

Egypt

The challenges of the agricultural sector

Due to the country's economic development, the agricultural sector is in relative decline as a share of GDP. Moreover, investment in agriculture is fairly sluggish. Yet the sector still plays a decisive role in food security in Egypt, a country where demographic growth is strong and households are highly sensitive to food prices. The agri-food sector also has an impact on macroeconomic fundamentals, including inflation, foreign trade and the public accounts. For Egypt, like the rest of the region, water resources are a major issue. Yet in Egypt's case, this issue is especially crucial given the uncertainty that looms over the waters of the Nile and their availability for agriculture in the medium term.

■ A key economic sector in relative decline

Egypt's key macroeconomic indicators have improved significantly since 2016, thanks to the implementation of monetary and fiscal reforms and financial support from official donors. Although vulnerabilities remain, it is the second round of reforms that now draws our attention. These reforms should help reinvigorate economic growth and create jobs. From a sector perspective, positive trends have been registered in the energy and tourism sectors. Less attention is being paid to the agriculture sector, even though it is a key component of the Egyptian economy. Agriculture, and the agri-food industry in general, are a source of revenue, a factor of economic vulnerability and a way to boost medium-term economic growth prospects.

The agricultural sector accounted for 11.4% of GDP in December 2018. Its economic weight has declined structurally, from 16.5% of GDP in 2002 to 12.5% in 2012. In real terms, GDP of the agricultural sector has grown at an average rate of 3.2% since 2003, compared to 4.4% for total GDP. The main crops are rice, corn, wheat, cotton and sugar cane. The sector employs about 14.5% of the active population. Although private producers produce virtually all of production, the public sector still plays a key role, notable through the supply of inputs, loan distribution and the management of irrigation systems. Confirming the sector's relative decline, agriculture attracted only 4.2% of total investment in 2016/2017. Yet to reduce their dependence on imports in the face of persistently strong local demand, some agri-food companies are pursuing vertical integration of the production process by investing in modern production units. This strategy, combined with deliberate efforts to set up water efficient production processes, should trigger an acceleration in agricultural investment in the medium term. Like the rest of the non-hydrocarbon economy, the sector attracts little foreign direct investment (FDI). In 2016/2017, it attracted only 0.6% of total FDI, which remains concentrated in the hydrocarbon sector (61% of the total).

The agricultural sector contributes to the Egyptian economy at two levels: it ensures part of the nation's food security at a time of fierce demographic pressures, and to a lesser extent, it brings in export revenues.

According to the EIU indicator¹, Egyptian food security ranks 61st out of 113 countries. Among the key factors of food security, two

1- Forecasts

	2016	2017e	2018e	2019e
Real GDP growth (%)	4.2	5.3	5.5	5.8
Inflation (CPI, year average, %)	23.3	21.5	13.8	10.8
Gen. Gov. balance / GDP (%)	-10.4	-9.5	-7.5	-6.1
Gen. Gov. debt / GDP (%)	96	103	89	88
Current account balance / GDP (%)	-6.1	-2.4	-2.2	-1.8
External debt / GDP (%)	17	34	38	38
Forex reserves (USD bn)	31	44	47	52
Forex reserves, in months of imports	5.5	7.2	7.2	7.6
Ex change rate USDEGP (year end)	18.1	17.9	17.5	18.5

(*) Fiscal years T-1/T (July-June)

e: estimates and forecasts BNP Paribas Group Economic Research

2- Real GDP growth (%)

— Total GDP - - - Agriculture GDP



Source: BNP Paribas

strong points are the quality of infrastructure (ports, storage) and the low volatility of national production. Food production in Egypt is not very vulnerable to climate variations due to the predominance of irrigation in the production process (thanks to the use of the Nile's waters, and to a lesser extent, ground water). Primary farm production (unprocessed) covers 91.5% of national demand².

¹ Global Food Security Index 2018, The Economist Intelligence Unit

² Beyond the business case for agricultural value chain development. An economy-wide approach applied to Egypt. WP 18, March 2019, IFPRI



Primary production exports are low as a share of total production (2.7% in 2015), while agricultural exports account for only 8.7% of total exports of goods.

■ A source of macroeconomic vulnerability

The external accounts for primary agricultural goods and food products show a structural deficit. In 2017/2018, this deficit amounted to USD 7.6 bn, or about 20% of the total trade deficit (11% for grains alone). Egypt is one of the world's largest grain importers, given the size of its population (about 100 m inhabitants) and the central role that grains play in the average diet (Egyptians are the world's largest consumers of wheat on average). This dependency increases the economy's vulnerability to food price fluctuations. A sharp rise in grain prices tends to trigger social unrest, as was the case in 2008.

The inflationary impact of food price trends also makes it hard to implement the central bank's inflation targeting policy, even though the core index (which excludes the most volatile food products) is an important indicator. In addition to specific factors linked to economic reforms (currency flotation, cutbacks in subsidies), food pricing trends make a big contribution to consumer price inflation. Given the low seasonality of farm production, food price inflation is due either to the increase in world grain prices, or to the rigidities and lack of competition in the national agri-food market. Food prices account for 40% of the consumer price index and are highly volatile. In March 2019, the average annual inflation of food prices was 13.5%, more or less equivalent to the general price index (13.7%).

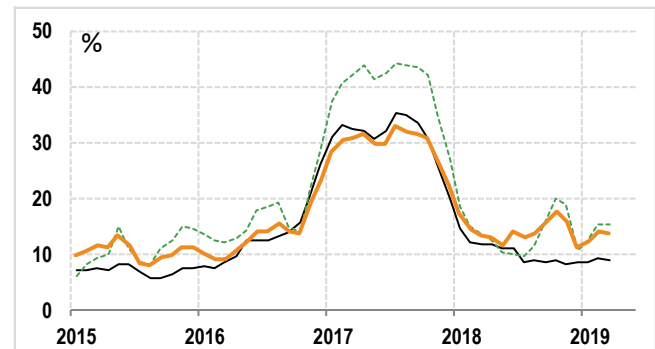
Food subsidies were not affected by the fiscal reform programme. To the contrary, to boost household purchasing power, food subsidies virtually doubled in value over the course of 2017/2018 and account for 8.6% of primary fiscal expenditure (1.8% of GDP). They should continue to rise moderately in the medium term.

■ Outlook: water issues

Agricultural sector prospects are dominated by the problem of water resources. The Nile covers 90% of the country's water needs (all usages combined), and agriculture uses about 85% of these water resources. Intensive use of the Nile's waters is likely to be called into question by Ethiopia's construction of the GERD³ further upstream. With an estimated cost of USD 5 bn, the dam will serve notably to supply Africa's largest hydroelectric power plant, with an output capacity of 6 gigawatts. For the moment, it is hard to estimate the dam's impact on Egyptian food production. Egypt and Ethiopia have not reached an agreement on a common impact study⁴. Yet with 95% of Egypt's population concentrated along the banks of the Nile, and given its essential role in food production, a decline in the river's water flow is bound to have major, negative consequences. Food production will certainly be hit by greater soil salinity and lower yields. Moreover, the start-up of the Ethiopian dam will significantly reduce the power generation capacity of the

3- Consumer price inflation (y/y)

— Headline inflation — Core inflation - - - Food products



Source: BNP Paribas

Aswan dam, located downstream from GERD⁵. Aswan provides about 4.3% of the country's total power generation capacity.

At the regional level, bilateral talks have advanced since 2014, but no agreements have been reached for the moment. At the national level, the government is implementing measures to preserve water resources. It is encouraging rice imports again to reduce water-intensive rice crops. Alternative water resources are also being developed, such as greater use of groundwater, the development of desalination plants and better waste water management. Yet this policy will surely be expensive in terms of imports (by limiting more water intensive crops), energy consumption (water desalination is very energy intensive) and investment.

Although the agricultural sector seems to have been somewhat side-lined by recent economic developments and reforms, it is nonetheless a core component of Egypt's macroeconomic stability.

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³ Grand Ethiopian Renaissance Dam

⁴ *Bridging the gap in the Nile waters dispute*, Africa Report n°271, 20 March 2019, International Crisis Group.

⁵ *Egypt sees end to water tension with Ethiopia: is it in denial?* 21 September 2018, MEES

