Egypt

Resilient economy: at least in the short term

The impact of the COVID-19 pandemic on the Egyptian economy will be significant and will result in a sharp economic growth slowdown this year. Growth is nevertheless likely to remain positive. In the short term, the expected deterioration in public finances is sustainable, and the government can deal with a temporary downturn in international investors' appetite for Egyptian debt. Foreign currency liquidity across the whole banking system has improved significantly in recent months, supporting the pound in the currency market. As a result, the financing of the current account deficit, repayment of foreign debt and the ability to cover massive capital outflows are all guaranteed for the short term.

Economic support measures

Faced with the COVID-19 pandemic, the government has so far taken measures to restrict movement and activity, but no confinement measures as such. All flights have been suspended. Economic support measures have come first in monetary form, with a 300 basis point cut in the Egyptian Central Bank's (CBE) policy rate. This took the CBE deposit rate from 12.25% to 9.25%. The CBE has also announced a number of measures aimed at the banking sector with a view to supporting economic activity, including the postponement of credit payments for six months for individuals and companies, a debt relief initiative for individuals at risk of default, a cut in the preferential interest rate reserved for targeted debtors, and the creation of a guarantee fund to back the tourist sector. Meanwhile, the government has introduced support measures for the private sector (loans at subsidised rates for industry, support for the hotel sector, direct support to certain households) for the equivalent of around 2% of GDP.

Sharp economic growth slowdown is expected

The economic growth slowdown will be substantial, but the structure of the Egyptian economy will help limit its extent. The sectors most vulnerable to the consequences of the epidemic, where the impact on growth will be significant, are manufacturing (16% of GDP), construction and real estate (16% of GDP) and tourism[1]. This sector only represents a small share of GDP (around 3% of the total), but its contribution to GDP growth has been significant in recent quarters, accounting for around 1 point out of total GDP growth of 5% to 6%. The extractive industries, agriculture, communications and healthcare (around 25% of GDP in total) are likely to be relatively less affected.

In fiscal year (FY) 2018/2019, real GDP growth was 5.6%. This pace was maintained in H1 2019/2020. In Q3 2019/2020, estimated growth was still largely positive albeit somewhat slower (we expect a figure of 5.0% y/y). To date, the economy has been relatively little affected by the international slowdown given the limited integration in international value chains. Restrictions on economic activity were introduced in March 2020 and will therefore mainly affect the final quarter of FY2019/2020 (-4.1% y/y). In FY2019/2020 as a whole, real GDP growth is likely to drop sharply but remain positive at 2.6%.

[1] According to the Ministry of International Cooperation, since the onset of the crisis, inbound tourism reservations have dropped by 80% in comparison to the same period last year.

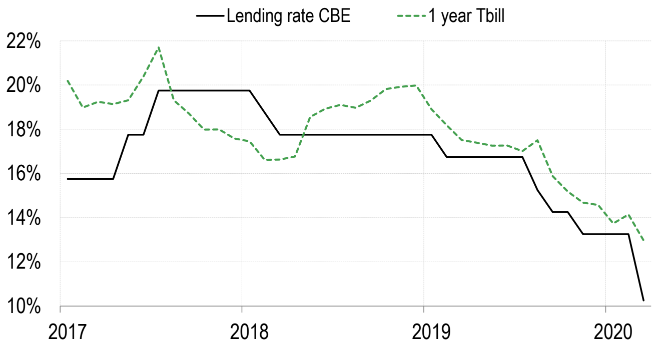
1- Forecasts

	2018	2019	2020e	2021e
Real GDP growth (%)	5.3	5.6	2.6	3.4
Inflation (CPI, year average, %)	21.5	13.4	5.9	7.5
Gen. Gov. balance / GDP (%)	-9.5	-8.0	-9.2	-9.8
Current account balance / GDP (%)	-2.0	-3.6	-4.1	-4.0

(*) Fiscal years T-1/T (July-June)

e: BNP Paribas Group Economic Research estimates and forecasts

2- Monetary easing and yields on Tbills



Sources : CBE, MoF

The economic consequences of the health crisis are likely to persist at least into the early months of FY2020/2021 and will affect the high season for tourism. At the same time, the fiscal capacity to support and revitalise the economy is constrained, whilst the drop in consumer living standards could limit the scope for recovery. Real GDP is expected to grow by 3.4% in FY2020/2021.

Stable inflation

In the short term, trends in consumer prices are likely to be influenced by two opposing factors: the inflationary effects of the possible disruption of the food supply chain (40% of the consumer price index), offset by the impact of lower oil prices. Prices for all oil products (apart from butane) are now linked to market prices, given the complete removal of subsidies. They are likely to be reviewed downwards for Q4 2019/2020. Overall, we are not making any significant changes to our inflation estimate, which we put at an annual average of 5.9% for FY2019/2020.

A sustainable fiscal position

The direct support fiscal measures announced so far remain relatively limited (around 2% of GDP) and will fall mainly in FY2020/2021. In addition, falling oil prices will reduce the subsidies for butane (other energy subsidies have already been removed), but this will have only a very marginal effect on total spending.

On the revenue side, direct and indirect tax income will fall, as will revenue from the Suez Canal (6% of government revenue in FY 2018/2019). Although the fall in revenue will directly affect the final quarter of the current fiscal year, stimulus spending will be spread over a longer period. Having been in surplus at 1.35% of GDP in FY2018/2019, the primary budget balance is likely to turn negative this year, at -0.3% of GDP. In FY2020/2021, the primary balance is likely to be in deficit by -1.8% of GDP, given the need for fiscal support to the economy and the fall in receipts.

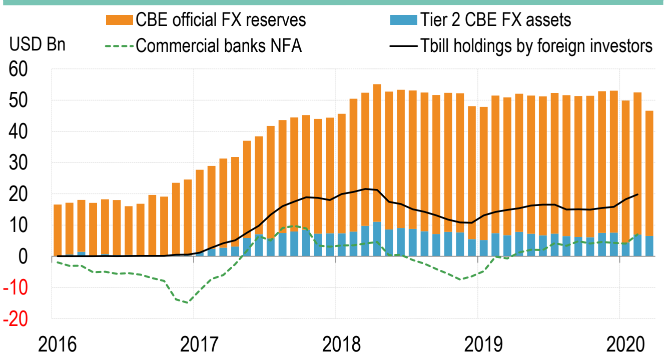
The hard-to-curb debt interest payments (47% of total revenue in FY2018/2019) are the main reason for significant and persistent budget deficits. The cut in the CBE's interest rate should reduce interest payments by 0.3% of GDP over a full year (they were equivalent to 9.5% of GDP in FY2018/2019). The potential savings linked to a cut in interest rates (a 100 bp cut is equivalent to around EGP 8 billion to EGP 10 billion in savings) will be partially offset by an increase in the rates on the treasury bills market due to increasing risk aversion, and reduced liquidity as a result of the withdrawal of foreign investors. As a result, the total budget deficit is likely to increase this year to some 9.2% of GDP.

Whilst the budget deficit remains under control, its financing will be ensured, despite the increasing scarcity of external financing. The liquidity of the local banking system appears sufficient to cover financing needs. Total CBE liabilities linked to open-market operations were equivalent to 13% of GDP in February 2020. The fall in yields on these transactions could encourage banks to turn instead to government securities.

Foreign currency liquidity is resilient

The consequences of the oil price fall for external accounts are mixed. By volume, the country is a net importer of oil products (both crude and refined) and has returned to a position as a net exporter of LNG (although in limited volumes). By value, the total hydrocarbon balance has been slightly negative during 2019, reflecting a lag between value and volume, which is linked to the nature of the agreement between the Egyptian national oil company (EGPC) and international oil companies. The expected collapse in oil prices in 2020 is likely to have a slightly positive effect on the trade balance. Conversely, the tourist sector is likely to be hit hard and we estimate that tourism revenues could fall by around 25% in FY2019/2020, before recovering in FY2020/2021 but without returning to the level of USD 12 billion achieved in FY2018/2019. Similarly, private transfers from expatriates are likely to be severely affected by the sharp economic slowdown in the Gulf, whilst Suez Canal receipts will suffer from the contraction of global trade and the fall in the oil price. The current account deficit is likely to increase to 4.1% of GDP in FY2019/2020 and then 4% in 2020/2021.

3- Banking system external liquidity



Source: CBE

In the short term, the foreign currency liquidity situation remains acceptable, even if confronted by capital outflows. In other words, the total of the current account deficit (USD 13 billion over a full year), amortisation on foreign debt (USD 7 bn in 2020) and those on T-bills held by foreign investors (around USD 20 bn in February 2020) is more than covered by total foreign currency assets held by the banking system as a whole. The net foreign asset position of commercial banks was positive to the tune of USD 7 bn in February 2020, whilst the CBE's foreign currency holdings currently stand at USD 47 bn (end-March 2020) if we add Tier 2 reserves (intended to cover part of portfolio flows) to official reserves.

However, although the external position appears solid for the short term, the worsening of the current account deficit and the likely reduction in portfolio inflows could bring to an end the pound's appreciation. Yet a number of factors are likely to limit any depreciation: a local debt market that remains attractive to international investors; foreign investment in the energy sector, although it could suffer from the depressed state of the oil market; and the renewed support of the Gulf monarchies should it be needed.

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