MENA ECONOMICS UPDATE

Egypt: investment key to sustaining manufacturing boom

- **Egypt's manufacturing sector has been one of the main beneficiaries from a weaker pound but the recent rapid pace of growth will be difficult to sustain in the absence of a significant pick up in investment.**
- Following the pound's 50% fall against the dollar late last year, Egypt's manufacturing output has boomed. In the three months to June, manufacturing output was 43.3% higher than a year earlier. (See Chart 1.)
- **The main channel through which manufacturers have benefitted from a weaker currency is through a boost to competitiveness**. The fall in the pound has caused local production costs to fall in foreign currency terms, while the rise in import prices has incentivised consumers to switch to domestically-produced goods – known in the jargon as import substitution. **Moreover, the Egyptian authorities have dismantled the FX restrictions that had inhibited the import of intermediate components (see Chart 2) and disrupted activity.**
- Looking ahead, it's unlikely that the recent rapid expansion of manufacturing production will be sustained. After all, manufacturers were only able to take advantage from the boost to demand because they were able to draw upon underutilised resources. **But that spare capacity may already be used up (see Chart 3) and, sooner rather than later, firms will need to invest in new facilities.**
- In principle, Egypt has many of the ingredients to attract investment into its manufacturing sector, including low wage costs, a young and growing workforce, close proximity to rich markets in Europe, and good transport infrastructure due to the Suez Canal. **At present, investment remains subdued**. In the four quarters to Q1, it stood at just 1.5% of GDP (see Chart 3), well below the rates of 4-5% of GDP that Egypt recorded prior to the global financial crisis.
- **There are grounds for optimism that investment into the manufacturing sector will strengthen**. In particular, the government has made good progress with fiscal consolidation which should alleviate crowding out of private sector investment. The authorities have also made some strides in improving the dire business environment, including the introduction earlier this year of a new investment law. **But the country still has a long way to go to fulfil its potential as a manufacturing hub.**

Chart 1: Manufacturing Production

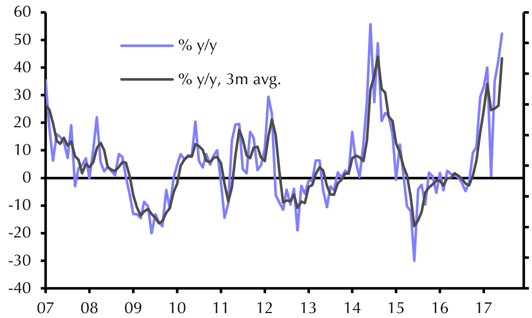


Chart 2: Intermediate Goods Imports (US$ Terms, % y/y)

Chart 3: Manufacturing Production (SA, Jan. 05 = 100)

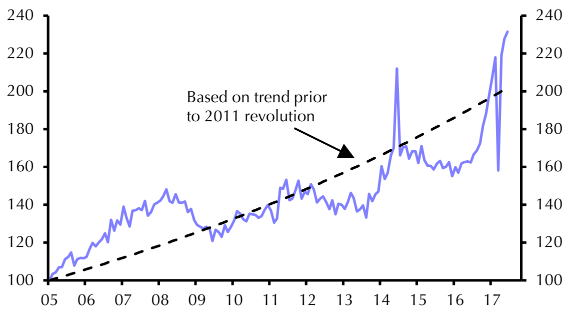
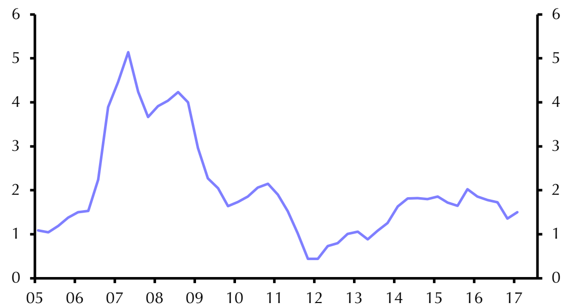


Chart 4: Investment in Manufact. (4Q Sum, % of GDP)



Sources: CEIC, Thomson Reuters, Capital Economics

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