EGYPT

BUYING TIME

The crisis is taking hold in Egypt, as evidenced by the deterioration in all macroeconomic indicators. Activity is slowing down against a backdrop of high inflation, caused in particular by the depreciation of the exchange rate. The balance of payments crisis has been endemic for a year, and the international support plan initiated by the IMF has not allowed any reduction in tensions regarding foreign currency liquidity. Despite the sharp rise in nominal rates on government securities, international investors remain cautious due to the very high level of inflation and expectations of currency depreciation. The external financing requirement will remain high for at least two years, with the privatisation programme only providing partial relief. Furthermore, international support has become increasingly conditional and has left government with little room for manoeuvre. In the very short term, excluding a debt repayment delay, the strategy can only be to maintain a primary surplus and very strict monetary policy despite the slowdown in growth, in order to restore portfolio investors' confidence and avoid a sharp balance of payments crisis.

STRONG INFLATIONARY PRESSURE

The Egyptian economy is currently in the midst of some turbulence, with a very uncertain outlook.. The fiscal year 2023 should be marked by a slowdown in economic activity (with 4% expected at best, compared to 6.6% the previous year) and by accelerating inflationary pressures. The drop in household purchasing power and the slowdown in some major infrastructure programmes are further reducing the prospects for growth in the short term. Inflation has showed little sign of slowing down (+33% year-on-year in March 2023) and should remain very high in the short term. On the contrary, emerging countries should see inflationary pressures ease this year (from 9.2% on average in 2022 to 7.1% in 2023). Indeed, even though the fall in commodity prices since mid-2022 has had a favourable effect in a country highly dependent on food product imports, the sharp depreciation of the pound over the past year (around 50%) will continue to fuel inflation. In 2023 (civil year), it should reach 31.5% on average compared to 13.8% in 2022.

THE BALANCE OF PAYMENTS CRISIS PERSISTS

Despite the expected reduction in the current account deficit, the financial support from international financial institutions, the cautious return of portfolio investments at the beginning of 2023 and financial support from Gulf states (rollovering their deposits at the Central Bank of Egypt when the IMF's new financing was agreed), foreign currency liquidity remains under pressure. The Central Bank's foreign exchange reserves have risen very moderately since the turn of the year (USD 37bn in February 2023, including Tier 2 reserves, i.e. less than four months of goods and services imports), while the net external position of commercial banks has once again deteriorated sharply, with banks' net external debt, of which approximately 40% is short-term, having reached USD 13.9 billion in February. This is close to the highest levels reached in Q4 2022 (USD 16.5bn). The causes of this crisis are known: a significant external financing need (current account deficit and amortisation of external debt) and volatile and more uncertain foreign currency resources.

The current account deficit is expected to decrease to around USD 13.5bn in fiscal year 2023 thanks to support from hydrocarbon exports, the increase in revenue from the Suez Canal, and restrictions on imports.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	3.5	3.3	6.6	4.0	4.0
Inflation, CPI, year average, %	5.7	4.5	8.5	24.4	21.6
Central. Gov. balance / GDP, %	-7.5	-7.0	-6.0	-8.3	-8.7
Central. Gov. debt / GDP, %	86	90	89	92	90
Current account balance / GDP, %	-2.9	-4.4	-3.5	-3.3	-2.7
External debt / GDP, %	32	33	37	40	38
Forex reserves (excl. gold), USD bn	38	41	33	35	38
Forex reserves, in months of imports	6.1	6.0	3.9	3.9	4.0

TABLE 1

(1) FISCAL YEAR FROM JULY 1ST OF YEAR N TO JUNE 30 OF YEAR N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: CPI INFLATION

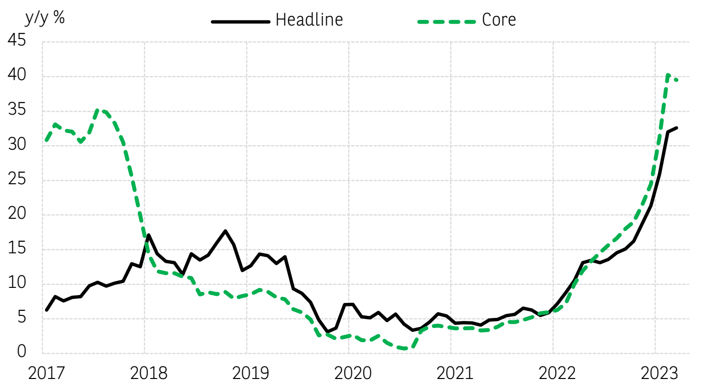

CHART 1

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

In terms of financing sources, the announcement of the IMF's USD 3bn support plan last October did not triggered an inflow of bilateral and private financing, as was the case in 2016-2017. Support from the Gulf states remains significant, but has taken the form of targeted investments (even though deposits at the Central Bank were still made in 2022). In addition, the payment of these investments depends on the timing of the public assets sales, which remains relatively uncertain despite the government's intention to do so. Portfolio investment flows (mainly treasury bills in local currency) have returned (USD 11bn in January compared to a low of USD 6.5bn last October). They remain potentially highly volatile due to negative real rates on all treasury securities maturities and the persistence of a short-term currency depreciation risk. According to data from the Cairo Stock Exchange (including the equity and bond markets), foreign investors were net sellers of securities in February and March. Futures markets continue to expect a fall in the pound in the short term (around 25% at 12-month maturity on the Egyptian pound offshore market). More generally, sovereign risk is considered very high by the markets. The risk premium on international sovereign bonds currently stands at 1,300 bps and has averaged 1,000 bps for the past year.

FOREIGN CURRENCY LIQUIDITY UNDER PRESSURE UNTIL 2025

The need for foreign currency financing will remain significant for at least the next two years. The current account deficit should stabilise at around USD 12bn, but the amortization of foreign currency debt should continue to increase until 2025. In fiscal year 2025, the IMF expects the external financing need to reach around USD 30bn a year. Even if Egypt regains access to the international bond market on acceptable terms, the use of external debt should remain limited in order to contain foreign currency debt servicing. Since 2015, external debt servicing as a percentage of current account income has increased fivefold to 25% in 2022. Portfolio flows could pick up again, but only at the cost of falling inflation and uncertainties weighing on the exchange rate. Given the structural constraints limiting the growth of foreign direct investment in the short term, the authorities are implementing a privatisation plan aimed at attracting foreign capital in particular.

At the beginning of this year, the government announced the opening of the capital of at least thirty public companies, either through investment with strategic investors or by introduction on the local equity market. The government hopes to raise USD 40 bn by 2026, but in the short term, the expected revenue will be limited to around USD 5bn, i.e. less than 1.5% of GDP forecast in 2023. Like portfolio investments, privatisations are subject to economic and political uncertainties.

DETERIORATING PUBLIC FINANCES

Against this deteriorating economic backdrop, the budget deficit should increase this year to around 8% of GDP, which will mark the end of six consecutive years of reducing the deficit. The main driver will be the significant rise in the debt service (interest only). This increased by 36% in the first half of the fiscal year, while the increase in current expenditure remained contained. In total, budgetary expenditure increased by 20% over the period, while the increase in revenue was 15%. Against a backdrop of deteriorating household living conditions, current expenditure should accelerate in the second half of this fiscal year. The government announced a 15% increase in salaries and pensions for employees in the public sector (around 18% of total budget spending) from April onwards, as well as an increase in allowances for the Takaful and Karama social programmes. The primary balance (excluding payment of interest on government debt) should nevertheless remain positive and reach around 1% of GDP in 2023.

EGYPT: NET FOREIGN ASSETS OF THE BANKING SYSTEM AND PORTFOLIO FLOWS

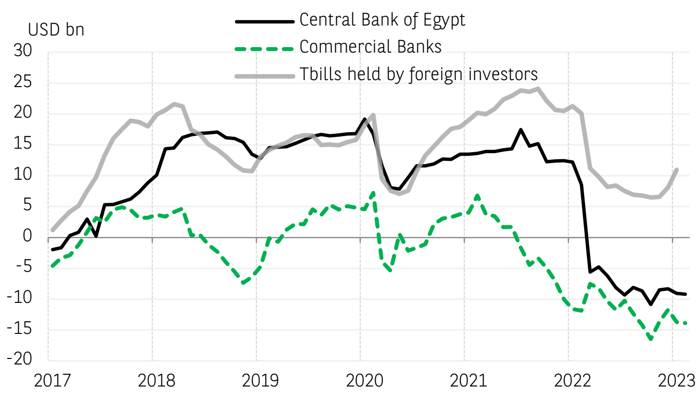

CHART 2

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

The debt service burden should continue to grow markedly with the transmission of part of the central bank's key interest rate hike (1,000 bps since the beginning of 2022) to yields offered on local currency debt issuances. Indeed, since the beginning of 2022, around 80% of the debt issued by the government has been in local currency on maturities of one year or less. During this period, the one-year treasury bill issue rate (the largest issue volume) rose from 13.2% to 21.8%. Furthermore, the very high level of risk premiums on the foreign currency bond issuances market (around 1,000 bps) closed off this market's access to the Egyptian government. Against this backdrop, the debt service as a percentage of income should rise again to reach more than 50%. This level, one of the highest among emerging countries, significantly reduces the government's leeway.

Government debt is expected to reach 92% of GDP at the end of the 2023 fiscal year, before falling back to 90% of GDP in 2024 if the government is able to maintain a primary budget surplus. Indeed, the implementation of the privatisation plan should not significantly reduce the debt ratio.

In the short term, the state's solvency clearly depends on fiscal execution, but also on the Central Bank's ability to preserve its foreign currency reserves and reduce foreign exchange pressure. Monetary easing is therefore not yet an option to ease the public debt burden.

Pascal DEVAUX
pascal.devaux@bnpparibas.com