Egypt

The economy looks to have turned a corner in recent months following the resumption of capital inflows, the devaluation of the currency and the introduction of measures linked to the IMF program. Inflation also looks to be trending down. GDP growth should accelerate to 3.5% in FY24/25 from an expected 2.5% in the current year, while in the external sector, we see a manageable net financing gap of close to $10 billion in the next 3 years, benefitting from the Ras El Hekma and other financing deals. Risks to the outlook include regional geopolitical conflict and 'higher for longer' interest rates on the downside, while greater than expected reform benefits and lower than expected inflation and interest rates are upside risks.

Positive early signs from reform initiatives

The Egyptian government has embarked on the long-awaited economic reform process, having secured a wave of new investment and loan commitments from the UAE government, the IMF and other international bodies that provide a much stronger financial platform. As part of the upgraded deal with the IMF, the authorities shifted in March to a more free-floating regime for the pound, which has subsequently dropped by 34%. Stricter fiscal consolidation is on the agenda, with energy subsidies cut and non-tax revenues increasing on the back of a privatization program that appears to be accelerating. Financial transparency has also improved, with the first ever General Government budget produced and more frequent financial reporting on the performance of state-owned enterprises. While it is still too early to judge the success of these initiatives, there are already some promising signs, and the outlook for Egypt's economy is much improved versus six months ago.

Growth to bottom out and bounce back in FY24/25

Economic growth slowed to 2.5% in 1H FY23/24 from 4.2% in 1H FY22/23, a rate that we see maintained for the full year. This is well down on FY22/23's reading of 3.8% and comes amid tighter monetary policy (an 8% hike in interest rates in March), gradually unwinding import restrictions, high – though moderating – inflation (down to 33% in April) and the weaker pound. Recent policy reforms will help growth bounce back in FY24/25 to the 3.5-4.0% range as inflation cools further, interest rates begin easing (potentially in Q3 2024) and foreign currency liquidity becomes more readily available, helping sectors such as the energy, manufacturing, wholesale & retail trade and the consumer sector, recover. Moreover, the government has said that it is committed to reducing its footprint in key sectors of the economy to enable the private sector to play a greater role in the market.

External financing gap almost covered but FX float is key

In addition to the $35 billion Ras El Hekma investment deal the authorities signed with the UAE in February, Egypt received around $18 billion in LCY debt investments and concluded financing agreements worth $20 billion over the next three years. Also adding to the FCY pile since March is a recovery in remittances, tourism and exports following the EGP float. Given these developments, Egypt's external risk metrics are at their most favorable in some time: 5-yr CDS rates have compressed to 613 bps from 1835 bps a year ago and 5-yr Eurobond yields are in single digits for the first time in several months – and should improve further over the forecast period. We estimate that the net cumulative external financing gap will fall to $10 billion by the end of FY25/26 (from a high of $40bn last year), a figure that could easily be covered through annual Eurobond issuance of $3-4 billion. Reducing the financing gap will, of course, be contingent on maintaining a flexible exchange rate that reflects the external dynamics of the economy.

Investment policies key to finance consumption

Given the importance of imports in Egypt's current account and of consumption for the economy (accounting for more than 90% of GDP), which will take time to shift under a new economic model, it is key that investment inflows (and technological know-how) are maintained to help finance a current account deficit that we expect at around 2-4% of GDP in the medium term. This will require a business environment more conducive to stimulating foreign investment (both direct and portfolio) across a range of sectors. A favorable regulatory environment built on a solid institutional framework should be a central plank of government FDI and business policy, as well as sound macroeconomic management. A high level of vocational education attainment will also be critical in providing the skilled labor force to realize business ends and compete with other emerging markets.

Regional geopolitics and reform benefits are key risks

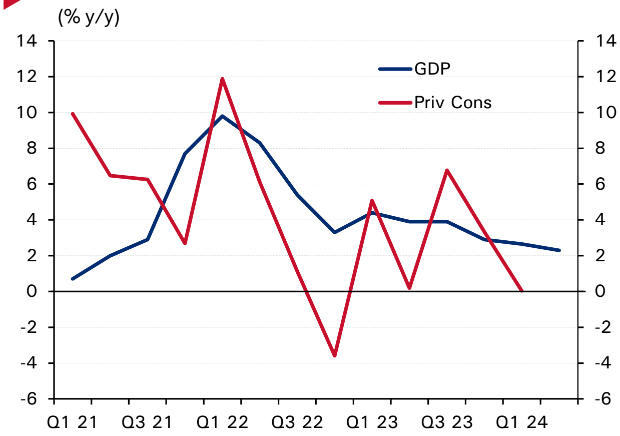
Egypt has been sensitive to spillover from a succession of geopolitical confrontations in recent years, from the Russia-Ukraine crisis (impact on tourism) to the conflict in Gaza (refugees) and disruptions to Red Sea shipping (Suez Canal receipts). A global monetary environment of 'higher for longer' interest rates would also adversely affect Egypt, raising external borrowing costs. On the upside, the government's recent commitment to reform and the tenets of the IMF program looks serious and is unlikely to waver over the forecast period. Reforms could yield economic benefits more quickly or more strongly than we expect, boosting economic growth. There is also potential for inflation to fall more rapidly than forecast, allowing interest rates to be cut and growth to accelerate more sharply.

Table 1: Key economic indicators

		FY22/23	FY23/24	FY24/25
Nominal GDP	EGP bn	10,377	13,810	16,656
Real GDP	% y/y	3.8	2.5	3.5
Fiscal balance (FY)	% of GDP	-6.0	-4.0*	-8.5
Inflation	% y/y	24.1	36.0	25.0
Current Account	% of GDP	-1.6	-6.26	-2.9

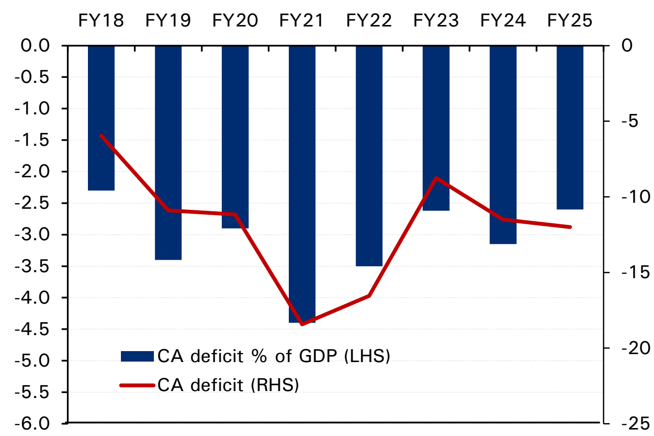
Source: Official sources, NBK forecasts. *Fiscal deficit shrinks from 8% as per the new agreement whereby the MoF will receive half of the Ras El Hekma deal in local currency.

Chart 1: Real GDP



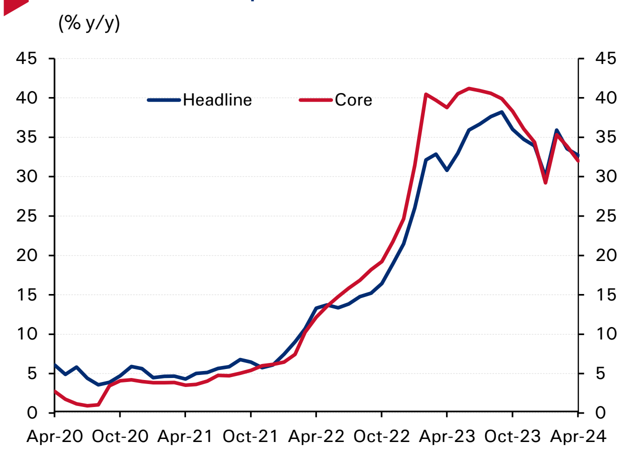
Source: Central Bank of Egypt (CBE), Ministry of Planning, NBK forecasts

Chart 2: Current account balance



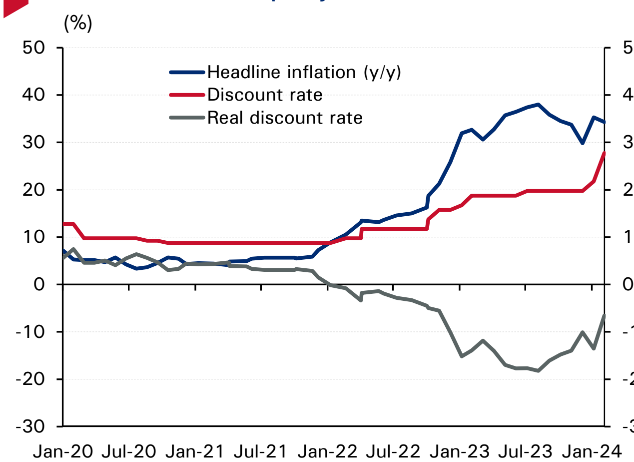
Source: CBE, NBK Forecasts

Chart 3: Consumer price inflation



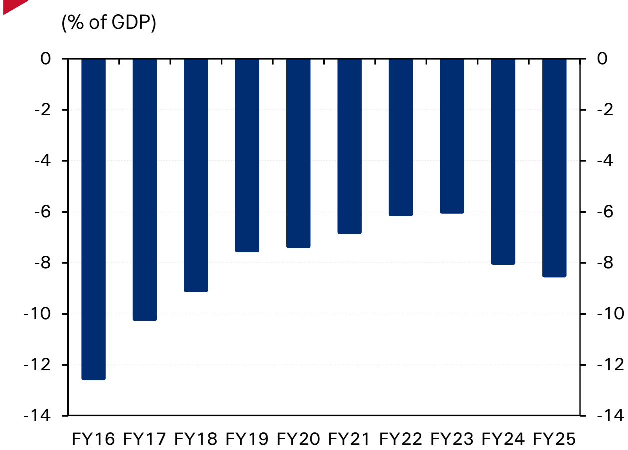
Source: CBE

Chart 4: Inflation and policy interest rates



Source: CBE, NBK Forecasts

Chart 5: Fiscal deficit



Source: CBE, NBK Forecasts