Egypt

Mixed trade performance

Although still showing a significant deficit, the trade balance has improved substantially since 2017. It has benefited from a recovery in hydrocarbon exports, whilst the steep depreciation of the pound has had only limited consequences on trade in non-hydrocarbon goods. A substantial share of imports is incompressible, whilst structural constraints weigh on the country's export potential. Moreover, the moderate appreciation of the pound over the past year has not helped price competitiveness. Measures have been introduced to support exports, but we remain cautious on the prospects for a significant improvement in international trade over the medium term.

In 2016, the Egyptian economy found itself at a serious dead end. On top of a significant deterioration in the public finances, the widening of the current account deficit and the absence of capital inflows suffocated the economy due to a lack of available foreign currency. The accelerated expansion of gas production and renewed investor confidence as a result of the IMF-backed reform programme have produced a spectacular improvement in external balances. The current account deficit has shrunk considerably and foreign currency liquidity has returned to an acceptable level.

However, the international trade performances in 2017/18 and 2018/19 were disappointing. Despite the fact that the pound depreciated by half following the liberalisation of the foreign exchange market in November 2016, the trade balance remains in sizeable deficit: USD 37.3 bn in 2017/18 and USD 38 bn in 2018/19.

A lacklustre improvement

There has been a marked improvement in the international balances in the hydrocarbons sector over the past two years. From a deficit of USD 5.4 bn in 2016/17, provisional figures for 2018/19 show a symbolic surplus of USD 8 million. The balance on the trade in gas became positive in October 2018. Exports of LNG have recovered thanks to the Zohr gas field coming into production and, according to JODI[1], reached a monthly average of 500 million cubic metres in H1 2019, after a complete stop in 2014 and 2015. Meanwhile, imports of LNG have stopped since November 2018, having reached an average of 740 million cubic metres in 2017. Although the country remains a substantial net importer of oil products, the imbalance has narrowed over the past two years. Exports have tripled since 2016, to an average of 0.127 million barrels per day (mb per day) in the first half of 2019, whilst imports fell by 9% on average over the same period (0.293 mb per day in H1 2019). It seems that the increase in oil prices over the course of the 2018/19 fiscal year (8% for Brent crude) has had positive consequences given the increase in the volume of oil exports.

For the time being, the balance sheet is much less flattering when it comes to the non-hydrocarbon sector. Here the deficit reached the record level of USD 38 bn in 2018/19, equivalent to 12.7% of GDP. Exports were practically stable in value terms in 2018/19, having risen 10% over the previous two years. Taking account of the sharp increase in hydrocarbon exports in volume (10% for oil and oil derivatives and 240% for LNG) and the growth of 11% in total exports in volume as calculated by the IMF[2], we would estimate that the volume of non-oil exports declined in 2018/19. Meanwhile, imports have continued to grow steadily since 2017. These are largely incompressible, both for capital goods and consumer goods. They increased by 9% in value in 2017/18 and 2018/19.

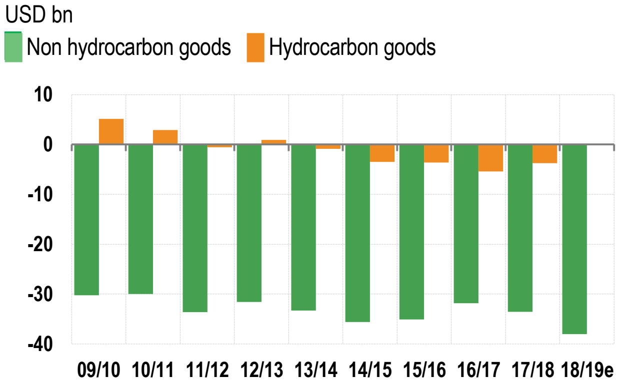
1-Forecasts

	2017	2018	2019e	2020e
Real GDP growth (%)	4.2	5.3	5.6	5.8
Inflation (CPI, year average, %)	23.3	21.5	13.4	10.4
Central. Gov. balance / GDP (%)	-17	-9.5	-8.6	-6.7
Central. Gov. debt / GDP (%)	103	93	89	88
Current account balance / GDP (%)	-6.1	-2.4	-2.7	-3.0
External debt / GDP (%)	41	37	33	31
Forex reserves (USD bn)	31	44	44	43
Forex reserves, in months of imports	5.5	7.2	6.8	6.2
Exchange rate USDEGP (year end)	18.1	17.9	16.7	17.4

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

e: BNP Paribas Group Economic Research estimates and forecasts

2- Trade balance



Source: CBE, BNP Paribas

Multiple constraints

The most obvious reason for the disappointing performance of non-oil exports relates to the increase in production costs following the floating of the pound. The sharp rise in import costs and widespread

[1] Joint Oil Data Initiative

[2] World Economic Outlook, October 2019

wage increases, against a background of high inflation, prevented exporters from benefiting from gains in price competitiveness.

More generally, even though we know that the positive effects on exports of significant currency depreciation are limited in time, an international comparison carried out by the World Bank[3] underlined the limited elasticity of Egyptian exports to a sharp depreciation in the exchange rate. According to this study, the positioning of exported goods, in terms of characteristics and geographical destination, does not help their integration into world trade. Around 25% of goods exports go to Arab countries whose international trade is amongst the least dynamic. On average, the growth in imports to Arab countries was 1.6% between 2014 and 2018, compared to a global average of 3.3%. Political upheaval in North Africa, notably in Libya and the weak economic trends in the Gulf states, have affected Egyptian exporters. Conversely, the fastest growing region, Asia (4.2% growth), takes only 10% of Egypt's exports.

Moreover, the main exports have limited technological content. They are mainly unsophisticated extracted goods (hydrocarbons, minerals, agricultural products) or manufactured goods with little technological content (textiles, food). Egypt's comparative advantages[4] are focused on poorly performing markets (cotton, fertilisers, tobacco and oil seeds). Only its exports of electrical equipment, essential oils and fruit and vegetables are in markets seeing growth on the global level. These represent only just over 15% of Egyptian exports.

According to the World Bank, non-tariff barriers, such as administrative constraints, technical and health requirements and the lack of infrastructure, affect the whole of Egypt's international trade and are therefore also a constraint on the performance of exports.

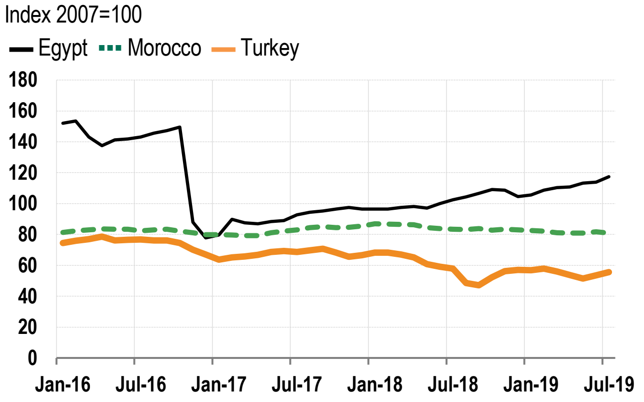
The government has recently relaunched its export support policy, adopting a number of measures implemented by the export development fund: direct financial support, tax benefits and the provision of services such as training and communication. In total, this support package could be worth as much as 10% of total exports, and would be linked to certain criteria in order to favour SMEs or exports to the rest of Africa.

Mixed prospects

The balance of trade in hydrocarbons will continue to improve in the short term, with further growth in LNG exports. However, given the continued rise in domestic energy demand, only the bringing on stream of a substantial new gas field will prevent the energy balance moving back into deficit within two or three years.

Meanwhile prospects remain mixed for the trade balance in the non-hydrocarbons sector of the economy and we do not foresee any significant improvement. In the short term, the stronger pound coupled with the downward trend in inflation is likely to make Egyptian exports less competitive.

3- Real exchange rate against USD



Source: BNP Paribas

The pound's real exchange rate has risen by 47% since the end of 2016, whilst the Turkish lira has fallen by 12% and the Moroccan dirham has remained more or less stable. Given the slightly less favourable trend in external balances over the coming year and despite the central bank's willingness to control inflation, the pound should slightly depreciate over the short term. Against this background, prospects for global trade are negative in the short term.

Foreign direct investment (FDI) could provide the means to tackle the structural constraints holding back Egyptian exports, most notably by allowing the country to move up international value chains. Indeed, a few multinationals have recently set up in the country. Even so, for the time being inflows of non-hydrocarbon FDI have been well below the levels hoped for.

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3 Egypt Economic Monitor, July 2019
4 Defined as the case where exports of a product as a share of a country's total exports is greater than that product's share of global trade.