EGYPT

RISING PRESSURE ON PUBLIC FINANCES

Against a backdrop of rising regional geopolitical pressures, the economic crisis is deepening further in Egypt and now poses a threat to public finances. With no agreement reached with the IMF, the balance of payments crisis is continuing to unfold, and the adjustments needed are being postponed. As a result of the exchange rate depreciating and interest rates rocketing, this crisis has pushed the interest burden on government debt to a level that could quickly become unsustainable. As a matter of fact, it could hit 70% of government revenue this year and remain very high next year. While reaching an agreement with the IMF should provide a solution for the balance of payments crisis, at least in the short term, the government restructuring domestic debt is becoming an increasingly likely scenario.

SLOWING ACTIVITY AND MODERATING INFLATION

Economic activity has slowed sharply since 2022. Real GDP rose 3.8% during the 2023 fiscal year (FY) (compared to 6.6% in 2022), and only increased by 2.7% y/y in Q1 FY2024, continuing a downturn that began in Q1 FY2023. The main factors driving this slowdown are the balance of payments crisis and its ramifications on foreign currency availability and cost, as well as inflation.

The resurging geopolitical risk in the region should reinforce this negative trend in the short term. The recent threats to safe maritime transportation in the Red Sea have reduced traffic on the Suez Canal (around 2% of GDP) by more than 40% since the start of this year. In addition, this deteriorating political environment in the region could negatively impact tourist numbers. In the energy sector, gas production was down for a second year in 2023 (-11%) and this fall in production is expected to continue in 2024.

More broadly, high inflation and interest rates, as well as the short-term uncertainties around the exchange rate, will continue to constrain household consumption and corporate investment. In total, we are anticipating 3% growth in real GDP in FY2024. A potential rebound next year still depends above all on the geopolitical risk in the region, and particularly on the beginning of the stabilisation of the macroeconomic situation under the IMF's supervision. At this stage, the visibility on each of these two factors is very limited.

The fall in inflation (in year-on-year terms), which began last September, is not expected to continue this year. In December 2023, prices were up 34% in year-on-year terms, down from the high of 38% in September. However, a number of price hikes (electricity, urban transport and internet) are coming into force at the start of this year and will fuel service price rises. In addition, an agreement with the IMF will very likely result in a significant downward adjustment of the exchange rate, and therefore in additional inflationary pressures. On average, inflation is expected to hit 32% in FY2024 before falling to around 20% in FY2025.

PERSISTING PRESSURES ON THE POUND

According to the most recent figures available, the current account deficit continued to decrease in Q1 FY2024. Over a rolling year, this deficit is equivalent to around 1.1% of GDP. Positive developments concern exports of non-hydrocarbon goods, high tourism revenues (in 2023, tourist numbers hit an all-time high of 14.9 million visitors) and revenues from the Suez Canal. By contrast, the fall in private transfers (linked to the widening gap between the official exchange rate and the parallel exchange rate) and the decline in hydrocarbon exports hit foreign exchange revenue hard. In addition, it should be noted that the improvement in the current account is strongly linked to the decline in goods imports due to the constraints on access to foreign currency.

FORECASTS

	2021	2022	2023e	2024e	2025e
Real GDP growth, %	3.3	6.6	3.8	3.0	4.0
Inflation, CPI, year average, %	4.5	8.5	24.0	32.0	20.0
Central gov. balance / GDP (%)	-7.0	-6.5	-7.3	-10.1	-8.6
Central gov. debt / GDP (%)	91	89	93	85	83
Current account balance / GDP (%)	-4.4	-3.5	-1.2	-2.4	-2.7
External debt / GDP (%)	35	33	41	49	48
Forex reserves (USD bn)	41	33	35	43	46
Forex reserves, in months of imports	6.0	3.9	4.9	5.5	5.5

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: ECONOMIC GROWTH AND INFLATION

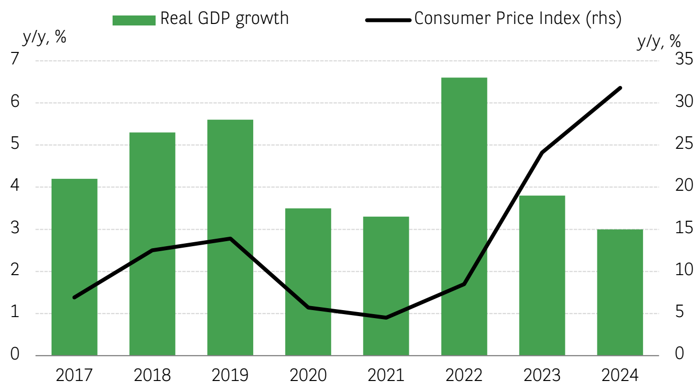

CHART 1

SOURCE: CENTRAL BANK OF EGYPT, BNP PARIBAS

In the short term, geopolitical factors will hurt tourism and revenue from the Suez Canal, which account for 14% and 9% of foreign exchange revenue, respectively. In addition, the persisting wide gap between the official and parallel exchange rates will continue to adversely affect remittances, which, in a normal year, account for more than a third of foreign exchange revenue. Finally, hydrocarbon export revenues are not expected to improve.

This is because, on the one hand, Egypt is increasingly struggling to generate an exportable gas surplus as a result of sustained consumption and lower production. On the other hand, according to our central scenario, oil and LNG prices in Europe should not rise significantly during the first half of 2024.

For several months, the issue of covering the external financing need (current deficit plus amortisation of foreign currency debt) has been relying on the resumption of the IMF financial support (and the bilateral and multilateral financing that rely on it), which was suspended at the start of 2023 and is subject to the implementation of specific economic reforms. Throughout 2024, Egypt faces a huge debt wall in foreign currency. This is because, according to the Central Bank of Egypt, the amortisation of external debt (mainly due from public creditors, and excluding deposits from the Gulf states in the Central Bank of Egypt) amounts to USD 10.1 billion in H1 2024 and USD 12.8 billion in H2 2024. The total external debt service (amortisation and interest) amounts to around USD 31 billion for 2024 as a whole.

According to our estimates, the combination of international support (the amount of support from the IMF will very likely be higher than the USD 3 billion originally planned), FDI flows, including revenue from privatisations, and an additional increase in the net external liabilities of commercial banks, should help Egypt to cover its foreign currency financing need and fuel an increase in the Central Bank of Egypt's foreign exchange reserves. In FY2025, whether the external financing need can be covered will depend on Egypt's capacity to tap the international bond market and on the return of portfolio investments. Portfolio investments are relying on the restoration of foreign currency liquidity and on the effectiveness of the policy to curb inflation. However, the recent exclusion of Egypt from an international benchmark bond index will negatively impact foreign investment inflows into the local debt market. In the medium term, a persistent sizeable current account deficit and dependence on volatile sources of financing will keep the pressure on the pound and foreign currency liquidity.

AN INCREASINGLY UNSUSTAINABLE DEBT SERVICE

While we believe that the foreign currency liquidity crisis can be managed in the short term, the public finance situation is seemingly becoming increasingly unsustainable, due to the alarming levels of some indicators. Despite the persistent high budget deficits, up until now, the government's financing needs have been covered thanks to the high level of local bank liquidity (around 80% of the government's outstanding debt is in local currency) and greater access to external financing sources. The lingering balance of payments crisis has led to a sharp depreciation of the pound (by around 50% against the USD in 2023) and a huge rise in central bank interest rates (+1,200 bp since March 2022) in response to the surge in inflation. Public finances are very sensitive to these two variables, due to, in particular, the steady rise in foreign currency public debt, which increased from 7.4% of GDP in FY2016 to 21% in FY2023, and the short maturities of domestic debt. During the first five months of FY2024, 85% of local debt issues had a maturity of less than one year. And for the time being, as long as inflationary pressures remain high and foreign currency liquidity remains tight, there is very little scope for exploring extending the maturity on local government debt issues.

EGYPT: FISCAL BALANCE AND INTEREST PAYMENT

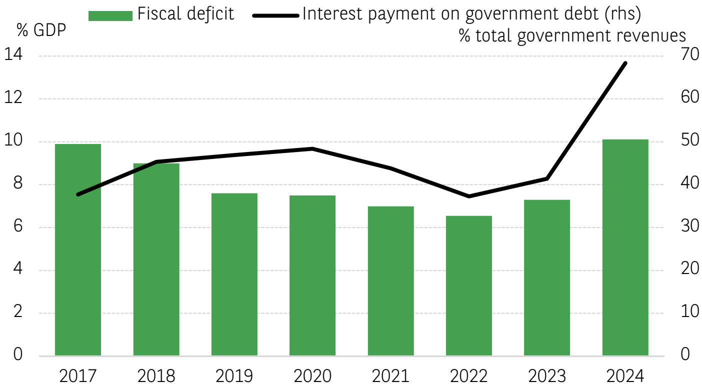

CHART 2

SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

With this in mind, the ratio of government debt interest payments to total government revenue is expected to reach an all-time high in FY2024. This ratio, which measures the affordability of debt for the government, hit 43% in FY2023, which was already one of the highest among emerging economies. According to the budgetary figures for the first half of FY2024, debt interest payments hit 6.2% of GDP. Over the entire year, they are expected to increase to around 12-15% of GDP. According to our estimates, the debt interest payments-to-revenue ratio could rise to 70% in FY2024 and is expected to remain very high in FY2025. This is because the macroeconomic adjustment that will be attached to the IMF support is expected to result in further exchange rate depreciation and domestic interest rates increase, therefore causing a further rise in debt service. The monetary policy committee rose its benchmark interest rate by 200 bps on 1st February. The difference between the official exchange rate and the exchange rate on derivative market (NDF 12m) is 50% against the USD.

The debt burden is clearly unsustainable and is drastically reducing the budgetary leeway.

Although fiscal performance in the first half of the year was relatively good (tax revenues were up 43% y/y), this is partly due to an expansion of the tax base, but certainly also to the automatic effect of rising inflation on budgetary revenues. The prospects of slowing growth and a struggle to find further budget revenue streams, set against a backdrop of falling household disposable income, may further reduce the government's budgetary leeway. On the expenditure side, there is not much scope for cuts. Social welfare expenditure and wages account for approximately 61% of total primary expenditure.

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