EGYPT

A combination of external pressures, domestic imbalances and a sharply lower currency have hit growth in 2022. But with the announcement of a new IMF deal in October, the path to recovery is now more visible. Monetary and fiscal reform measures tied to the deal will weigh on economic performance in 1H 23, but this should give way to a stronger H2 on the back of lower inflation and availability of foreign currency. A key upside risk is a better-than-expected global economic environment allowing for a recovery in foreign investment and easier access to eurobonds. Downside risks include a delay in implementing the IMF program, a jump in international commodity prices that keeps inflation high and slow progress on structural reforms, even with the IMF deal.

Growth to pick up in 2023 as reforms proceed

Economic activity has been hit by a challenging external backdrop and as the sharp (and ongoing) drop in the currency – driven also by the economy's structural vulnerabilities – that began in March works its way through the system, pushing prices and interest rates up and weakening household and business spending. GDP growth had slipped to 3.2% y/y in 2Q22 (well below pre-pandemic levels), with recent PMI survey readings consistent with 3-4% growth in 2H 22. This is still well clear of recession, but insufficient to absorb high population growth and make serious inroads into poverty levels. We see a gradual improvement in 2023, with the IMF financing deal announced in October helping to plug the external funding gap and re-catalyze the economic reform process – necessary both to improve economic growth and rebuild investor confidence. These reforms took a back seat to macroeconomic stabilization efforts during the pandemic. Alongside a more flexible currency, reforms should include steps to improve the business climate, increase the private sector's share of GDP and strengthen the public finances. Many of these objectives feature in the government's National Structural Reform Programme that aims to boost GDP growth to 6-7% by 2023/24.

Fiscal deficit to widen on lower growth, higher interest bill

Despite the tough economic climate, the government has managed to maintain overall control of the fiscal position, benefitting from reforms started in earlier years including subsidy cuts, a broadening of the tax base and improved debt management. In the first eleven months of FY21/22 (i.e. July-May) for example, revenue growth at 12% outpaced spending growth of 11% on strong tax revenues (+16%), partly driven by a Covid-related rebound in taxes on spending. Our base case is that the deficit narrowed slightly to 7.2% of GDP in FY21/22 and remains on a downward path in FY22/23. This also reflects expected conditionality from the IMF deal, which will help maintain reform momentum. However, this assumes that the government can contain growth in debt interest payments, which equate to around 8% of GDP and benefitted during Covid from interest rate cuts which are now going into reverse. According to the Minister of Finance, each 100 bps rate hike adds EGP30 billion to the fiscal deficit, equivalent to 0.3-0.4% of GDP.

Public debt stood at about 87% of GDP in June 2022, with external debt accounting for about one-fifth of this. The near-35% currency drop (versus the US dollar) this year has added around 7-8% of GDP to debt in local currency terms. Still, given high nominal GDP growth and a narrowing fiscal deficit, the debt ratio is projected to come down over time: the government is targeting 80% of GDP by 2026. The government also plans $40bn or 7% of FY22/23 GDP in privatizations over the next four years which could help cut the debt burden, although previous initiatives have been delayed due to execution challenges and unfavorable market conditions.

IMF $3-4bn loan to help plug external financing gap

Egypt reached a deal over a $3bn loan with the IMF in the form of a 3.8 years Extended Fund Facility (potentially rising to $4bn under an additional program being discussed). The loan will unlock further international and regional financial support which would be crucial to fill a large financing gap of $27bn over the coming 12 months. We expect the current account deficit to narrow in FY22/23 to 3.5% of GDP versus 3.7% in FY21/22 on possible import compression and a strong recovery in tourism. However, global monetary tightening is limiting access to international markets, thus larger GCC investments are crucial to cover the majority of the external gap.

Following the deal announcement, the pound fell by 18% to EGP24/$1, bringing its total year-to-date drop to 35%. While the pound could weaken over time if inflation is not brought under control (see below), there is also some upside in 2023 from a) a rebound if the pound reaches oversold levels, b) a possible Fed pivot (softening the US dollar), c) a recovery of foreign portfolio investment, and d) a return to the international bond market.

Central bank raised interest rates by 2% amid high inflation

Inflation accelerated to a three year high of 15.1% y/y in September as the pass-through effect of a weaker pound and the global inflationary wave continued to kick in. We see inflation rising further over the coming six months to average 17% for FY22/23 versus 8.5% for FY21/22 mainly on local factors such as the weakening of the pound and fiscal consolidation measures (potentially to include cuts in bread, electricity and petrol subsidies). The central bank raised policy rates by 2% as the IMF deal was announced and further tightening is possible over coming months. However, we expect that a window to cut rates could emerge from mid-2023 as inflation starts to fall.

The major risk surrounding this outlook is a delay in the implementation of the IMF program. Upside risks would include a stronger global economy, benefiting foreign investment and access to international capital markets.

Table 1: Key economic indicators

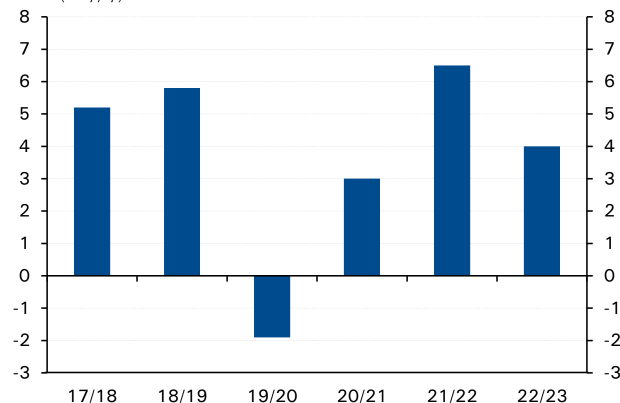
(year averages)

		FY20/21	FY21/22	FY22/23
Nominal GDP	$ bn	403	445	424
Real GDP	% y/y	3.3	6.6	4.0
Fiscal balance	% of GDP	-7.4	-7.2	-6.8
Inflation	% y/y	4.5	8.5	17.0
Current account	% of GDP	-4.6	-3.7	-3.5

Source: Official sources, NBK estimates

Chart 1: Real GDP

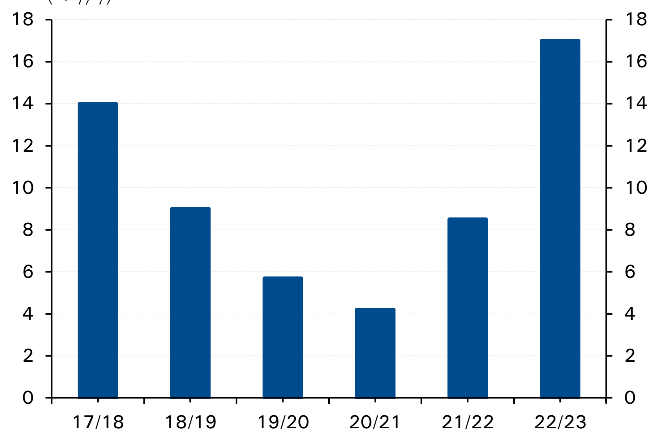
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

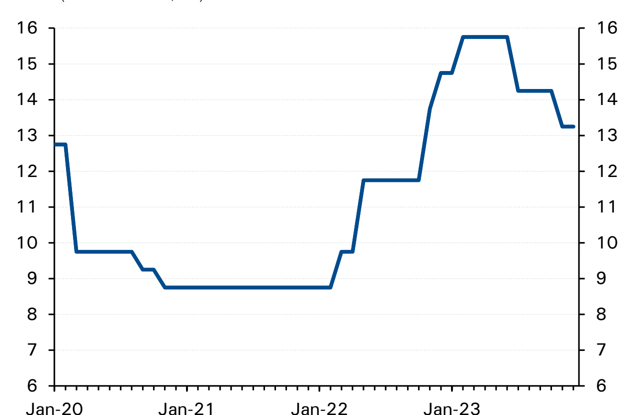
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

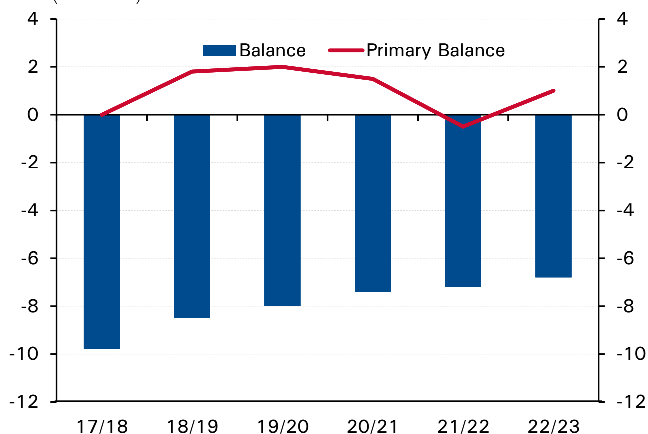
(Discount rate, %)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

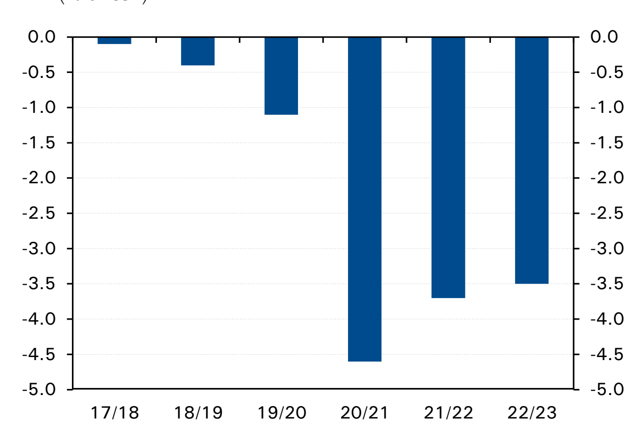
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates