EGYPT

DARK PROSPECTS

Egypt's management of external accounts, which consists of buying time thanks to external support between two drastic exchange rate readjustments, is reaching its limits. The persistence of a significant external financing need, notably due to the amortisation of external debt, and international creditors (Gulf States and the IMF) who condition their support on painful and politically costly reforms, have led the Egyptian economy to a dead end. The banks' net external position is deteriorating at an alarming rate. Restrictions on foreign currency transactions are increasing, with negative consequences on activity in a country highly dependent on imports. The central bank is still able to cope with external debt amortisation in the very short term, but any further postponement of an agreement with the IMF reduces this capacity beyond that.

ACCUMULATION OF BAD NEWS

Affected by a balance of payments crisis for several months, the Egyptian economy is experiencing a series of bad news: the postponement to an indefinite date of the first review of the IMF's financial support programme (essential for the release of funds), the downgrading of the sovereign rating by Moody's, the prospects of an exit of Egyptian financial assets from certain international indices and, finally, the sudden resumption of political tensions in the region.

The agreement with the IMF was concluded in December 2022 to deal with the consequences of the war in Ukraine on Egyptian external accounts: capital outflow (around USD 20 billion in H1 2022) and an increase in the cost of commodity imports. Conditional on a series of macroeconomic reforms (mainly the continuation of fiscal consolidation, the privatisation of public assets and the flexibility of the exchange regime), the IMF's USD 3 billion loan must trigger other financing from multilateral creditors and the return of foreign investors to the government's local currency debt market, as well as that of foreign direct investment. After a postponement of the IMF's first review, from March to June and then during Q3 2023, the continuation of the support programme will now have to wait at best for the first half of 2024.

DIFFICULT ADJUSTMENTS IN THE FACE OF A CURRENCY SHORTAGE

The Egyptian pound exchange rate is not flexible and the central bank is trying to maintain a level of foreign exchange reserves in line with the IMF's prudential standards (reserves in foreign currency of more than 3 months of goods and services imports). Egypt is highly dependent on imports (especially food) and its external debt has doubled since 2016.

Against this backdrop, the currency shortage is reflected in multiple rationing, the development of a parallel exchange market, a deterioration in the net external position of the banking system and, as a last resort, a sharp depreciation in the exchange rate. The Egyptian pound has depreciated by more than 50% since the beginning of 2022, while the exchange rate on the one-year offshore market has now reached more than EGP 50 for one USD, representing a gap of more than 50% compared to the official exchange rate.

Currently, the official foreign exchange reserves of the central bank are relatively stable (USD 33 billion or 4.6 months of goods and services imports in August 2023). Tier 2 reserves (a priori intended to cope with volatile capital outflows) amounting to USD 9.9 billion can be added to this. However, the maintenance of an acceptable level of reserves for the central bank is at the price of a regular deterioration in the external situation of commercial banks.

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth, %	3.3	6.6	4.2	3.6	5.0
Inflation, CPI, year average, %	4.5	8.5	24.0	32.2	20.0
Central. Gov. balance / GDP (%)	-7.0	-5.8	-4.6	-10.7	-11.1
Central. Gov. debt / GDP (%)	91	89	93	88	84
Current account balance / GDP (%)	-4.4	-3.5	-1.2	-2.4	-2.6
External debt / GDP (%)	35	33	40	38	36
Forex reserves (USD bn)	41	33	35	39	40
Forex reserves, in months of imports	6.0	3.9	4.3	5.9	5.6

TABLE 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: NET FOREIGN ASSETS

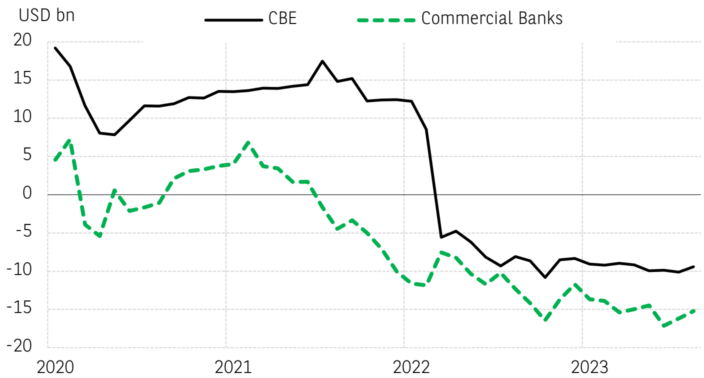

CHART 1

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

Foreign currencies that they cannot obtain from the central bank are provided to them by international creditors in the form of foreign currency bond issues and bank loans. Net external debt in the banking system reached around USD 15.2 billion in August (4.1% of GDP), down slightly compared to June (USD 17.2 billion), but remains at a historically high level. Furthermore, according to local estimates, the backlog linked to imports of goods amounted to around USD 6-9 billion.

These constraints, which affect all imports to varying degrees according to their priority, are hindering Egyptian economic activity. Finally, another indicator of the severity of the current situation, the central bank is extending a ban to the entire banking system on foreign currency payments to holders of a payment card linked to an Egyptian pound account.

SHORT-TERM INCREASE IN CURRENCY TENSIONS

The external financing requirement (current account deficit and amortisation of external debt) is estimated at USD 22-30 billion per year for the fiscal years (FY) 2024 and 2025. According to estimates by the central bank, the amortisation of external debt due to multilateral creditors and that of eurobonds amounted to around USD 7.6 billion in H1 2024, while more than USD 8 billion of short-term external debt should be amortised in Q1 2024. In this context, we can refer to a debt wall for the beginning of 2024, and any postponement of external financial support increases tensions on foreign currency liquidity accordingly. The central bank's foreign exchange reserves are sufficient to cope with short-term debt maturities. Nevertheless, further deterioration in the external situation of the banking system and a widening of the gap between official and offshore exchange rates can be expected in the coming months. The planning of the presidential elections in December 2023 makes an exchange rate adjustment before the end of 2023 unlikely.

Furthermore, access to private external financing deteriorated, particularly following the downgrading of the sovereign rating by Moody's, which mechanically led to that of the country's main commercial banks being downgraded, given the link between the banking sector and the government. Public banks hold approximately half of the total banking assets, and government debt accounts for approximately 50% of the total assets of all public and private commercial banks. Government access to the international capital market has been closed for several months given the level of risk premiums (greater than 1,500 basis points), except for issues of a reduced amount (a few hundred million USD) and denominated in Asian currencies.

A MISLEADING IMPROVEMENT IN THE CURRENT ACCOUNT

With regard to current account revenue, the positive developments observed in recent months are not enough to loosen the constraints weighing on foreign currency liquidity. Indeed, the improvement is largely due to restrictions affecting foreign currency transactions. A current account surplus was recorded in the last quarter of the FY 2023 (USD 0.6 billion compared to USD -3 billion a year previously). It is the sharp drop in imports (-24% y/y), constrained by the lack of available foreign currency, which explains much of this improvement. Tourism revenues and those of the Suez Canal are up sharply (+30% and +33% y/y respectively in Q4 of the FY 2023), but expatriate transfers (around 30% of total current income) fell sharply (-38% in H1 2023 y/y) because they use non-official channels for part of the transfers. There were no LNG exports during the three summer months due to a peak in seasonal consumption and a drop in domestic gas production, despite a sharp increase in Israeli gas exports compared to 2022 (+50% y/y over the first 7 months of the year). The sudden reduction in Israeli exports (estimated at 20%) for security reasons will further reduce Egypt's LNG export prospects for an indefinite period. Furthermore, assuming a return of the exportable surplus of LNG in the coming months, prices on

EGYPT: EGP/USD OFFICIAL EXCHANGE RATE & MARKETS' EXPECTATIONS

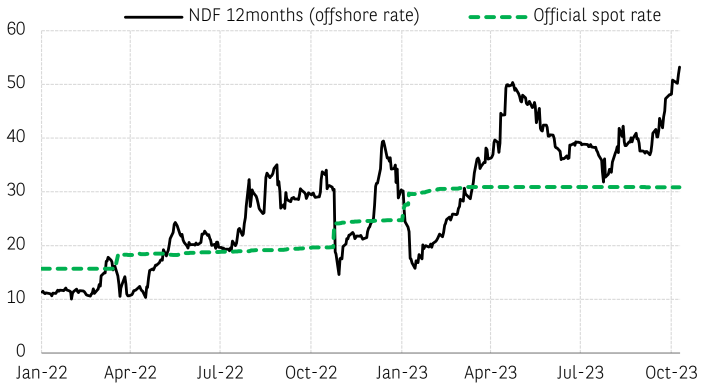

CHART 2

SOURCE: CENTRAL BANK OF EGYPT, BLOOMBERG, BNP PARIBAS

the European market will probably not be as high this winter as in 2022 due to the level of European stocks and high imports from the US.

A NARROW PATH OUT OF CRISIS

The IMF is making its support conditional mainly on the progress made in the privatisation of public assets and in the flexibility of the exchange rate system. The privatisations already carried out and in progress seem relatively in line with the IMF requirements. Approximately USD 2 billion in asset sales was made for the FY 2023, while around USD 6 billion is underway or scheduled for this fiscal year. The question of exchange rate flexibility is much more difficult, particularly due to its consequences for inflation, an endemic problem in the Egyptian economy. The rise in consumer goods prices reached a record level last September (+38% y/y), while core inflation reached 40%.

The structural weakness of Egyptian external accounts and the need to regularly call on external support are not new, but the current situation differs from the crisis in 2016 by the attitude of international creditors which have become more conditional. The IMF's conditionality in terms of macroeconomic reforms is certainly stronger, particularly regarding the functioning of the foreign exchange market. For their part, the Gulf countries have changed the nature of their support. While they continued to make government deposits with the central bank of Egypt in 2022, sovereign wealth funds are looking to optimise their investment. Support in the form of equity investments in listed companies and in privatisations can therefore be seen, but at a price that suits them, in particular by taking into account currency risk.

If an agreement with the IMF were to take place at the beginning of 2024, we believe that Egypt will be able to avoid the short-term balance of payments crisis. However, in the medium term, the vulnerability of the balance of payments will persist. On the one hand, Egypt will once again see its external debt increase, although at concessional conditions. On the other hand, the problem of the country's economic competitiveness remains unresolved. Exports of non-hydrocarbon-related goods remain concentrated in low value-added sectors, and foreign direct investment outside the hydrocarbon sector is low.

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