PERSISTENT PRESSURE ON THE BALANCE OF PAYMENTS

Egyptian external accounts have been under pressure since the beginning of the year and the outlook is uncertain. Although the current account was able to withstand external shocks thanks to the rise in gas revenues, only the massive support of the Gulf countries enabled Egypt to cope with portfolio investment outflows and to avoid a foreign exchange crisis. The dynamic remains negative in the short term, given the drop in net foreign currency assets in the banking system and persistent exchange rate pressures, despite depreciation of more than 20% since the beginning of the year. In the short term, support from the IMF and the Gulf countries, as well as a favourable gas outlook, are positive factors, but, in the medium term, external financing needs are high and are rising, and dependence on volatile capital flows remains significant.

Despite improving current account balance, the Egyptian economy faces the accelerated deterioration of its foreign currency liquidity due to structural weaknesses in its balance of payments and to external shocks. Foreign currency liquidity across the banking system has contracted since the beginning of the year and exchange rate pressures are significant.

LOWER CURRENT ACCOUNT DEFICIT DESPITE EXTERNAL SHOCKS

During the fiscal year (FY) 2022 (June year-end), the current account deficit fell by 10% to 3.7% of GDP, despite the consequences of the war in Ukraine (rising prices of food and tourist flows from Russia and Ukraine drying up over the last quarter). The trade deficit deteriorated only slightly (+USD 1.3 billion to USD 43.5 billion). This performance was mainly due to the large surplus of the hydrocarbon balance (USD 4.4 bn, the highest since 2010) which benefited from the rise in European demand for natural gas and the sharp rise in gas prices on the international markets. Non-hydrocarbon imports grew relatively moderately (+16%), considering the rise in prices and the 15% depreciation of the Egyptian pound in March 2022. The introduction of regulatory constraints on imports has probably hampered their increase.

The doubling of the balance of services surplus (up 120% in tourism revenues and 7.5% in revenues from the Suez Canal) and sustained remittances resulted in a reduction in the current account deficit.

A CURRENCY CRISIS AVOIDED THANKS TO GULF SUPPORT

The Egyptian external financing requirement is declining but remains significant. The sum of the current account deficit and amortisation of external debt amounted to USD 28 bn (6.3% of GDP) in FY2022. Its financing, which relies largely on volatile capital flows, remains the Egyptian economy's Achilles' heel. The war in Ukraine and its consequences for the financial markets triggered a massive capital flight from the Egyptian market (USD 21 bn) and a sharp rise in the sovereign currency risk premium, which has been above 800 bps since April 2022. It temporarily closed the international bond market for the Egyptian Government and it was thanks to the financial support of the Gulf countries that a balance-of-payments crisis was avoided. Government deposits at the Central Bank (around USD 15 bn from Saudi Arabia, the UAE and Kuwait) and purchases of Egyptian assets by Gulf sovereign funds (at least USD 3 bn) have helped limit the deterioration of the balance of payments and the extent of the depreciation of the pound (-22% against the dollar since January 2022).

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	5.6	3.5	3.3	5.4	4.5
Inflation, CPI, year average, %	11.0	10.2	7.2	8.5	14.5
Central. Gov. balance / GDP, %	-8.0	-8.0	-7.4	-7.0	-7.0
Central. Gov. debt / GDP, %	84	90	91	89	90
Current account balance / GDP, %	-3.6	-3.1	-4.7	-3.7	-3.4
External debt / GDP, %	36	34	35	34	38
Forex reserves (excl. gold), USD bn	42	34	36	33	35
Forex reserves, in months of imports	6.4	5.4	5.4	3.9	3.9

TABLE 1

FISCAL YEARS FROM JULY 1ST OF YEAR N-1 TO JUNE 30TH OF YEAR N
e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

EGYPT: CENTRAL BANK'S FOREIGN EXCHANGE RESERVES

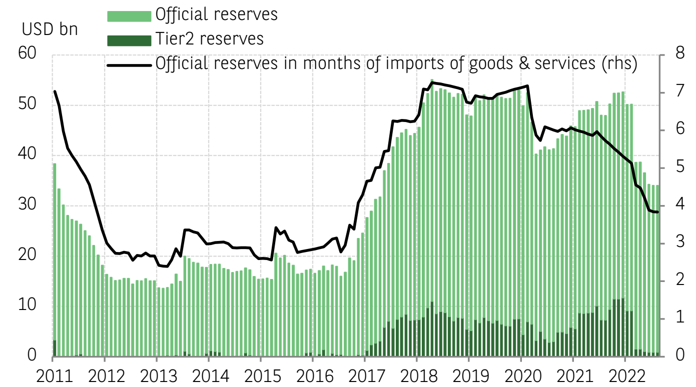

CHART 1

SOURCE: CENTRAL BANK, BNP PARIBAS

Foreign currency liquidity, however, deteriorated sharply between December 2021 and June 2022, despite the massive external support and the currency depreciation. The Central Bank's foreign exchange reserves fell by USD 7.6 bn to USD 33.4 bn (i.e. 3.9 months of imports of goods and services) and the net external liabilities of commercial banks rose by USD 1.5 bn to USD 11.6 bn. At the same time, the Central Bank's Tier 2 foreign exchange reserves (for managing volatile portfolio flows) fell by USD 11.8 bn to USD 0.9 bn. The crisis was avoided at the expense of a sharp increase in the vulnerability of external accounts:

the foreign currency position of the whole banking system deteriorated sharply, the future financing requirement is substantial and investors' aversion to Egyptian risk remains strong.

PERSISTENT TENSIONS IN THE SHORT TERM

Since the beginning of FY2023, the Central Bank's foreign exchange reserves have remained stable, but the recent deterioration in the net external position of commercial banks (net external liabilities increased by USD 2 bn in August) indicates an outflow of portfolio investment. According to the Central Bank, foreign investors held USD 7.5 bn in Government T-bills in July 2022. On the future market, the 12-month EGP/USD exchange rate is currently 24.4, i.e. a difference of around 20% from the current rate. The risk of another significant depreciation of the pound is a constraint on portfolio investment inflows as well as for remittances. Against this backdrop, the outlook is very uncertain and the financial support from the IMF, which is being negotiated, does not guarantee the end of tensions on foreign currency liquidity.

DECREASE IN THE CURRENT ACCOUNT DEFICIT EXPECTED IN 2023

The current account should continue to improve in FY2023. Food commodity prices have been falling since June (wheat prices have dropped by around 8%) while tensions on the energy market should persist and favour Egyptian hydrocarbon exports. Non-hydrocarbon imports should remain limited at least in volume due to constraints on non-priority imports. On the other hand, the continued depreciation of the pound will continue to weigh on the prices of imported goods. Assuming that remittances remain high and tourism revenues do not suffer a geopolitical shock, the current account deficit should shrink slightly but remain above 3% of GDP. In FY2023, the total external financing requirement is expected to amount to around USD 26 bn.

POSITIVE GAS OUTLOOK, AT LEAST IN THE SHORT TERM

This scenario is relatively conservative, and the trade balance could be better than expected thanks to the energy sector. According to the Egyptian oil minister, LNG sales income should go up from USD 6.5 billion in 2022 to USD 8.5-10 billion in 2023. Given the pressure on foreign currency liquidity and the sharp rise in European demand, the authorities are maximising LNG exports. Nevertheless, it should be highlighted that the increase in exports comes at the expense of restrictions on domestic gas consumption (summer temperature ceilings in public buildings and reduced public lighting) and thanks to the switch from gas to oil as the energy source for some power stations. In H1 2022, oil consumption increased fivefold, year on year, and returned to a level close to that seen in 2018 before the massive increase in gas' contribution to the energy mix. According to MEES, oil's share of the energy mix went from 1.1% in May 2021 to 11.5% in May 2022. In the short term, the coming on stream of an offshore gas pipeline in Q2 2023 should make it possible to increase Israeli exports to Egypt. Indeed, it is partly thanks to imports from Israel (on average 650 million cubic feet per day compared to a total Egyptian production of 6.6 billion cubic feet per day) that Egypt has an export surplus. In the medium term, maintaining Israeli export capacities depends in part on the Karish gas field entering into operation, which is currently subject to geopolitical uncertainties. In addition, both Egypt and Israel experience peaks in energy consumption in the summer which significantly limit Egyptian

EGYPT: USD/EGP EXCHANGE RATE

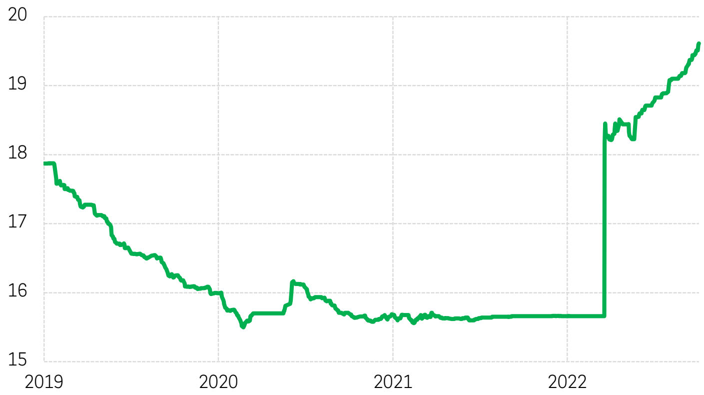

CHART 2 SOURCE: CENTRAL BANK, BNP PARIBAS

export capacities. Finally, in the longer term, export capacities will depend on discovering new gas fields in Egypt.

THE EXTERNAL FINANCING REQUIREMENT IS EXPECTED TO INCREASE

Whatever the amount of the IMF's financing (a total of USD 3-5 billion is likely with the release of USD 1 billion in the first year), the external financing gap will require significant net portfolio investment and direct investment inflows (at least USD 15-20 bn). Some of these flows will continue to come from Gulf countries which should continue to take stakes in local companies and participate in the opening-up of the capital of public-sector companies (although the timing is uncertain for the time being). More generally, the international environment is different from that of 2016, when the IMF's first financing plan triggered a significant flow of capital. The rise in interest rates in developed countries, global inflationary pressures and the persistence of geopolitical tensions will continue to have a negative impact on the attractiveness of emerging debt in local currency.

In Egypt, the external financing requirement will increase in the medium term, given the amount of debt amortisation expected in FY2024 and FY2025 (USD 13.3 bn and USD 19 bn, respectively) and a current account deficit which should amount to around USD 15 bn per year.

Pascal DEVAUX
pascal.devaux@bnpparibas.com