Potential Socioeconomic Impacts of the Gaza War on Egypt: A rapid assessment

Executive Summary

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The Gaza war that started in October 2023 is unprecedented in terms of the scale of death and destruction, and its regional ramifications. It also had a catastrophic impact on the Palestinian economy and significant negative effects on neighbouring countries, especially, Egypt, Jordan and Lebanon. Before the Gaza war, Egypt's economy was facing significant fragilities and mounting socioeconomic difficulties following the severe setbacks caused by the COVID-19 pandemic and the war in Ukraine. Egypt's reliance on fluctuating foreign earnings such as revenues from tourism, Suez Canal tolls and remittances makes it highly vulnerable to external shocks. The Gaza war has amplified these challenges and put additional pressure on the country's limited resources.

This study sheds light on the ongoing and potential additional socioeconomic impact of the Gaza war on the Egyptian economy, which was estimated using both a Keynesian multiplier approach and a dynamic Computable General Equilibrium (CGE) model.

To date, the key transmission channels of the Gaza war on the Egypt's economy are primarily manifested in the decline in tourism revenues, which accounted for around 8.3 percent of GDP in mid-2023 (taking into consideration indirect linkages to the economy), and the decline in Suez Canal revenues. Combined, these account for around 20 percent of the country's foreign currency receipts. The decline in these revenues has multiplier effects on all sectors and on the overall GDP. In addition to these direct impacts, there are other secondary transmission channels of the conflict such as a deterioration in economic expectations, an increase in transportation costs for imports, and potential trade disruptions. Finally, while not yet fully realized, another potential risk looms in the form of an increase in energy prices in international markets.

While the socioeconomic impact of the war on Egypt is contingent upon its duration, intensity, geographical scale (reflected in various assumptions and scenarios utilized in this analysis), and responses from national authorities and the international community, the consequences may entail significant economic costs arising from the above, multiple transmission channels and ultimately reflected in lower growth rates, higher unemployment, and an increase in poverty.

Three conflict scenarios are considered in this analysis, reflecting the increasing intensity and scope of regional conflict: contained confrontations (a low-intensity scenario assuming that the war lasts six months); limited regional conflict escalation (a medium-intensity scenario assuming that the war lasts nine months); and widespread regional military escalation (a high-intensity scenario assuming that the war lasts one year).

According to UNDP estimates, the total decline in tourism and Suez Canal revenues over the course of the two fiscal years 2023–2024 and 2024–2025 could reach approximately $3.7 billion under he low-intensity scenario, $9.9 billion under the medium-intensity scenario, and $13.7 billion under the high-intensity scenario, which assumes an intensification of the war. The preliminary simplified analysis suggests that the total economic cost of the war to Egypt's

economy including the multiplier impacts over the course of the two fiscal years may reach $5.6 billion under the low intensity-scenario, $14.6 billion under the medium-intensity scenario, and $19.8 billion under the high-intensity scenario. These costs correspond to a loss of 1.6 percent of the annual average baseline GDP under the low-intensity scenario, 3.9 percent under the medium-intensity scenario, and 5.2 percent under the high-intensity scenario.

A more comprehensive dynamic CGE model shows similar negative impacts. GDP would fall by 1.6 percent of the baseline GDP in the 2023–2024 fiscal year under the low-intensity scenario; by 2.6 percent in the 2023–2024 fiscal year and 1.3 percent in the 2024–2025 fiscal year under the medium-intensity scenario; and by 3.0 percent in the 2023–2024 fiscal year and 2.6 percent in the 2024–2025 fiscal year under the high-intensity scenario.

The decline in GDP growth would also imply a potential notable increase in unemployment and a decline in household consumption, and hence an increase in the povertyate. The unemployment rate is expected to increase by 0.5 percentage points under the low-intensity scenario, 0.9 percentage points under the medium-intensity scenario, and 1.3 percentage points under the high-intensity scenario in the 2023–2024 fiscal year.

Moreover, households' real disposable income and consumption would decline below the business-as-usual levels by 1.3 percent under the low-intensity scenario, by 2.1 percent under the medium-intensity scenario and by 2.5 percent under the high-intensity scenario in 2023–2024 fiscal year. Additionally, the negative impacts of the Gaza war would persist in the 2024–2025 fiscal year under the medium- and high-intensity scenarios.

The HDI and MPI figures are also expected to be negatively affected by the war. The simulation exercise conducted in this report indicates that in the lommmand medium intensity scenarios, the most HDI would decline from 0.728 in 2022 to 0.726, while in the high intensity scenario, it would decrease to 0.720. This would bring human development in Egypt back to the 2021 level in the first two scenarios and to the level observed in 2018 in the third scenario. Furthermore, a microsimulation exercise has been conducted to simulate the impact of the war on MPI. While we don't expect any significant impact on MPI in the low-intensity scenario, the medium and high-intensity scenarios indicate that MPI would increase to 0.031 and 0.046, respectively, up from 0.024 in the no-war/baseline scenario.

To restore macro-financial stability, Egypt's Government has recently signed a new agreement with the International Monetary Fund (IMF), an ambitious investment agreement partnership with the United Arab Emirates (UAE), as well as the Egypt-European Union (EU) Strategic Partnership Agreement. The inflow of foreign currency and capital through these agreements together with the implementation of prudent macroeconomic policies and recovery actions recommended here will likely help the Government mitigate the problems and smooth-out the negative impacts of the Gaza war.

Based on the analysis in this study, a package of “Prepare, Respond and Recover” policy recommendations is proposed to mitigate the impact of the current compounding challenges on Egypt’s social and economic outlook following an inclusive, people-centred approach.

Policy recommendations pertaining to preparing and responding to the impact of the Gaza war in Egypt and breaking the cycle of fragility include: (i) supporting an immediate and permanent ceasefire while ensuring sufficient international humanitarian support to Gaza; (ii) strengthening area-based basic service delivery and infrastructure to address the immediate needs of the most vulnerable or directly affected individuals and communities; (iii) formulating a robust crisis-response cooperation platform that includes development partners, civil society, the private sector and relevant local-level stakeholders to ensure a timely response to the evolving context, and rapid mobilization of resources based on evolving, prioritized needs; (iv) facilitating access to shock-responsive social protection schemes; (v) supporting the tourism value chain and considering shifting to sustainable tourism as an alternative model to enhance resilience, prioritizing local communities; (vi) strengthening the resilience of sectors most impacted by the crisis while promoting the growth of sectors such as textiles and agriculture that continue to positively contribute to outputs amid the crisis; and (vii) investing in responsive institutions and multi-dimensional risk assessment to inform development and contingency planning.

Inaddition to immediate preparedness for and response to the impact of the Gaza war on Egypt, nvesting in recovery and prevention measures will also be important. Some of the recommendations are based on the need to address structural issues that prevailed even before the Gaza war but that have become even-more pressing as a result of the ramifications on Egypt of the war, and the opportunities for transformational change that have emerged. Enhancing the longer-term resilience of the Egyptian economy and paving the path for a sustainable recovery will largely depend on necessary structural reform measures that: (i) conduct an analysis of social implications and extensively communicate policies as a basis for reform; (ii) strengthen adaptative social protection and reduce inequalities; (iii) advance an ambitious lprogramme of labour market reforms that tackles unemployment and informality; (iv) promote widespread insurance to guarantee protection or compensation against shocks resulting from uncertainty; and (v) promote innovative development financing solutions.

Therefore, the challenges arising from the impact of the Gaza war also present an opportunity or Egypt to transform its growth model, which has primarily relied on private consumption without a commensurate increase in productive investment.