EGYPT

POSITIVE SHORT-TERM PROSPECTS

Economic growth remained rather strong in FY 2020/21 thanks mainly to the dynamic momentum of household consumption and the moderate support of public spending. This bolstered the retail and construction sectors. Through cautious management of public finances, the government reported a slightly smaller fiscal deficit in FY 2020/21, and it should continue to report an improvement this year despite possible upward pressures on current expenditures. The main obstacle to a more ambitious fiscal policy lies in the government's debt service, which despite better financing conditions, will only narrow very gradually. As to the external accounts, there is not only the question of the attractiveness of Egyptian debt at a time when the US is expected to begin tightening monetary policy, but also the vulnerability of the current account deficit, which is subjected to the rigidity of imports, higher commodity prices and an uncertain recovery in tourism.

BUOYANT HOUSEHOLD CONSUMPTION

Real GDP growth maintained a rather rapid pace in fiscal year 2020/21 (+3.3%), thanks to the support of household consumption. This is a notable performance compared to other emerging countries, especially considering the troubles the tourism sector is having in the midst of the pandemic.

Private consumption has not contracted for a single quarter since early 2020. Lockdown restrictions due to the Covid-19 pandemic were very short-lived and had only a limited impact on activity. Household lending (excluding real estate loans) remains very strong. It has increased at an average rate of more than 30% year-on-year since the end of 2019, to about 8.5% of GDP in June 2021 (vs. 6.7% at year-end 2019). In real terms, lending has grown significantly since mid-2019 (over 20% y/y) as inflation has eased. At the same time, remittances from Egyptian expatriates (mainly in the Gulf countries) were very high in FY 2020/21, despite the tough economic situation in the Gulf in 2020 and the acceleration in labour market nationalisation policies. Remittances increased 13% in FY 2020/21 to a total of USD 31.4 bn, or about 40% of current account revenue. This growth seems to be linked to asset sales by expats leaving the Gulf region, and financial transfers that had to pass through official channels due to travel restrictions between countries. Moreover, although fiscal policy support is still moderate, targeted government subsidies helped boost the revenue of low-income categories of the population.

In contrast, investment trends continue to weigh on economic activity (down 50% y/y in the first three quarters of 2020/21), after a 20% decline in FY 2019/20. This is mainly due to an 80% decline in investment in the hydrocarbon sector (about 18% of total investment).

From a sector perspective, buoyant household consumption benefited the retail sector. Unsurprisingly, construction (+6.8% in 2020/21) and the real estate sector (17% of GDP altogether) also fuelled growth, bolstered by major urban and infrastructure projects. In contrast, the manufacturing sector (16% of GDP) contracted 5.8% over the course of FY 2020/21.

In the short term, we expect growth to accelerate to 5.6% in FY 2021/22. Leading economic indicators have rebounded since June 2021. The industrial output index has accelerated rapidly since the end of Q1 2021, while mobility indicators have shifted into recovery territory since June. Moreover, the FY 2021/22 budget calls for an increase in public-sector wages and pensions. As to tourism, tourist frequentation should increase very gradually as some existing travel bans are lifted and as the global pandemic possibly begins to ebb.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	5.6	3.5	3.3	5.6
Inflation (CPI, year average, %)	13.4	5.6	4.5	5.9
Central. Gov. balance / GDP (%)	-8.0	-8.0	-7.4	-6.9
Central. Gov. debt / GDP (%)	84	90	94	94
Current account balance / GDP (%)	-3.6	-3.1	-4.2	-2.8
External debt / GDP (%)	36	34	36	37
Forex reserves (USD bn)	45	38	41	42
Forex reserves, in months of imports	8.0	6.1	6.2	6.9

(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

REAL GDP GROWTH (CONTRIBUTIONS, %)

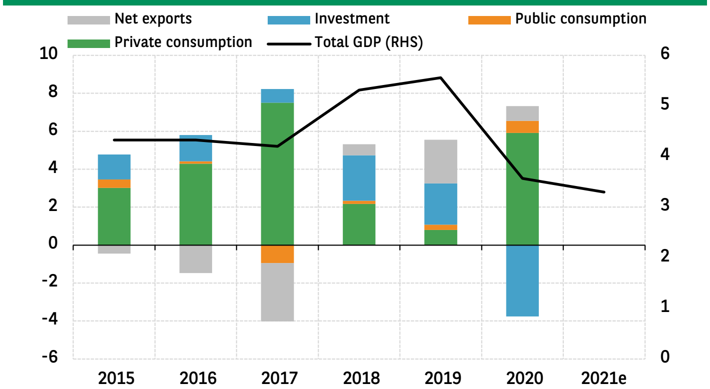

CHART 1

SOURCE: MINISTRY OF PLANNING, BNPPARIBAS

FISCAL CONSOLIDATION CONTINUES

In a relatively dynamic economic environment, limited fiscal support measures (about 2% of GDP, only part of which was actually spent) have mainly targeted low-income families and the sectors with the highest exposure to the consequences of the pandemic. At the same time, some exceptional taxes have helped buffer the economic slowdown's impact on government revenues. From a more structural perspective, fiscal revenues have also benefited from measures to improve tax collection since 2019, including the automation and digitalisation of some tax payments, and the expansion of the tax base. According to government sources, these measures contributed about 15-20% of the increase in fiscal revenues observed in the first three quarters of 2020/21. Altogether, revenues increased by 15% over the same period.

Total expenditures rose only 11%. As a result, the primary fiscal balance will remain positive in FY 2020/21 (equivalent to about 1.4% of GDP), which will help reduce the fiscal deficit given the quasi stability of the interest charge (+1% in the first three quarters of 2020/21). The full-year deficit is estimated at 7.5% of GDP, compared to 8% in FY 2019/20. Debt service continues to place the biggest strain on public finances. Although it declined slightly, to about 54% of total fiscal revenues (from 58% in FY 2019/20), it is still very high and sharply curtails the manoeuvring room of public policies.

Given higher economic growth, the fiscal deficit should continue to narrow in FY 2021/22 (to an estimated 6.8% of GDP), despite an increase in the public sector wage bill. This scenario has some downside risks, notably pricing trends for agricultural commodities and energy. Food subsidies, which account for 5% of total fiscal spending, increased by more than 10% in the first nine months of FY 2020/21. Egypt is the world's leading importer of wheat, and prices on the global market have risen 11% since end-June 2021. The impact of higher oil prices is less obvious since subsidies on petroleum-based products were officially eliminated in 2019. Yet the official quarterly fuel indexation mechanism for retail sales prices (within a limit of 10%) may be not fully in line with the trend in international market prices. Given the expected 40% increase in oil prices in 2021/22, an insufficient adjustment of sales prices could generate extra costs for public finances.

Debt service should continue to decline, albeit at a slower pace. The central bank is expected to end its monetary easing cycle, which should maintain bond yields in local currency at high levels. Longer maturities in the local market (there have been more net issues of T-bonds than T-bills since 2018/19) and the issue of medium to long-term international debt in foreign currency is positive for debt dynamics. According to the IMF, the average maturity of the debt stock was 3.38 years in February 2021 compared to 2.1 years in June 2016. Yet given the slope of the yield curve for debt issues in the local currency (230 bp yield spread between 1-year T-bills and 5-year T-bonds at end-September 2021), debt servicing will only be reduced very gradually.

EXTERNAL VULNERABILITY IS MANAGEABLE IN THE SHORT TERM

Thanks to IMF support in 2020, regular Eurobond issues, and portfolio investment inflows in 2021, foreign-currency liquidity has reached a satisfactory level. Central bank reserves amounted to USD 40.7 bn at the end of August 2021 (USD 53 bn including Tier II reserves), the equivalent of 6.1 months of imports of goods and services. Even so, this figure is about USD 5 bn less than at year-end 2019. The downside risks to external liquidity seem limited in the short-term given the attractiveness of Egyptian debt (in real terms, the yield on 10-year bonds is currently 9.2%). Yet the country still has significant external financing needs (more than USD 30 bn if we take into account public sector short-term debt held by non-residents, and assuming that the Gulf countries will renew their deposits with the central bank), and vulnerabilities persist. The current account deficit is high (estimated at 4.2% of GDP in FY 2020/2021, or more than USD 16 bn) due to the rigidity of imports and the slump in tourism frequentation.

CURRENT ACCOUNT (% OF GDP)

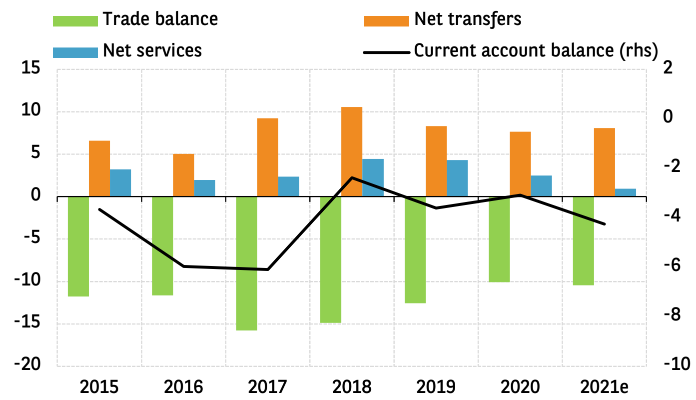

CHART 2

SOURCE: CENTRAL BANK OF EGYPT, BNPPARIBAS

In the short term, accelerated growth should favour a rise in imports, while tourism frequentation will gradually pick up. Higher oil prices should widen the deficit on the energy accounts. The sustainability of LNG export growth observed since mid-2020 must still be confirmed. In FY 2021/22, the current account deficit should reach 4.4% of GDP. Foreign direct investment declined 19% in Q3 2020/21, and we are maintaining a conservative estimate of FDI inflows in 2021/22 (equivalent to 2% of GDP). Given the mixed prospects for FDI, a key factor for external liquidity will be to maintain a high volume of government debt held by non-residents (which is volatile by nature). Lastly, the central bank's determination to limit exchange rate volatility potentially could be costly in terms of foreign currency, as was the case in early 2020. This makes it difficult to estimate the acceptable level of the central bank's foreign reserves.

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Pascal DEVAUX
pascal.devaux@bnpparibas.com