# EGYPT



## THE EGYPTIAN ECONOMY REMAINS VULNERABLE DESPITE POSITIVE MOMENTUM

**The massive support of international donors has restored a degree of optimism to the Egyptian economic outlook. The depreciation of the exchange rate is under control and inflation is clearly on a downward trajectory, which should make it possible to ease monetary policy. Nevertheless, structural problems remain and will only be resolved very gradually, both in terms of public finances and external accounts. The policies of the new US administration should have a limited impact on Egypt's external accounts.**

### UNCERTAIN ECONOMIC RECOVERY

After a downturn in activity in fiscal year 2024 (FY2024) due to a deep balance of payments crisis, the Egyptian economy is in a phase of gradual recovery, with growth expected to average 4% in FY2025. The stabilisation of the foreign exchange market and the easing of tensions over foreign currency liquidity over the next two years will be key factors in the recovery, particularly given the country's heavy dependence on imports and expatriate remittances. This recovery should initially be based on household consumption, the traditional driver of Egyptian growth (around 80% of GDP), which showed signs of recovery in the first half of FY2025. Nevertheless, some uncertainties remain in the short term, and we expect a more balanced recovery from the start of 2026. Household disposable income continues to be affected by persistently high inflation. Public sector investment is not expected to be a significant support factor due to the fiscal consolidation effort under the IMF programme. In turn, productive investment by the private sector should only really pick up again from 2026 onwards. For the time being, capacity utilisation remains below 70% on average, which is not enough to trigger an investment drive (above 90%). Moreover, in nominal terms, interest rates remain very high, and monetary easing is likely to be gradual because of the risks to the pace of decline in inflation. Against this backdrop, we expect a moderate acceleration in growth in FY2026 to 4.7%.

### DEPRECIATION OF THE EGYPTIAN POUND UNDER CONTROL

The balance of payments crisis triggered by the geopolitical shock of 2022 led to a massive depreciation of the pound and access to the dollar rationed on multiple segments of the economy. Financial support from the UAE and then from international donors enabled the foreign exchange market to return to normal. The main imbalances have been corrected (in particular, the net foreign asset position of commercial banks), the central bank's foreign exchange reserves hit USD 46.4 billion in December (excluding gold and including Tier II reserves), equivalent to 6.5 months of imports of goods and services (USD 33.2 billion and 4.8 months in December 2023), and the pound has become more flexible. The pound depreciated by only 5.5% in the second half of 2024, mainly due to the appreciation of the US dollar against all other currencies. The low volatility of the exchange rate during this period signalled the central bank's desire to keep some influence over this market. In the short term, the pound should continue to depreciate as a result of the dollar's strength on international markets and the increase in the current account deficit, albeit at a moderate pace.

### MONETARY POLICY EXPECTED TO EASE

Consumer price inflation hit 24.1% in December, confirming the downward trend which began last September, thanks in particular to the sharp fall in food prices and the stabilisation of the exchange rate.

FORECASTS

| | 2022 | 2023 | 2024e | 2025e | 2026e |
|---|---|---|---|---|---|
| Real GDP growth, % | 6.6 | 3.8 | 2.6 | 4.0 | 4.7 |
| Inflation, CPI, year average, % | 8.5 | 24.0 | 33.6 | 19.8 | 10.3 |
| Central gov. balance / GDP (%) | -5.8 | -5.7 | -3.3 | -6.8 | -5.3 |
| Central gov. debt / GDP (%) | 89 | 96 | 94 | 83 | 76 |
| Current account balance / GDP (%) | -3.5 | -1.2 | -5.4 | -4.4 | -4.2 |
| External debt / GDP (%) | 33 | 42 | 40 | 46 | 44 |
| Forex reserves, excl. Gold, incl. Tier II (USD bn) | 27 | 31 | 46 | 52 | 57 |
| Forex reserves, in months of imports | 3.1 | 4.5 | 6.3 | 6.9 | 7.0 |

Fiscal year from July 1st of year n to June 30 of year n+1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: RESTORATION OF FOREIGN CURRENCY LIQUIDITY

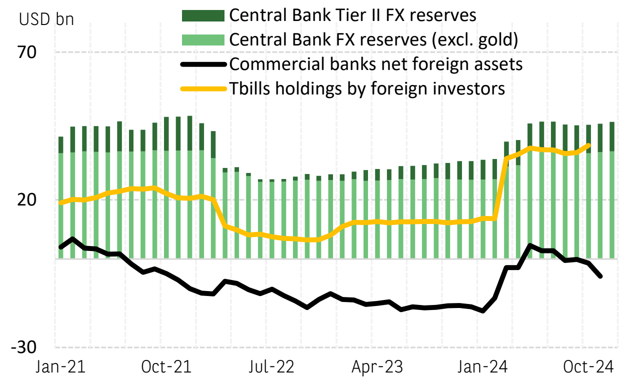


CHART 1 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

Nevertheless, overall inflation is still far above the central bank's target (7% +/-2%). Core inflation is following a similar trend. Due in part to base effects, inflation should fall significantly from February 2025, averaging at 19.8% for FY2025 as a whole and around 10% for FY2026. While the downward trend seems assured for the next 18 months, specific factors could slow the pace, particularly fiscal consolidation, especially if it takes the form of VAT hikes and subsidy cuts. In addition, the expected depreciation of the pound, even if kept under control, could fuel inflationary pressures.

The expected acceleration in the fall in inflation in Q1 2025 should enable the central bank to begin a cycle of monetary easing, following 1,900 basis points of increases since February 2022. The pace of this rate cut presents the central bank with a difficult choice, as, on the one hand, the sharp rise in real interest rates from February onwards will act as a brake on the recovery in investment. With an unchanged nominal rate, the central bank's lending rate should rise from 4% in December 2024 to over 16% in February 2025 in real terms. On the other hand, uncertainties over the inflation outlook are likely to make the central bank cautious. We can therefore expect rates to fall gradually in 2025.

## AN AMBITIOUS PRIMARY SURPLUS TARGET

Fiscal performance in FY2024 was remarkable, but exceptional in nature due to the inflow of funds linked to the Ras El-Hekma deal (USD 24 billion, around 7% of GDP, in FDI from the United Arab Emirates). The budget deficit hit 3.3% of GDP, while the primary balance was in surplus by more than 6% of GDP. The government's fiscal target for the current year remains ambitious, with a primary surplus equivalent to 3.5% of GDP. This objective should be achieved through measures to broaden the tax base, reduce some subsidies (mainly energy), cut some public investment expenditure and increase VAT on specific categories of products. In the first five months of the current fiscal year, the Ministry of Finance estimates the primary surplus to stand at 1% of GDP, compared to 0.4% for the same period last year. The total budget deficit will remain high (6.8% of GDP expected this year) due to the interest burden, which amounted to 47% of general government revenues in FY2024 (55% this year), one of the highest levels among emerging countries. Active debt management should make it possible to reduce the cost of debt, notably by extending maturities. The government aims to get to an average maturity of 4.5 years in FY2026 (3.2 in FY2023). The gradual nature of the fall in rates will make this a fairly slow process. It is in the government's interest to continue issuing on short maturities initially in order to benefit from the gradual fall in rates.

## WHAT IMPACT WILL TRUMP 2.0 HAVE ON THE EXTERNAL ACCOUNTS?

From a US perspective, Egypt is not a major trading partner, accounting for less than 0.05% of total US imports. This reduces the risk of a unilateral increase in customs duties. The Trump administration's policy will have a more indirect impact on Egypt's external accounts.

On the geopolitical front, US support for a ceasefire agreement between Israel and Hamas, if it lasts, will have positive effects. Tensions in the Red Sea should ease, allowing maritime traffic through the Suez Canal to gradually resume. Revenues from the Suez Canal (9% of the country's foreign currency earnings) fell by 60% in the first nine months of 2024. Tourism revenues should also benefit from the reduced geopolitical tensions. Nevertheless, the current ease in tensions remains precarious, and US objectives in the region and how they might be achieved are still uncertain.

Energy is a key issue in Egypt, and the deterioration in the external balance for hydrocarbons is making external accounts more vulnerable to fluctuations in oil and gas prices. The faster than expected decline in Egyptian gas production and the steady increase in consumption are forcing Egypt to import increasing quantities of liquefied natural gas (LNG) in order to supplement imports from Israel via pipeline. These LNG imports cost around USD 1 billion in FY2024. Despite encouraging

EGYPT: DECLINING INFLATIONARY PRESSURE

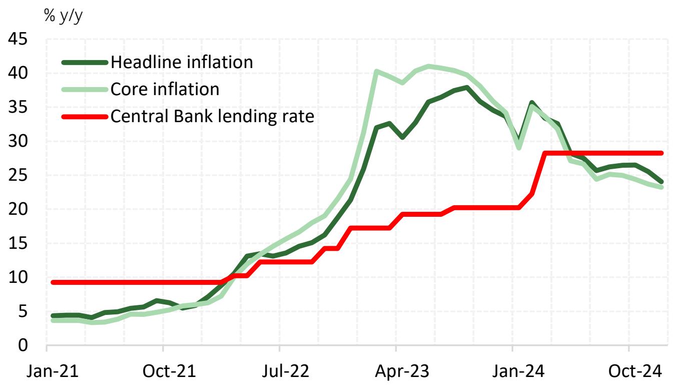


CHART 2 SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

exploration results from gas companies, the gradual implementation of new solar power generation capacity and the possible import of electricity from Saudi Arabia, Egypt's gas deficit could persist for at least the next 2-3 years. The increased LNG production and export capacity at the heart of future US energy policy is unlikely to have a positive short-term impact on Egypt's energy bill. The increase in US LNG exports expected in 2025 is linked to decisions taken under the previous administration. The effects of the new export licences will not be felt for a few years, and will then only be one of the drivers behind increased LNG production, with Qatar expected to play a dominant role.

US monetary policy plays an important role in i/ covering Egypt's external financing needs through carry-trade flows and ii/ the cost of servicing external debt.

Although carry-trade transactions are expected to be less significant than before 2022, due to the increased bilateral financing and FDI, they are still an important factor in the balance of payments. We estimate that net investment inflows linked to carry-trade transactions should cover 19% and 12% of the total external financing requirement (current account deficit and amortisation of external debt) in FY2025 and FY2026, respectively. But the Fed could leave rates unchanged this year. However, stable US rates and reduced rates in Egypt would automatically reduce the appeal of Egyptian securities denominated in local currency. Further depreciation of the pound, even if moderate, would add an additional negative factor to the appeal of Egyptian securities in local currency.

Foreign currency debt servicing has increased significantly in recent years and is contributing to the vulnerability of Egypt's external finances. In FY2024, interest payments on foreign currency debt were equivalent to 9% of total foreign currency revenues, compared with an average of 3% between 2018 and 2022. The Egyptian government, which has just issued USD 2 billion in international bonds (in USD), plans to issue around USD 3 billion (not only in USD) in the first half of 2025.

All in all, we feel that the potential consequences of the new US administration's policy on external accounts will be relatively balanced and, in principle, limited in scope. They could be fairly positive on the current account balance and neutral or even negative on the financing side.

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