EGYPT

Egypt showed resilience during the Covid-19 crisis, supported by early lockdown policies and public health response, as well as the implementation of important fiscal and monetary measures. The economic recovery remains broadly on track. Fiscal and external deficits continue to improve, while inflation remains below target. Risks include the strength of the global recovery, progress of the vaccination campaign and the ability to forge ahead with more reforms especially on the structural front to bolster private sector activity.

Economic recovery on the horizon

The gradual reopening of businesses and activities in 2H20, as lockdown restrictions eased, saw economic growth accelerate to 2% y/y in Q2 of FY20/21 (Oct – Dec) from 0.7% a quarter earlier, pushing the average growth rate to about 1.4% in the first half of the current fiscal year. Still, despite this promising trend, uncertainties over global growth and progress of the domestic vaccination campaign could weigh yet on the recovery, especially the important tourism sector. We forecast growth of 2.5% in FY20/21 after 3.6% a year earlier. We expect growth to recover to around 5% over the medium term, benefitting from the authorities' commitment to reforms and available IMF support, if needed.

Fiscal position remains on an improving trend

The government efforts to consolidate the budgetary position continued apace during a difficult year. The deficit reached about 4.4% of GDP during the first seven months of FY20/21 (Jul – Jan), against 4.6% during the same period a year ago, achieving a primary surplus of 0.5% of GDP. For the fiscal year as a whole, the deficit is expected to shrink to 7% of GDP from 7.9% in FY19/20 and to stabilize around 6.5% over the medium term, supported by increasing revenues through the modernization of the tax systems, and rationalizing spending. However, the recently announced increase in public salaries and the hike in the minimum wage by 20%, while warranted, may add $2.4 billion to the year's budget and put the fiscal position under pressure.

The projected deficits are expected to be financed by borrowing. Given the still prevailing low global interest rates, we forecast more external over domestic borrowing in the coming year to reduce interest costs. The revised budget of FY20/21 projects a slight increase in the public debt-to-GDP ratio to 82.7% (up from 82.5% in FY19/20), but should decline to 77.5% in FY21/22. These appear ambitious targets, especially if the pandemic lingers for much longer.

External sector is still under pandemic pressure

With key sectors affected by the pandemic, the current account deficit widened to $2.8 billion (2.7% of GDP) in the first quarter of FY20/21 (Jul-Sep) from $1.4 billion (1.5% of GDP) a year earlier. The deficit could reach 4.0% of GDP in FY20/21 overall, before improving to around 2.5% in coming years on possible recovery of tourism, trade and gas prices.

Foreign reserves increased from its lowest level of $36 billion in May to $40.2 billion in February (about eight months of imports), thanks to increasing capital inflows. Also, Egypt should receive soon the third tranche of the loan that is worth $1.6 billion, as part of the $5.2 billion IMF loan. Thus, we believe that foreign reserves will recover to their pre-pandemic level of $45.5 billion in the next few years, given efforts to continue with reforms and the still relatively attractive real interest rates.

Lower inflation supports accommodative monetary policy

Despite the recent rise in commodity and energy prices and the potential pick-up in demand as economic activity recovers, we expect inflation to remain under control. Urban inflation averaged 5.1% in 2020, the lowest since 2005, and continued its downward trend to 4.5% in February 2021, supported by government efforts to avoid food shortages. Continued reforms and improved economic fundamentals should help reduce the pass-through of a possible acceleration in foreign inflation to domestic prices through exchange rate relative stability.

Although inflation remains below target (7% ±2%), the Central Bank of Egypt (CBE) kept its policy rates unchanged during its first two meetings of 2021. This was likely motivated by the need to maintain relatively high interest rates to support capital inflows and avoid any sudden reversals. However, the CBE still has some room to continue cautiously loosening monetary policy to support economic recovery and minimize debt servicing costs.

Healthy banking sector as credit growth accelerates

The banking sector has remained resilient with robust credit growth, helped by a gradual reduction in interest rates and authorities' efforts to encourage lending to SMEs. The CBE also launched an EGP 100 billion mortgage finance initiative, targeting low and middle-income homebuyers, with repayment periods up to 30 years. Domestic credit growth rose sharply to 23% in December from 7.6% a year ago. We forecast credit to remain high in the next couple of years but to decelerate afterward when the effect of credit-boosting measures fades.

Challenges remain to sustain strong growth

Egypt has made significant efforts to achieve macroeconomic stability, which resulted in some resilience to the pandemic's fallout. However, several challenges remain. The authorities will need to focus on improving the business environment and making the private sector the primary driver of economic growth. Achieving inclusive economic growth will help in poverty reduction and in creating the jobs needed to accommodate the large number of Egyptians entering the labor force.

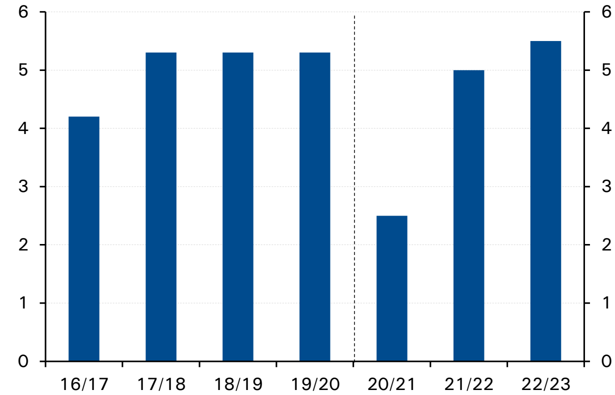
Table 1: Key economic indicators

		FY19/20	FY20/21	FY21/22	FY22/23
Nominal GDP	$ bn	331	354	386	428
Real GDP	% y/y	3.6	2.5	5.0	5.5
Fiscal balance	% of GDP	-7.9	-7.0	-6.5	-6.5
Public debt	% of GDP	82.5	83.0	80.0	75.0
Inflation	% y/y	5.7	4.2	4.3	5.2
Current account	% of GDP	-4.5	-4.0	-2.5	-2.0

Source: Official sources, NBK estimates

Chart 1: Real GDP

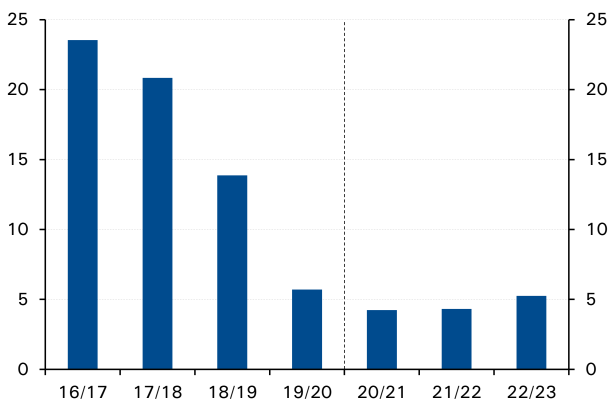
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

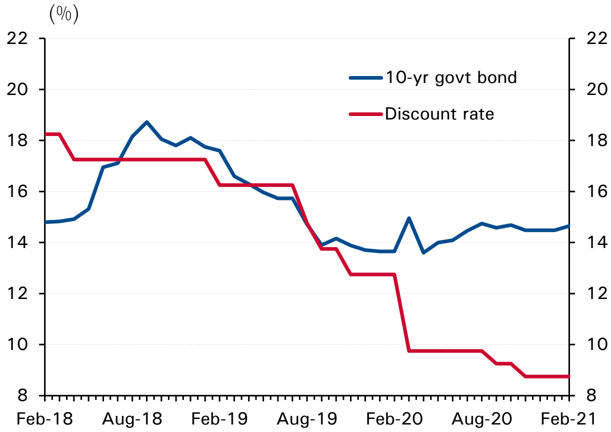
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

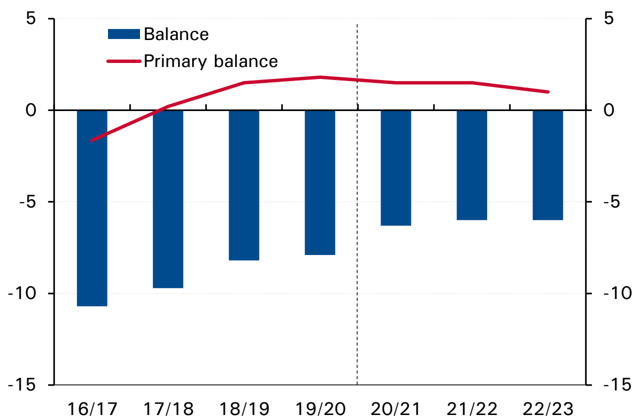
(%)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

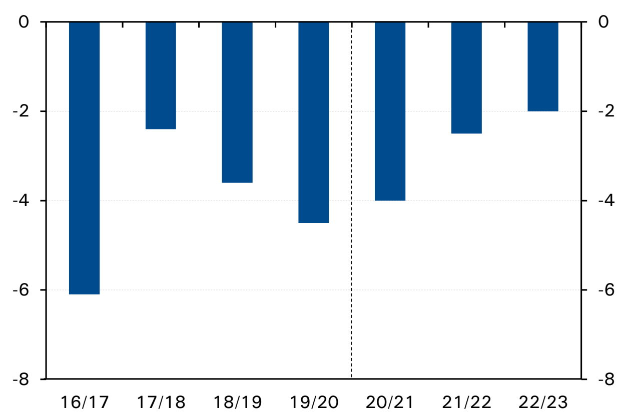
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates