is measured as the number of conditions per program year. Depth is assessed according to the degree and durability of change expected as a result of the reform (*High-depth* measures are reforms that lead to permanent institutional changes; *medium-depth* measures are reforms that lead to a significant change but are one-off in nature; and *low-depth* measures are reforms that in themselves do not bring about change but are steps towards a change). Focus is assessed by categorizing the subject area of structural conditions into core, shared, and non-core areas of Fund responsibility (*Core* areas include fiscal, central bank and financial reforms. *Shared* areas include pension and civil service reforms, SOE and social sector reforms, and labor and product market reforms). Other exceptional access SBAs from 2008 to 2020 comprise Argentina (2018), Armenia (2009), Belarus (2009), Georgia (2008), Greece (2010), Hungary (2008), Iceland (2008), Jordan (2012), Latvia (2008), Mongolia (2009), Pakistan (2008), Romania (2009), Sri Lanka (2009), St. Kitts and Nevis (2011), and Ukraine (2008, 2010, 2014).

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Impact of Structural Reforms

52. 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. The publication of updated financial reports on SOEs and Economic Authorities under the SBA was an important step to strengthen governance and should become a regular and timely exercise.

53. 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. More ambitious structural reforms, which could have led to longer-lasting changes in the business environment and to improvements in non-price competitiveness were left to a later time in the hope that uncertainty over the macroeconomic environment would decline. As in many countries, policies adopted in response to the pandemic (e.g., support to households and firms through fiscal and financial policies) intensified, rather than reduced, the role of the government in the economy, thus creating a difficult environment for incentivizing private sector investment. Post pandemic, this places a premium on further implementing and reinvigorating the structural reform agenda to place the Egyptian economy on a more competitive footing to increase its resilience against future shocks.[12]

CONSISTENCY WITH FUND POLICIES AND PROCEDURES

A. Financing

54. 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. Assuming continued successful rollover of short-term debt and limited use of reserves to address disorderly market conditions, the RFI and first SBA disbursements, which took place in the last two months of Egypt's FY 2019/20, together with the placement of the Eurobond in May 2020 were expected to fill the financing gap of around \$9 billion (Table 1).

[12] See the discussion of structural reforms priorities in the 2021 Article IV Consultation (IMF 2021b).

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55. 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 (Table 1).

Table 1. Egypt: External Financing Requirements and Sources, 2019/20 – 2020/21 1/

(In billions of US$, unless otherwise indicated)

	2019/20				2020/21			
	RFI request (5/11/2020)	SBA request (6/26/2020)	SBA 1st review (12/18/2020)	SBA 2nd review (6/23/2021)	RFI request (5/11/2020)	SBA request (6/26/2020)	SBA 1st review (12/18/2020)	SBA 2nd review (6/23/2021
Gross External Financing Requirements	**38.4**	**38.0**	**38.9**	**36.6**	**42.0**	**42.0**	**49.6**	**50.1**
Current account deficit	15.2	14.8	11.2	11.2	16.2	16.2	16.5	15.4
Maturing debt payments 2/	23.2	23.2	27.7	25.4	25.7	25.8	33.4	34.7
Amortization of medium- and long-term debt	7.0	7.0	…	…	6.5	6.6	…	…
Maturing short-term debt	16.2	16.2	…	…	19.2	19.2	…	…
Gross External Financing Sources	**29.2**	**28.8**	**29.0**	**26.7**	**37.5**	**29.8**	**36.4**	**37.8**
Foreign direct investment, net	7.8	8.0	7.1	7.1	7.2	5.5	5.4	5.4
Portfolio and capital flows, net	11.6	12.8	13.3	11.0	27.4	27.9	34.6	36.5
Portfolio flows, net	-12.5	-7.5	-8.1	-8.1	3.0	3.5	9.6	20.2
Other capital flows, net	0.1	4.1	5.2	2.9	-1.5	5.2	5.8	-2.9
Rollover of short-term debt	16.2	16.2	16.2	16.2	19.2	19.2	19.2	19.2
Medium- and long-term borrowing	7.7	0.0	0.0	0.0	6.7	0.0	0.0	0.0
Change in arrears	-1.0	-1.0	0.0	0.0	0.0	0.0	0.0	0.0
Use of international reserves	8.8	7.1	6.6	6.6	3.1	-3.3	-3.4	-3.9
2019 EFF purchase	2.0	2.0	2.0	2.0	-0.2	-0.2	-0.2	-0.2
External Financing Gap	**9.2**	**9.2**	**9.9**	**9.9**	**4.5**	**12.2**	**13.2**	**12.3**
IMF purchase of RFI and SBA, net	2.8	4.8	4.8	4.8	0.0	3.2	3.2	3.2
Financing from other multilateral and bilateral creditors	0.0	0.4	0.1	0.1	0.0	2.4	3.6	2.4
External commercial loans assumed under the program	0.0	4.1	5.0	5.0	0.0	6.5	6.5	6.5
Residual external financing gap	6.4	0.0	0.0	0.0	4.5	0.0	0.0	0.0

Memorandum items: 3/	SBA request	SBA 1st review	SBA 2nd review
Other non-Fund financing during the SBA	18.4	19.0	19.0
GCC member deposits falling due during the SBA (rollover) 4/	13.4	10.0	10.0
Eurobond issuance since staff level agreement on the SBA 5/	5.0	9.0	9.0

1/ Fiscal year: July-June. Table based on *Table 11. Egypt: External Financing Requirements and Sources* from IMF 2020a and 2020b, with adjustments for 2021a and 2021b. Figures correspond to actuals or projections at the time of the reviews.

2/ Reflects presentational changes in the 1st and 2nd review of the SBA.

3/ The memorandum items correspond to information at the time of the reviews for the full SBA duration.

4/ GCC member deposits are not listed in the financing sources to maintain consistency with the presentation in the program documents.

5/ Eurobond issuances were part of the external commercial loans assumed under the program.

56. 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.

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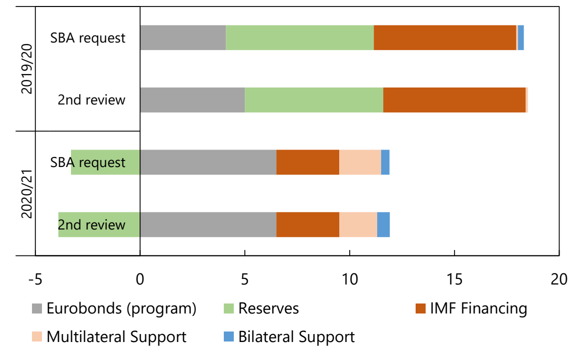
57. The Fund was the largest official creditor to provide financing in 2019/20 while others increased their contributions in 2020/21. Net external financing needs[13] amounted to about $18 billion in FY2019/20, ¾ of which were covered, in roughly equal parts, by Fund financing and a drawdown in reserves, and the remainder was financed by the Eurobond issuance projected under the program. In FY2020/21, projected and actual net financing needs were smaller—about $12 billion including reserve accumulation—with bond placements contributing more than half, the Fund about ¼, and the remainder being provided by other official creditors. The World Bank was the second largest official creditor after the Fund to provide financing that year, primarily through disbursements for ongoing projects in the health and transportation sectors. Reflecting the program documentation, where deposits from Gulf Cooperation Council (GCC) members were not detailed as regular or exceptional financing items, these deposits are not included in this discussion. However, at $13.4 billion, the amount of GCC member deposits maturing during the program period represent 2.6 times the total SBA disbursements, and, as such, are significant. Pending a determination of what share of these deposits would have been rolled over absent the pandemic shock, the financing burden covered by the GCC members is potentially significant.

Net External Financing Sources
(in USD billion)



Sources: IMF 2020b, 2021b.

58. 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. Moreover, the burden sharing envisaged at the time of the approval of the arrangement was broadly in line with outcomes.

59. In hindsight, the program may have benefited from a strategy to deal with upside risks. Overall, external buffers were rebuilt more strongly than expected, in particular with respect to reserve accumulation through FX deposits with local banks. However, the authorities could also have taken advantage of the strong recovery in portfolio inflows in the second half of 2020 to more forcefully rebuild official FX reserves, or possibly substitute for Fund financing. Any effort to reduce the net exposure to the Fund would have accelerated a return to normal cumulative access levels. However unlikely it may have appeared at the time of the program discussions, contingent discussions about how best to respond to better-than-expected macroeconomic outcomes could have prepared the groundwork for a more systematic capture of upside risks, including the recalibration of NIR targets. Given the high uncertainty over the future of the pandemic, including recurring infection waves, virus mutations, and uneven vaccine progress, and the continued

[13] Net external financing needs are defined as financing required to balance the current account, capital account, and financial account, and the balances of these accounts exclude official reserves, credit from the Fund and other bilateral and official creditors, and exceptional program financing.

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disruptions in the tourism industry such recalibration was not considered at any point during the SBA.

60. The discussion of external financing needs could have benefited from a consistent presentation over time with more details on the GCC member deposits. At the time of the RFI and SBA request, short-term debt was reflected in the gross financing needs, with an equivalent rollover item as a financing source. In the first and second review, however, these items were netted out, which could mistakenly give rise to the impression that financing needs had changed more fundamentally. While the changes were purely presentational in nature, headline gross financing figures are important elements of the BOP financing needs and hence matter for the discussion of access levels. Furthermore, some financing items varied significantly across reviews, reflecting additional and updated information made available to staff. Finally, the rollover of GCC member deposits were important financing elements, and played a role in the application of the Fund's safeguards framework (see below). A clear discussion of these deposits, in both stocks and flows, their main characteristics, and their shock resilience would have been helpful, and the inclusion of these discussions into the determination of financing needs and sources would have provided additional transparency and a more complete picture of burden sharing. More generally, these considerations underscore the need for timely, consistent, and complete discussions of external financing data in UFR. More standardized financing tables for UFR requests would help ensure consistency over time and across countries.

B. Application of the Exceptional Access Framework

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.

61. Given the unique circumstances and financing needs created by the pandemic, the Fund introduced temporary adjustments to its lending framework to better respond to its members' needs. With respect to the financing window available to Egypt in the GRA, these adjustments included increases in the limits on access to the Fund's emergency financing instruments and increases in annual limits on access to financing (Box 3).

62. Financing under Egypt's SBA involved exceptional access, which required all four Exceptional Access Criteria (EAC) to be satisfied, same as under the RFI (Boxes 3 and 4). Under the SBA, access exceeded both the cumulative and annual access limits in place at the time. Egypt purchased the full available amount under the RFI at 100 percent of quota in May 2020, surpassing the normal *cumulative* access limit. The approved access of 184.8 percent of quota for the SBA in June 2020, with disbursement of 127.2 percent of quota within 12 months of the purchase under the RFI, also exceeded the normal *annual* access limit in place at the time.

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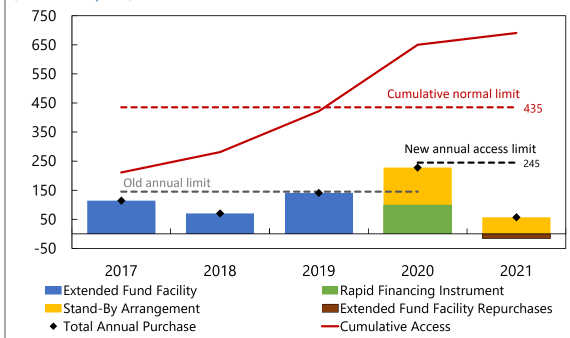
Box 3. Egypt: Access to GRA Resources

GRA access limits: In April 2020, the Fund increased annual access limits under the RFI from 50 to 100 percent of quota.[1] In June 2020, at the time of Egypt's SBA approval, *annual* limits for overall access to GRA resources was at 145 percent of quota, over any 12-month period. In July 2020 this normal annual access limit was increased to 245 percent of quota.[2] The *cumulative* normal access limit to GRA resources (net of scheduled repayments) remained unchanged at 435 percent of quota.

Egypt's Access to GRA Resources
(Percent of quota)



Sources: MONA and IMF staff estimates.

Egypt's annual access: Egypt took full advantage of the increased RFI access (100 percent of quota). Combined with the disbursements under the SBA, Egypt's annual access peaked at 227.9 percent of quota in 2020 exceeding the annual limit in place at time of approval (145 percent). However, the 12-months SBA remained within the *increased* annual access limit (245 percent), which would be the relevant threshold for the eligibility for an EPE.

Egypt's cumulative access: With an existing exposure of 422 percent of quota from the EFF at end-2019, any purchase above 13 percent of quota — be it RFI or SBA — would have required exceptional access as the normal cumulative access limits remained at 435 percent of quota throughout the crisis. Egypt exceeded normal cumulative access limits with the RFI purchase and, subsequently, the SBA.

1/ 2020 Enhancing the Emergency Financing Toolkit – Responding to the COVID-19 Pandemic.
2/ The higher limit was extended to remain in place through the end of 2021, before the normal annual access limit was reduced back to 145 on January 1, 2022. See Temporary Modification to the Fund's Annual Access Limits, and Temporary Extensions and Modifications Of Access Limits In The Fund's Lending Facilities.

63. **The balance of payments needs facing Egypt satisfied EAC1.** 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. While external financing pressures alleviated somewhat by the time of the first and second reviews following a recovery of capital flows and resilient remittances, external financing needs remained broadly unchanged (Table 1).

64. **EAC2 was deemed to be met because market access was retained and the rollover of external debt liabilities from official bilateral creditors was secured.** Debt was assessed to be "sustainable but not with high probability" which is referred to as being in the "gray zone".[14] The

[14] Egypt was the first gray zone case since the 2018 Argentina SBA.

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Box 4. Exceptional Access Criteria

The provisions of the Exceptional Access Framework (EAF) were updated by the Executive Board in 2016, and determine that such access satisfies the four exceptional access criteria (EAC) below:

- **EAC1**. The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.

- **EAC2**. A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term. Where the member's debt is assessed to be unsustainable ex ante, exceptional access will only be made available where the financing being provided from sources other than the Fund restores debt sustainability with a high probability. Where the member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances the safeguards for Fund resources.

- **EAC3.** The member has prospects of gaining or regaining access to private capital markets within a timeframe and on a scale that would enable the member to meet its obligations falling due to the Fund.

- **EAC4.** The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.

In particular, for EAC2, if the member's debt is considered sustainable but not with a high probability, the provision of Fund financing under this category had been introduced under the EAF policy to provide flexibility and avoid potentially very costly and unnecessary debt restructurings. Definitive debt operation is required only for cases where debt is assessed to be unsustainable. For cases with sustainable debt but not with a high probability, a definitive debt operation is not required if financing from other sources during the program is available on a scale and terms such that the policies implemented with program support and associated financing improve debt sustainability and sufficiently enhance the safeguards for Fund resources, although they may not restore projected debt sustainability with a high probability. The sources of other financing would depend on the circumstances, which would need to be justified accordingly.

two key aspects of the EAC2 are the application of the Debt Sustainability Analysis (DSA) and the safeguards to Fund resources:

- **Application of the Debt Sustainability Analysis (DSA).** The DSA provides a bottom-line assessment of debt sustainability based on an array of indicators and tools, with judgment involved to reach the overall assessment (Figure 7). At the time of the SBA approval in June 2020, staff assessed that debt was "sustainable, but not with a high probability." This assessment remained the same throughout the program, with applied judgment was carefully balanced. In the baseline scenario, the debt-to-GDP ratio for the program period was projected to be in the range between 87 to 93 percent, consistently above the benchmark threshold of 70 percent. The public gross financing needs have been in the range between 30-50 percent of GDP since before the EFF, well above the threshold of 15 percent. Debt was projected to increase during the program period before it could be reduced after the program to reach the range of 75–80 percent in 2026.

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High uncertainty around the baseline forecasts was highlighted, supported by the realism of the Fund's past forecasts on Egypt, and the stress tests with alternative scenarios. Risks to the baseline considered included a prolonged and severe impact of COVID-19, a sustained increase in interest rates, a less ambitious fiscal consolidation path, and potential contingent liabilities arising from state-owned enterprises. Mitigants to these risks included a high share of local currency debt, the quick return to international capital markets expected at that time, and a recent affirmation of credit ratings with a stable outlook by major rating agencies. The authorities were also extending their debt maturities to reduce the high gross financing needs. From the SBA request to the second review, the debt-to-GDP ratio and gross financing needs for 2020/21 increased slightly, but external financing needs declined, together with the EMBIG spread, reflected in an improvement in the relevant cell of the heat map (Figure 7).

- **Safeguards to Fund resources**. Against the backdrop of the considerations above, EAC2 was deemed to be satisfied in view of continued market access and the stock of claims from private and official bilateral creditors that matured after the SBA but were already outstanding at the time of the SBA request. With respect to market access, the Egyptian authorities were able to issue a Eurobond of $5 billion after the RFI approval and following an announcement of a staff-level agreement on the SBA, bringing the total bond issuance since the EFF program to $25 billion. In addition, the authorities had secured agreements in the run-up to the SBA approval with three official GCC bilateral creditors to roll over $13.4 billion of their deposits held at the CBE and coming due in 12 months. Expected other bilateral financing during the program, which is a small share of overall financing, was also considered to strengthen the safeguards to the Fund's resources.

  Safeguards considered in the first and second reviews followed similar considerations, with the financing composition shifting, but becoming increasingly favorable for Egypt overall. In particular, bond issuance in the market increased ($9 billion since May 2020 and $29 billion since the EFF) as more bonds were issued after the program started and the GCC member deposits continued to be rolled over, though at a slightly lower level ($10 billion).

  The safeguards under EA2 in Egypt's case was sufficient, as reflected in two aspects. First, the share of other financing relative to Fund financing was reasonable, and second, the rollover of external debt liabilities was *guaranteed* by the creditors instead of assumed.

65. EAC3 was judged to be met amid the ability to maintain market access even before the SBA approval, and Egypt's good track record of maintaining market access under Fund engagements. Egypt had comfortable market access during the EFF program. As noted, after a brief period of capital outflows at the onset of the pandemic, sentiment towards EMs turned, coinciding with the announcement of Egypt's request for Fund assistance and subsequently of staff-level agreements on the RFI and SBA. The successful placement of the Eurobond reflected catalytic effects of the Fund engagement for regaining market access, similar to the experience with the EFF in 2016. Therefore, staff expected that the SBA program would further strengthen investor confidence. Confirming this expectation, Egypt continued to have comfortable market access during the SBA,

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including a $750 million green bond issuance in September 2020 and $3.75 billion Eurobond issuance in February 2021, meeting the EAC3 in the first and second SBA reviews.

66. The political and institutional capacity to implement the program that is called for under EAC4 was assessed to be satisfactory based on Egypt's proven track record and focused nature of structural conditionality. In the SBA request, and the two reviews, the main consideration of staff was the strong ownership of the authorities in implementing the 2016-19 EFF, which stabilized the economy, built credibility, and restored confidence. The government was further considered to have broad support to implement the agreed policies so there was no major concern of political challenges. In particular, the structural reforms in the SBA agenda represented a continuation of priorities commenced under the EFF, the importance of which was well understood (see above). In addition, institutional capacity building through CD support by the Fund was ongoing, including on strengthening the PFM law and the measurement of the non-observed economy for statistical purposes.

67. In summary, the application of the Fund's EAF proved to be straightforward, while the flexibility under EAC2 was paired with a consistent application of safeguards. Specifically, Egypt's balance of payment need was evident from the sudden stop of capital flows and tourism, market access was maintained, and the track record of both market access and EFF program implementation represented important safeguards. Regarding EAC2, as a "gray zone case" that has sustainable debt but not with high probability, the required safeguards were the result of a consistent application of the criteria, with a reasonable share of other financing relative to Fund financing and guaranteed rollover of external debt liabilities. However, more details about the contribution of GCC member deposits in the safeguards would have been useful (see above).

C. Risks to the Fund

The SBA entailed risks to the Fund and the risk tradeoff was considered in the decisions. The risk management elements were consistent with the Fund's policy. In addition, risk management practices were strengthened compared to previous Fund programs, including through a contingency plan to address downside risk and the involvement of the Fund's Office of Risk Management (ORM) at the arrangement request stage. A fully integrated assessment of overall enterprise risks would have been beneficial.

68. The SBA represented risks to the Fund. The Fund entered into the SBA with high credit exposure to Egypt, which accounted for 17 percent of total GRA credit at the time of the program request. Egypt was the second largest borrower of the Fund, following Argentina. Risks to the program success arose from the uncertainty around the path of the pandemic, further tightening of global financial conditions and the higher cost of borrowing, which in turn could have created risks to the capacity to repay (CtR). Even with successful program completion, risks of bunching of the debt service repayment to the Fund during FY2023/24-FY2024/25 were present, together with the risk of increasing the Fund's credit concentration in the lending portfolio. A tradeoff between taking additional financial risks and facing reputational risks of not supporting a member with a proven track record of implementing Fund programs was embedded in the Fund's decision.

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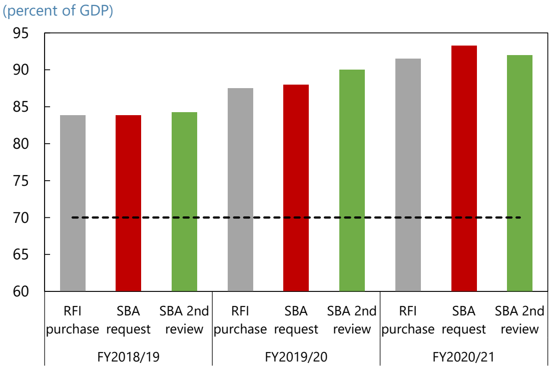
Figure 7. Debt Indicators [1]

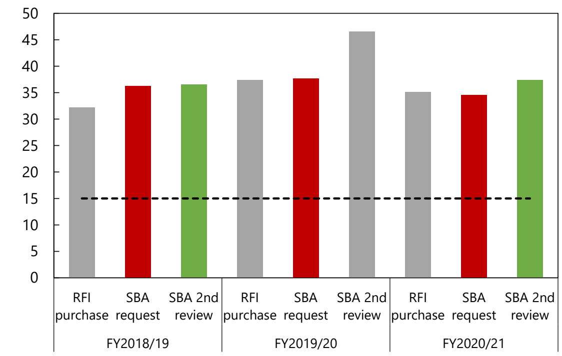
Debt was projected to increase during the program period and to remain above the threshold.

Growth Public Debt
(percent of GDP)



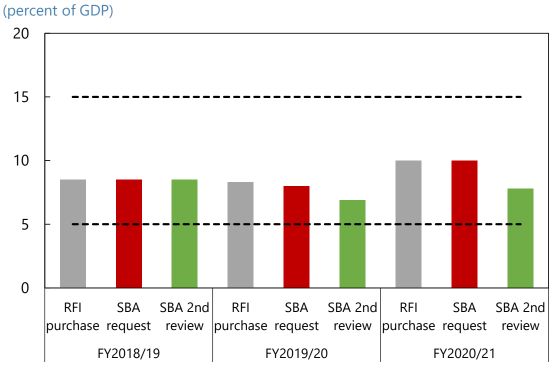
Gross financing needs were consistently higher than the threshold.

Public Gross Financing Needs
(percent of GDP)



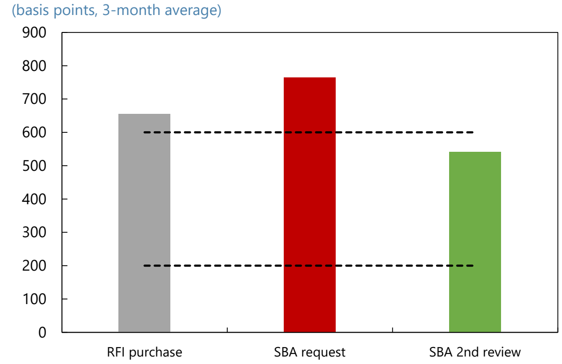
The external financing requirement was projected to be lower at the end of the program compared to the outset of the SBA and the RFI.

External Financing Requirements
(percent of GDP)



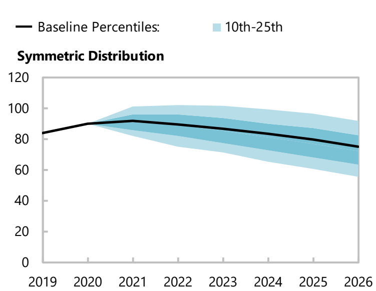
EMBI global spreads declined after the SBA program started and fell below the upper risk-assessment benchmark.

EMBI Global Spreads or Spread over US Bonds for AEs
(basis points, 3-month average)



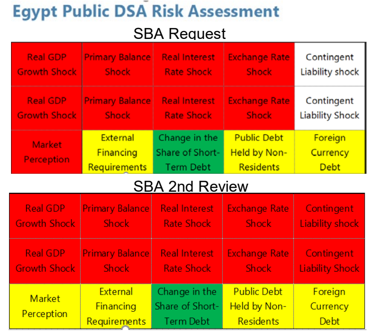
Debt was projected to remain high before declining to the pre-pandemic level, along with uncertainties.

Evolution of Predictive Densities of Gross Nominal Public Deb
(in percent of GDP)



There was improvement in one out of 15 cells of the heatmap at the end of the program compared to the program outset.

Egypt Public DSA Risk Assessment



1/ Dashed lines in panels 1-4 correspond to DSA benchmarks: 70 percent for gross public debt and 15 percent for gross financing needs. Lower and upper risk-assessment benchmarks are: 200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement.
Sources: IMF 2020a, 2020b, 2021b

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69. Besides the EAF, the program-related risk management elements were consistent with relevant policies and reflected improvements in the Fund's management of program related risks. In particular,

- Downside risks around the baseline forecast of the macroeconomic outlook were properly discussed in the program documents, supported by the Global Risk Assessment Matrix, realism checks of past forecasts, adverse scenarios such as further outbreak of the pandemic, deeper global recession, real GDP shocks, primary balance shock and interest rate shocks, and standard stress tests for the debt sustainability analysis.

- Risks to the Fund's finances were assessed quantitatively with judgment, noting the modest impact on the Fund's liquidity but highlighting the additional concentration Egypt added to the Fund's lending portfolio. In particular, the CtR was assessed to be adequate with some risks based on the CtR indicators under the baseline and downside scenarios, and in comparison with recent exceptional access arrangements. These risks are related to the bunching of the debt service repayment to the Fund during FY2023/24-FY2024/25, as the repurchase under SBA would largely coincide with those under the RFI and the EFF (Figure 8), and the debt service payments to the Fund under an adverse scenario would account for relatively high share of gross official reserves and of exports.[15] The SBA slightly increased the share of total credit outstanding to the Precautionary Balances, an important element in the Fund's credit risk buffer, and the burden sharing mechanism was assessed to be insufficient to cover arrears, were Egypt to accrue any.

- A contingency plan was developed in the face of downside risks to the macroeconomic outlook, detailing a set of alternative strategies that could be employed to meet the balance of payment needs. This plan was discussed with the authorities ahead of the approval of the SBA. This plan was a new risk-management tool aiming to increase the scrutiny of the baseline scenario and deepen the policy discussions with members in the event of risk scenarios. Such discussions are intended to place the authorities in a stronger position to consider a range of policy options in a timely manner and create an opportunity for the Fund to consider possible modifications in the program strategy should downside risks materialize.

- The ORM was involved in identifying the broader risks to the Fund related to the SBA. As part of the second line of defense in the enterprise risk management, the ORM is responsible for assessing the IMF's overall risk profile, highlighting areas where risk mitigation efforts are required (e.g., strategic risks, financial risks, and reputational risks). In a step towards better enterprise risk management, and unlike previous exceptional access cases, ORM reviewed the financial risk assessment of the SBA request.

- Safeguard assessments of the CBE were implemented appropriately. Since 2000, the Fund safeguards policy requires that governance and control frameworks of central banks of members seeking financial arrangements be assessed to ensure the proper use of Fund resources and

[15] Total debt service payments to the Fund for FY2023/24 and FY2024/25 would amount to almost 24 percent of gross international reserves and the debt service in each of these two years accounts for around 8 percent of exports.

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mitigation of misreporting risks.[16] In addition, since 2015, fiscal safeguards reviews have been required for IMF arrangements in which a member requests exceptional access and there is significant channeling of the proceeds of Fund financial support to the government budget.[17] These assessments are conducted independently from program discussions. In the case of the Egypt SBA, a safeguards assessment was concluded before the first review, and the fiscal safeguards review was completed before the second review. The safeguards assessment found strong governance arrangements and control environment, but continued efforts will be required to anchor the CBE's financial reporting framework in international standards. While the CBE implemented most of the recommendations, two recommendations related to (i) aligning financial reporting practices with IFRS and (ii) ceasing subsidized lending schemes while transferring interest costs from uncommitted remaining facilities to the government did not progress as planned at the completion of the second review. The fiscal safeguards review found the PFM system to be generally well-developed, with some advanced features, but flagged areas for further improvements in the PFM framework and audit functions.

70. In summary, policies relevant for risk management were followed and enhancements were applied, but a better integration of overall enterprise risks in program documents could be considered. The SBA followed policies relevant for the Fund's program related risk management, including the EAF and other elements and procedures. Enhancements compared to previous exceptional access case include the development of the contingency plan for downside scenarios, and the involvement of the ORM on financial risks. A full integration of enterprise risk assessment in the program documents, including a discussion of key risk tradeoffs for the Fund's program approval decisions and residual risks would be beneficial. Such assessment could be built on, but not limited to summarizing findings in different pieces of risk management work. In addition, contingency planning could be expanded to consider policy options under upside scenarios, where applicable.

[16] The assessment covers external audit, legal structure, financial reporting, internal audit and control mechanisms. See Summing Up by the Acting Chairman on Strengthening Safeguards on the Use of Fund Resources and Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations, Executive Board Meeting 00/32, March 23, 2000 (BUFF/00/48, 3/30/2000); and The Acting Chair's Summing Up—Safeguards Assessments—Review of Experience and Next Steps, Executive Board Meeting 02/26, March 14, 2002 (BUFF/02/43 Rev. 1, 4/1/2002).

[17] See the 2015 Review of the Safeguards Assessment Policy: Safeguards Assessments—Review of Experience (SM/15/250, 9/24/2015); and The Acting Chair's Summing Up—Safeguards Assessments—Review of Experience, Executive Board Meeting 15/96, October 23, 2015 (BUFF/15/94, 10/28/2015). The review is required for IMF arrangements with exceptional access to IMF resources and an expectation that at least 25 percent of the funds will be used for budget support. The review aims to secure reasonable assurances that Fund resources provided to the member will be used in accordance with the country's legal framework and reported under transparent and effective government budgeting, banking, accounting, and auditing procedures.

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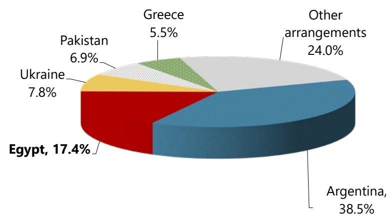
Figure 8. Risks to the Fund at the Time of the SBA Request

Egypt was the Fund's second largest borrower.

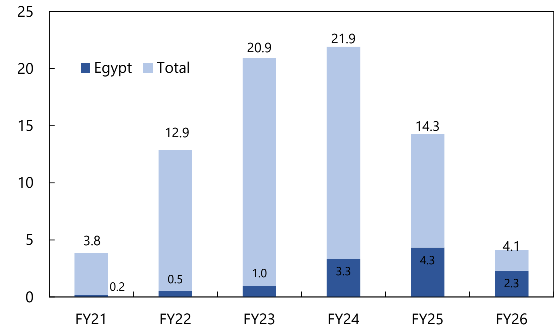
Credit Concentration of Fund GRA Exposure
(as a percentage of total credit outstanding)



Sources: IMF Finance Department.
Note: Total credit outstanding refers to credit outstanding as of May 1, 2020 plus Egypt's proposed access under the SBA.

Egypt's share in total GRA repurchases was expected to rise significantly over the medium term.

Scheduled GRA Repurchases
(Billions of SDR)



Sources: IMF Finance Department. Notes: Fiscal year (FY) is from July to June.

CONCLUSIONS AND LESSONS

Conclusions

71. The SBA achieved its primary objective and helped stabilize the macroeconomy 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 macroeconomy. This two-step approach and the SBA's main features were characteristic of the Fund's approach to lending during the pandemic. Financing needs and sources were appropriately assessed and the phasing of disbursements under the SBA was consistent with the macroeconomic diagnosis at the time and the program strategy. The reviews were concluded on time and all program conditionality was met.

72. 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. Overperformance of the primary balance compared to program expectations, however, did not translate into lower debt due to offsetting factors. Inflation expectations were successfully anchored, and headline inflation remained below the CBE's target

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range, triggering additional monetary easing and a revision of the inflation target and its bands. Nonetheless, the transmission of monetary easing appears to have been incomplete.

73. 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.

74. Fund policies and procedures for financing under exceptional access were followed. The application of the EAF was consistent with Fund policies and involved carefully balanced assessments, especially with respect to EAC2 and at the time of the SBA request. Overall, it was stringently applied. Program-related risk management was consistent with Fund policies and reflected improvements in the Fund's approach.

Lessons

75. 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. The discussion of external financing needs could have usefully detailed the exceptional financing contribution originating from the extension of GCC member deposits to give a full picture of the burden sharing. Finally, a 15-month SBA would have allowed for test dates to cover the full fiscal year 2020/21. That said, more considerations would have had to be given for a longer program, including regarding financing commitments and safeguards.

76. 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. The current commodity price shock and capital flow volatility are reminders that not only FX buffers are needed, but that a comprehensive response to such shocks, including exchange rate flexibility, is necessary. Entrenching such flexibility in calmer times would enable smoother adjustments in times of crises. Even as the overall external position was assessed to be in line with fundamentals given available data at that time, greater flexibility could have been helpful, and staff pointed out the importance of two-sided exchange rate flexibility to absorb external shocks.

77. Decisive 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

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many countries, intensified the role of the government in the economy, creating a more difficult environment for incentivizing private sector investment. Post-pandemic, the combination of vulnerabilities originating from the external sector and high public debt places a premium on reinvigorating a structural reform agenda that puts the Egyptian economy on a more competitive footing and builds resilience against shocks.

78. 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 overperformance relative to targets. Ownership of the commitment to fiscal discipline while accommodating needed health and social spending, and the inclusion of a set of focused structural reforms were other important factors that facilitated the completion. Against the background of Egypt's history of successful Fund engagements (e.g., 2016-19 EFF), the size, phasing and frontloading of Fund financing in 2020 (when seen in combination with the RFI) is likely to have been a critical factor in catalyzing private capital flows.

79. The EAF and enhanced risk management allowed for a flexible application of the Fund's lending toolkit to support Egypt in facing the impact of the COVID-19 pandemic. The consistent application of the EAF, with some flexibility under EAC2, allowed for a balanced risk assessment that resulted in reasonable safeguards to Fund resources. The improved enterprise risk assessments in exceptional access cases in the program discussions for Egypt's SBA also constituted progress on this front but a better integration into the program documents would be beneficial. During the COVID-19 pandemic, the Fund's GRA lending toolkit was applied in a flexible manner in the face of an unprecedented crisis, to the benefit of its members, including Egypt.

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Table 2. Egypt: Quantitative Performance Criteria and Indicative Targets

(In billions of Egyptian pounds, unless otherwise indicated)

	end-September 2020			end-December 2020			end-March 2021		
	Prog.	Actual	Status	Indicative	Actual	Status	Prog.	Actual	Status
I. Quantitative Performance Criteria 1/									
Net international reserves of the CBE ($ million; cumulative change, floor) 2/	0	4,316	Met	0	7,229	Met	3,000	6,366	Met
Primary fiscal balance of the budget sector (cumulative, floor) 3/	0	0.1	Met	7	14	Met	15	25	Met
Accumulation of external debt payment arrears by the general government ($ million; continuous ceiling)	0	0	Met	0	0	Met	0	0	Met
II. Indicative Targets 3/									
Government overdraft at the CBE (ceiling)	93	9	Met	93	0	Met	93	29	Met
Tax revenues (cumulative floor)	121	150	Met	304	334	Met	484	539	Met
Social spending of the budget sector (floor)	23	24	Met	52	53	Met	81	83	Met
issuances (ceiling)	40	21	Met	40	11	Met	30	-1	Met
Accumulation of gross debt of the budget sector (cumulative ceiling)	226	219	Met	450	377	Met	679	531	Met
III. Monetary Policy Consultation									
(12-month change in consumer prices)									
Upper outer band	13	...		10	...		10	...	
Upper inner band	12	...		9	...		9	...	
Actual/Center target	9	3.7	Not met	7	5.4	Met	7	4.5	Not met
Lower inner band	6	...		5	...		5	...	
Lower outer band	4	...		3	...		3	...	
Memorandum items:									
Program disbursements at completion of review ($ million; cumulative change) 2/	10,100	4,673		12,315	7,283		12,930	11,443	
($ million) 2/	6,500	2,028		6,500	2,728		6,500	6,623	
Of which:									
International bank financing	...	261		...	261		...	261	
Net issuance of FX T-Bills	...	-211		...	-182		...	-116	
External program financing assumed under the program ($ million) 2/	1,600	659		2,215	907		2,830	1,172	
IMF financing assumed under the program ($ million) 2/	2,000	1,986		3,600	3,648		3,600	3,648	

Note: For definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU).
1/ The targets for December 2020 are indicative.
2/ From May 31, 2020.
3/ From the beginning of the fiscal year (July 1, 2020).

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Table 3. Egypt: Structural Conditionality Under the Egypt SBA

Structural Benchmark	Objective	Timing	Met/ Not Met
Approval by Parliament of FY2020/21 budget, consistent with the program understandings with a provision for primary balance of no less than 0.5 percent of GDP	Strengthen fiscal sustainability	Prior action	Met
Develop a reform plan for NIB, approved by the Prime Minister	Strengthen public finances and contain risks to the financial sector	End-January 2021	Met
Publish an updated SOE report to include detailed financial information for FY2018/19 on all SOEs and a separate one for Economic Authorities that includes detailed financial information for FY2018/19	Fiscal transparency and governance (and thereby strengthen fiscal sustainability)	End-September 2020	Met
Cabinet approval of the updated Medium Term Revenue Strategy	Increase tax revenue (and thereby strengthen fiscal sustainability)	End-December 2020	Met
Submission to Parliament of the revised PFM law to strengthen the entire budget process, including by (i) fiscal responsibility provisions to guide macro-fiscal policy; (ii) a medium-term budget framework; (iii) main elements of the budget calendar; (iv) minimum contents of the budget documentation; (v) robust provisions on reallocation of resources, contingency reserve and supplementary appropriations; and (vi) accounting rules for all public entities including economic authorities	Strengthen PFM, improve governance/and reduce corruption risks (and thereby strengthen fiscal sustainability)	End-December 2020	Met
Update the debt management strategy with the focus on lengthening maturities	Reduce debt vulnerabilities (and thereby strengthen fiscal sustainability)	End-December 2020	Met
Submit to Parliament amendments to the competition law to add a new chapter on mergers and acquisitions	Improve the business climate	End-December 2020	Met
Pass the draft customs law that streamlines customs procedures in line with MEFP ¶25	Improve the business climate	End-March 2021	Met
Complete Public Expenditure Review to enhance social protection	Social protection	End-April 2021	Met

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Appendix I. Authorities' Views

1. This is a thorough, constructive, and well-balanced 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. Beyond that, it points to areas of remaining vulnerabilities that need to be tackled, namely, strengthening the resilience of the external position and deeper structural reforms with broader private sector participation—which are appropriate objectives. As such, the report can be considered forward-looking in pinpointing areas for future work and progress.

2. 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.

3. It is appropriately mentioned in the report 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 success of the program also reflects the strong commitment by the authorities to the objectives of their economic program, and the timely implementation of policies and reforms that led to over-performance relative to program targets. Other elements of the program's success were the strong domestic ownership and commitment to fiscal discipline, while also accommodating additional health and targeted social spending, as well as the inclusion of a set of focused structural reforms. Another element of the program success was the appropriate size and frontloading of financing and we agree with the staff assessment that such factor played a role in catalyzing additional and timely private capital flows to Egypt.

4. 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.

5. During the SBA, the CBE considered a low volatility exchange rate an important factor to bolster confidence. Increased volatility would not have led to an improvement in the current account given the global travel restrictions and worldwide slowdown in trade. Furthermore, excessive movement in the rate could have led to heightened volatility that would have deterred the progress made on the macroeconomic front, especially given the fact that the overall external position was assessed to be in line with fundamentals.

6. 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.

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7. Staff indicates that the over-performance of the primary balance compared to program expectations did not translate into lower debt due to offsetting factors. In response to this statement, we would like to highlight that the authorities' commitment to fiscal discipline has been very strong before, during, and after the program. At the same time, there has been strong conviction and commitment to address legacy issues, including key contingent liabilities, to ensure and preserve fiscal and debt sustainability over both the medium and long term. As such, the offsetting factors that were carried out during such period (program times) are one-off factors and are not meant to be repeated. These additional treatments may have delayed the strong decline in General Government debt-to-GDP, yet it was for good and healthy reasons, and this should not be viewed as a weakness. These decisions and treatments represent a comprehensive settlement to legacy issues and long due arrears, including dealing with circular debt between the EGPC, the electricity sector and the Treasury, and carrying out a comprehensive pensions reform program with clear identified commitments and responsibilities for all parties for more than a 50-year horizon. Delaying such decisions and postponing these legacy issues would have led to more complicated problems with higher financial burden to be borne by future generations. This clarification is needed and should be clearly highlighted to avoid the perception that the authorities' commitment to a downward path in the debt to GDP ratio has wavered during the SBA arrangement.

8. It is important also to note that the over-achievement of the program targets coincided with a strong and robust performance of the Egyptian economy compared to peers and other emerging market countries during the program horizon and time framework. The report could benefit from relevant peer comparisons that would allude to such finding. This confirms that Egypt's over-achievement of the program targets can and should be explained primarily by the authorities', the governments and the central bank's strong, ambitious, and timely implementation of their reform agenda, the balanced and coordinated approach adopted regarding macroeconomic policies, and the strong and speedy restoration of investor confidence in the Egyptian economy.

9. Also, 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.

10. We do agree with the conclusion mentioned in the report that 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. However, these were not the primary objectives pursued under the relatively limited and short-lived SBA agreed with the IMF. The main objectives of the SBA were rather maintaining macroeconomic stability amid the pandemic crisis, as well as preserving the hard-won macroeconomic gains during the EEF program, as correctly and accurately acknowledged in the report. Against this background, it was fully expected that other key structural reforms would need more time and efforts to be designed and carried out over a longer period that goes beyond and after the SBA program.

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11. The conclusion as mentioned in the report, therefore, does not seem fully in line with the Guidance Note, according to which the EPE assesses whether performance under the program achieve the program objectives, whether the macroeconomic strategy, program design, and financing were appropriate to address the challenges Egypt faced at the time, and if the program was consistent with Fund policies, including the justification of exceptional access. It is also well to highlight and stress on the fact that the structural reform agenda, which was designed to be parsimonious and focused, as acknowledged in the report, was carried out in a timely manner and was fully successful.

12. **Program Duration.** We agree that more consideration would have had to be given for a longer program after the normalization of conditions. This is what the Egyptian authorities have in mind at the current stage.

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