EGYPT

A SHORT-TERM RELIEF FOR EXTERNAL LIQUIDITY

Egypt's economic prospects have worsened with the outbreak of war in Ukraine and its consequences for commodity prices. The widespread increase in prices will result in a significant drop in consumer purchasing power and will thus stall the main engine of economic activity. The erosion of foreign currency liquidity has accelerated over the last month, with massive outflows of capital and an expected widening of the current account deficit due to the difficulty in reducing imports, a drop in tourist frequentation and the limited effect on exports of the Egyptian pound's depreciation. This highlights the continued vulnerability of the economy to external shocks and its reliance on external support. The support already in place from the Gulf states, and the expected package from the IMF, will give the country a little time, but foreign investors will remain cautious against a background of deterioration in the public finances.

GROWTH PROSPECTS WORSEN

Despite the substantial rebound in economic activity in the first half of the 2022 fiscal year (FY), with growth of over 8% y/y, economic growth over the year as a whole is likely to be below expectations. Consumer spending, the main driver of economic activity, is likely to be particularly hard hit by the consequences of the war in Ukraine. Although prices for certain foodstuffs (including bread, which is the staple food of most of the population) are likely to remain under control due to government subsidies, rising commodity prices on global markets will push all prices upwards and will thus eat into household purchasing power a bit more. Investment could also slow down as prices for construction materials rise.

The effects on international trade are less clear cut. Exports could benefit from European demand for gas and, for manufactured goods, from the pound's recent depreciation. But these effects will be constrained by reduced additional capacity for gas exports, after the rapid recovery in 2021, and the limited competitiveness of non-hydrocarbon exports. Moreover, exports of certain food products and raw material have been banned for at least six months to avoid supply disruption.

In addition, any recovery in tourism has been compromised in the short term, given that Russian and Ukrainian tourists account for some 30% of total visits. All of these factors linked to the crisis in Ukraine will have a particularly harsh effect on the final quarter of the current fiscal year.

Even so, given the strong recovery in the first part of the year, growth should reach 5.5% in FY 2022. But economic growth will slow over the first half of the calendar year, and we are expecting only a very modest growth in FY 2023. Our central scenario incorporates continued high prices for energy and agricultural goods at least until the end of 2022. Household consumption will thus continue to be hampered by high prices during the first half of FY 2023. Meanwhile, the constraint of expenditure that cannot be compressed, or only to a limited degree (wages, debt interest), limits the government's scope to support economic activity. Even in the event of a recovery in the second half of FY 2023, GDP growth for the year is likely to be just 3.9% at best.

FORECASTS

	2019	2020	2021e	2022e	2023e
Real GDP growth, %	5.6	3.5	3.3	5.5	3.9
Inflation, CPI, year average, %	11.0	10.2	7.2	8.2	10.1
Central. Gov. balance / GDP, %	-8.0	-8.0	-7.4	-7.9	-8.6
Central. Gov. debt / GDP, %	84	90	95	95	97
Current account balance / GDP, %	-3.6	-3.1	-4.5	-5.1	-5.0
External debt / GDP, %	36	34	35	37	40
Forex reserves (excl. gold), USD bn	42	34	36	32	30
Forex reserves, in months of imports	6.4	5.4	5.4	4.2	4.6

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: CONSUMER PRICE INDEX, CONTRIBUTIONS TO INFLATION

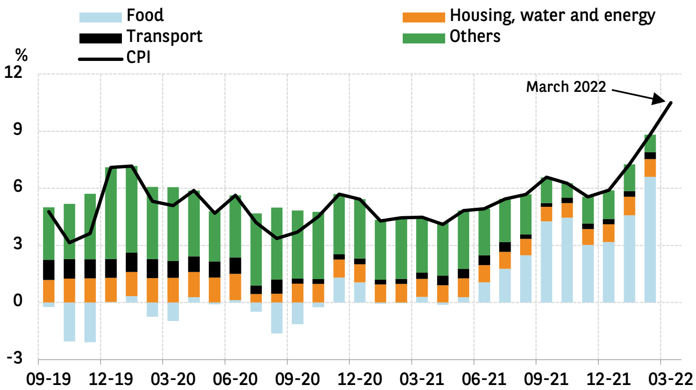

CHART 1

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

A SHARP INCREASE IN INFLATION

Consumer price inflation has accelerated significantly since the start of the year. It climbed from 6% y/y in December 2021 to 10.5% y/y in March 2022, with core inflation (10.1% in March) following the same trend. The impact of the pound's depreciation on the price of imported goods will only be partly offset by the setting of a specific exchange rate (EGP16 per USD) to be applied to some essential goods. The currency effect adds to the high level of commodity prices on international markets, and we are expecting an acceleration to 13% y/y in April. The month of Ramadan is traditionally associated with an inflationary surge. On average, we expect inflation for FY 2022 to hit 8.2%. Assuming that commodity prices remain high until at least the end of 2022, consumer price inflation could average 10.1% over FY 2023.

Against this background, inflation could significantly overshoot the average target of 7% +/-2% set by the monetary authorities for Q4 2022. The rate raising process initiated by the Central Bank of Egypt (CBE) in March is therefore likely to continue throughout 2022.

DETERIORATION OF EXTERNAL ACCOUNTS

Having begun in mid-2021, the erosion of foreign currency liquidity accelerated following the outbreak of the war in Ukraine. In the second half of 2021, a widening current account deficit and more risk aversion amongst international investors (risk premiums on foreign currency sovereign debt doubled between September and December of 2021) resulted in a deterioration of the balance of payments. Although the CBE's currency reserves remained more or less stable over the year at around USD36 billion (excluding gold), the net external debt of commercial banks jumped to USD11.5 billion by the end of 2021, having been nil six months earlier. The vulnerability of the Egyptian economy to the consequences of the conflict in Ukraine has resulted in significant capital outflows. In March 2022, the CBE's currency reserves fell by USD4.8 billion, whilst Tier 2 reserves (designed to tackle outflows of volatile capital) fell by USD7.4 billion.

Against this backdrop, the CBE allowed the pound to depreciate by 15% relative to the US dollar, and official discussions were opened with the IMF. In parallel, Saudi Arabia increased its deposits with the CBE by USD5 billion and an Emirati sovereign wealth fund acquired nearly USD2 billion of assets on the Egyptian stock market (equivalent to around 5% of total market capitalisation). This substantial support, in addition to the expected assistance from the IMF, should help limit downward pressure on currency reserves in the very short term.

Even so, we remain cautious about short-term and medium-term prospects. The Ukraine crisis has demonstrated once again the vulnerability of Egypt's balance of payments to external shocks and its reliance on substantial external support under such conditions. We expect the current account deficit to grow over 2022 and 2023. Even though import volumes are falling fast, the gains will be offset by higher commodity prices. The country has been a net importer of crude oil since 2015, and the current account deficit on hydrocarbons is likely to hit USD1 billion in 2022 and 2023 (from an average of USD0.4 billion over the previous three years). As far as food imports are concerned, although imports can be limited for a few months thanks to levels of wheat stocks and the beginning of the country's own harvest (meeting around 25% of demand), the difficulties of accessing Russian and Ukrainian wheat (80% of Egypt's wheat imports) and the high prices throughout the value chain (fertilisers, energy, transport) look set to maintain upward pressures on wheat prices until at least the end of 2022. For exports, the competitiveness improvements expected from the devaluation of the pound are far from guaranteed, given first that some categories of goods are covered by export bans, and secondly that global trade is expected to slow down. In all, the trade deficit could exceed USD50 billion (11% of GDP) for the first time ever in FY 2023. Revenues from the Suez Canal are likely to continue to grow, thanks in particular to an increase in fees, but these account for only some 6% of total current receipts. The long-awaited recovery in tourism is likely to be delayed by several months. The only truly positive point, remittances from expatriate Egyptians (one third of current receipts) are likely to remain strong, thanks to buoyant economic conditions in the Gulf states and the attractive interest rates on pound certificates of deposit offered by the two main public sector banks (18% per year). In FY 2023, the total external financing requirement (current account deficit and re-

EGYPT: FOREIGN ASSETS OF THE BANKING SYSTEM

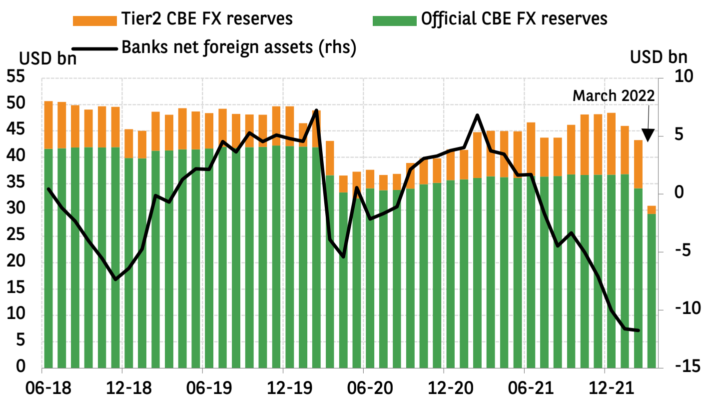

CHART 2

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

payments on foreign currency debt) is likely to approach USD30 billion. International financing, whether multilateral (IMF) or bilateral (Gulf states) will cover part of this requirement. However, flows of portfolio investments are both more uncertain and more costly. In particular, risk premiums on sovereign debt have risen by 150 points over the past year.

THE BUDGET DEFICIT IS GROWING AGAIN

The efforts to consolidate the government's budget, seen since 2015, will be interrupted. Due to higher food subsidies and a slower tax collection process, the budget deficit is likely to reach 7.9% of GDP this year, with the primary balance remaining in surplus by 0.1% of GDP. The deterioration in economic prospects since the start of the year has caused the government to review its 2023 budget. The measures announced include a widespread increase in social security spending and increases in public sector wages and pensions, coupled with tax cuts on financial transactions, which are likely to benefit foreign investors in particular. We estimate that these measures could represent around 5% of GDP. At the same time, the combination of higher short-term interest rates at the CBE and persistent inflationary pressures are likely to increase the government's cost of financing across all maturities. In all, we expect a primary deficit of 0.4% of GDP in FY 2023 and an increase in interest costs (51% of receipts in FY 2021).

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Pascal DEVAUX
pascal.devaux@bnpparibas.com