EGYPT

CONTINUED IMPROVEMENT IN FISCAL PERFORMANCE

The Egyptian economy proved to be resilient last year. Economic growth remained positive thanks to fiscal support, and the main macroeconomic metrics did not deteriorate significantly thanks notably to international support. The good fiscal performance was noteworthy, and will help maintain the attractiveness of Egyptian debt. This said, it would be wise to remain cautious. On the one hand, the rate of vaccination is slow and the pandemic is still active; on the other hand, the external accounts remain vulnerable, and the improvement in the external energy balance seen in 2020 may not continue in the short term.

ECONOMIC ACTIVITY PROVES RESILIENT

Over the past year, the economic consequences of the pandemic have been contained and restrictive measures have been relatively limited. According to official data, the Covid-19 mortality rate has been fairly low compared to the rest of the region, but the country is currently seeing a second wave of cases, which is lasting longer than the first wave and proving harder to curb. For the time being, the vaccination campaign has been limited. Some two million doses of vaccine have been received (some given by China and some from the Covax programme) and a total of 8 million is expected by the end of May. This remains low given a total population of 100 million, roughly half of whom are aged over 24. Egypt should be in a position to manufacture vaccines domestically within the next few months. Given these conditions, the health situation remains a significant source of uncertainty that could continue to weigh on the Egyptian economy.

Over the first three quarters of 2020, real GDP growth was positive, at 1.3% y/y on average, thanks mainly to domestic consumption, which benefited from public spending support. From a sector point of view, the main areas that drove growth were, unsurprisingly, construction, real estate and retail. These sectors benefited firstly from the continuation of major infrastructure and urban development projects and secondly from the government redistribution of purchasing power to households. These same elements should help growth remain positive throughout the fiscal year 2020/21, at 3.1%, although this will be lower than the 3.8% reported for 2019/20, due mainly to the fall in tourist frequentation.

Although uncertainty remains high, we expect a significant rebound in growth, to 5.3%, in 2021/22. In addition to the traditional driving forces of the construction sector and consumer spending, three factors are likely to support this scenario: 1/ a draft budget that will boost domestic demand, whilst placing the emphasis on structural spending; 2/ an upturn in gas production thanks to renewed growth in Asia, which is likely to underpin liquefied natural gas (LNG) prices; and 3/ a very gradual recovery in tourism.

THE GRADUAL IMPROVEMENT OF PUBLIC FINANCES LOOKS SET TO CONTINUE

The situation of public finance should continue to improve even if debt service remains a strong constraint. Despite a challenging economic environment, the budget deficit was more or less stable in 2019/20, at 8% of GDP. Over the past year, fiscal policy has focused on supporting consumer purchasing power, particularly for civil servants and the poorest groups in society, and increasing health spending. Moreover debt service saw a slight dip as a consequence of the downward cycle in interest rates that began in 2018-19. After a peak of 11.4% in 2019, the apparent interest rate on total central government debt was 10.9% in 2019-20.

In general terms, the increase in receipts will allow a continued improvement in the public finances in 2020/21, despite the cost of measures to support the economy. Over the first half of 2020/21, the fiscal performance improved, with receipts up more than 16%

FORECASTS

	2019	2020e	2021e	2022e
Real GDP growth (%)	5.6	3.8	3.1	5.3
Inflation (CPI, year average, %)	13.4	5.6	4.7	6.8
Central. Gov. balance / GDP (%)	-8.0	-8.0	-7.2	-7.0
Central. Gov. debt / GDP (%)	84	90	94	93
Current account balance / GDP (%)	-3.6	-3.1	-3.9	-2.9
External debt / GDP (%)	36	34	34	33
Forex reserves (USD bn)	45	38	42	43
Forex reserves, in months of imports	8.0	6.1	6.9	7.5

(1): Fiscal years from July 1st of year n to June 30th of year n+1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

GOVERNMENT BUDGET BALANCE (% OF GDP)

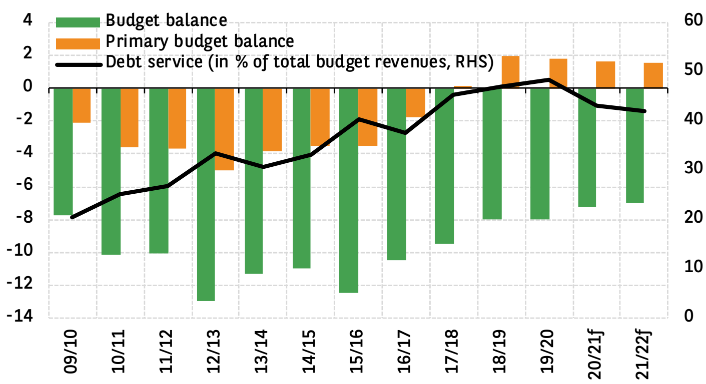

CHART 1 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

on the same period in the previous year (thanks in particular to an exceptional tax on the highest incomes), whilst spending increased by only 9.6%. This trend continued during Q3 2020/21 according to the ministry of finance. As a result, the government is again likely to generate a primary surplus (equivalent to around 1.6% of GDP) and the budget deficit will be reduced to 7.2% of GDP. However, while debt servicing costs are falling in value terms, they remain very high as a percentage of government revenue (48% in 2019/20), limiting fiscal flexibility. Although this ratio will also continue to fall (42% forecast for 2021/22), it will remain high over the medium term. The pace of falls in interest rates is likely to slow, whilst the IMF's concessional financing will make up a smaller share of the total from 2021/22 onwards. Meanwhile, growth in revenue is likely to remain modest over the medium term. According to the IMF, revenue will reach 22% of GDP in 2024/25, from 19% in 2018/19. Overall, therefore, debt servicing costs will still represent around one-third of revenue over the medium term.

The budget for 2021/22 is currently in its discussion and approval phase. The government's budget target (a deficit equal to 6.6% of GDP) is tightly linked to an economic recovery, and is currently suffering from the lack of any clearly identified new sources of revenue. Two factors could get in the way of the planned deficit reduction: the increase in the overall wage bill and the end of the exceptional tax on income. We expect a deficit of 7% of GDP in 2021/22.

Government debt will remain high over the medium term, given the persistent budget deficit and real interest rates that have moved back into positive territory since 2020. We expect it to peak at 94% of GDP by the end of the current fiscal year, before gradually falling back to 89% of GDP by 2023/24.

CONTINUED EXTERNAL VULNERABILITY

Although the public finances have continued to improve despite difficult economic circumstances, external accounts remain a source of vulnerability. In 2020, the collapse in tourism and the increased short-term volatility of international capital markets hit the country's foreign currency liquidity. The country's external liquidity was stable thanks to international financial support, the high levels of remittances from Egyptians abroad and a fall in imports. The central bank's foreign currency reserves stood at USD 40.3 billion in March 2021 (from USD 45 billion a year earlier), to which we can add USD 8.6 billion in Tier II currency reserves, whilst the net external position of commercial banks had returned to its pre-crisis level of USD7 billion. State-owned banks, which make up half of total bank assets, play an active role in the monetary authorities' exchange rate policy. The current account deficit is likely to grow, reaching 3.9% of GDP in 2020/21, due mainly to the fall in tourist income (expected to be around 40%). The high level of portfolio investment flows and disbursement from the IMF will ensure a satisfactory level of foreign currency liquidity over the short term. The outlook is less certain for 2021/22. We expect a slight fall in the current account deficit in value terms (to USD 14.7 billion) but much higher principal repayments of external debt than in 2020/21. According to the IMF, these are likely to total USD 17.5 billion (from USD 14.2 billion in 2020/21). Meanwhile, trends in international capital flows could be less favourable to emerging economies, given the rise seen in US long yields. Even so, the expected slowing in the downward cycle of Egyptian interest rates, the limited currency risk and the good fiscal performance should help protect the attractiveness of Egyptian sovereign debt.

CENTRAL BANK FOREIGN EXCHANGE RESERVES (USD BN)

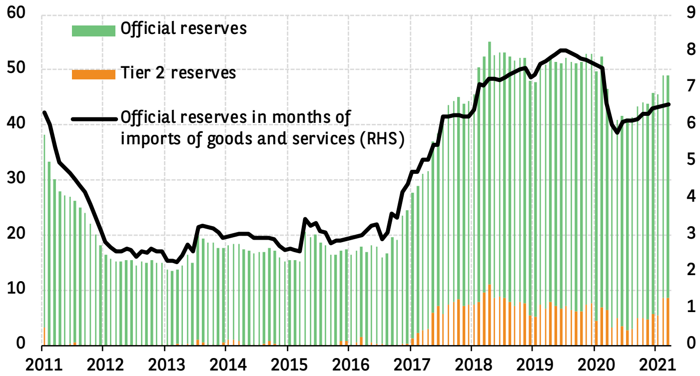

CHART 2

SOURCE: CBE, BNP PARIBAS

THE IMPROVEMENT IN THE ENERGY BALANCE MAY PROVE TEMPORARY

The energy balance improved significantly in 2020, under the combined effect of a fall in domestic demand and an increase in demand from Asia at the end of the year. In the short term, the trend in the energy balance remains fairly uncertain and the surplus seen in 2020 might not be repeated. In the domestic market, demand for oil products (both crude and refined) has been falling steadily over the past five years, due particularly to cuts in subsidies. In 2020, demand fell by around 13% due to the economic slowdown. On the supply side, crude oil production continued to decline, dropping 6% in 2020, due particularly to a lack of investment in new production capacity. At the same time, the production and export of refined oil products continued to grow, thanks to the expansion of production capacity. In volume terms, the external balance on refined products was positive for the first time ever in 2020 (17,000 barrels/day), but the overall balance of trade in oil (including crude) remained significantly negative (-101,000 barrels/day). In value terms, the data available suggests that there was a small nominal surplus, of USD 54 million, in Q3 2020. Meanwhile, LNG exports picked up towards the end of 2020 driven by rising demand and prices in Asia. Over the 2020/21 fiscal year, these exports are likely to total USD 1-2 billion. The prospects for LNG exports remain uncertain for the short term. LNG is sold on the spot market where prices see considerable volatility, and may drop below the Egyptian breakeven price, thus limiting exports.

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