EGYPT

The Ukraine war has hit Egypt hard, triggering a currency devaluation and higher prices, and growth is likely to slow over coming quarters. However, a steep contraction should be avoided, helped by external assistance as well as increased economic resilience thanks to earlier reforms. The fiscal deficit and high public debt levels are concerns, though both should decline over the medium term. Risks to the outlook include a prolonged war in Ukraine that affects inflation and tourism in Egypt, aggressive Fed policy tightening that affects capital flows to emerging markets, and delays in implementing critical reforms to bolster private sector activity and investment.

Devaluation, Ukraine war to slow growth

Prospects for a continued, steady post-pandemic economic recovery have been cast into doubt by a combination of the Ukraine war and sudden currency devaluation in March, which will push up prices, hit consumer spending and investment, reduce tourism and widen the fiscal and external deficits. We expect growth to be significantly reduced over coming quarters, slowing from a pandemic rebound-driven high of 8.3% y/y in 4Q21 to around 3% in 3Q22. Still, we expect a deep recession to be avoided. The economy's resilience has improved since the reform program that began 2017 – FX reserve levels are higher, inflation is well down from its highs and the fiscal deficit has narrowed – and the scale of the devaluation in the pound to date (15%) is much smaller than in 2016. Meanwhile, GCC countries have rallied to support Egypt with $22 billion in investment and funding pledged and a new IMF program (perhaps worth $7 billion) also looks likely. We expect growth to start recovering by the end of 2022 reverting to its pre-pandemic trend of around 4% by early 2023, assuming no major deterioration in the global economic picture and that the government remains committed to the economic reform process that slowed during the pandemic.

Fiscal deficit to widen on lower growth, higher interest bill

The above pressures will also interrupt the trend improvement in the fiscal deficit of recent years – albeit likely temporarily. Despite Covid, the deficit narrowed to 7.2% of GDP in FY20/21 thanks to cuts in the interest bill (due to lower interest rates). The deficit will widen again this year to 8.6% of GDP given fresh pressures on economic growth and spending, including from higher inflation and rising interest rates. Indeed, growth in spending (12% y/y) already exceeded revenues (9%) in February 2022. However, the deficit should be more stable in FY22/23 as commodity prices ease and the economy starts to recover.

Public debt stood at 87% of GDP in June 2020 and the devaluation will have increased external debt levels by around 3% of GDP in local currency terms. We expect the debt ratio to drift down over time, given high nominal GDP growth and the government's commitment to cut the fiscal deficit. This, together with a combination of higher interest rates, a solid FX reserve cushion, a more competitive exchange rate and external backing from the IMF should help underpin access to capital markets. However, relatively high debt levels and the large interest bill (which absorbs some 38% of all government spending) will constrain the government's ability to redirect funds to priority causes including infrastructure and poverty alleviation.

Drop in tourism revenue weighs on the external sector

The external position has been under pressure on a mix of the hit to tourism from Covid and the (previously) overvalued exchange rate. The current account deficit widened to 1.1% of GDP in FY20/21 amid a 51% plunge in export receipts from travel – previously worth around one-fifth of all trade income. This year the deficit will reach 2.9% of GDP with three additional factors weighing: depressed tourism due to the Ukraine war (Russia and Ukraine accounted for more than 30% of pre-crisis tourism to Egypt), plus the impact of both higher commodity prices and the cheaper currency on the import bill. A narrower deficit is expected in FY22/23 on import compression, an easing in commodity prices and improving tourism and trade supported by the cheaper pound.

The pound has been relatively steady at around EGP18.5/$1 since its March drop. The currency looks better supported at this level, though some uncertainty surrounds the outlook. Futures markets suggest the pound could ease further over the coming year and the IMF may emphasize the need for currency flexibility as part of any deal. The central bank's net foreign reserves fell nearly 10% in March at the peak of the external pressures, but at $37 billion remain more than double pre-2016 levels and comfortably enough to finance external debt maturities of $7 billion this year.

Rising interest rates to help dampen inflationary pressures

Inflation accelerated to a near-three year high of 13.1% y/y in April driven in particular by rising food costs (+26%) which are one-third of the CPI basket. We see inflation rising further over coming months on both high commodity prices and pass through from the weaker pound, peaking potentially above 15% in 3Q22 before falling back to within the central bank's current 5-9% target range mid-next year, helped also by tighter monetary policy. The bank raised the policy rate by 100 bps in March and at least a further 200 bps of hikes is expected this year.

In terms of risks, while pandemic concerns are fading, Egypt's economy would be hit by a prolonged war in Ukraine – which could jeopardize the external position – and by higher or more persistent inflation, which would worsen consumer incomes and economic growth and require even tighter monetary policy. Meanwhile, aggressive Fed policy tightening could hit inflows to emerging markets in general, causing financial volatility. Moreover, the weaker economy could further delay progress on the government's reform agenda, including key infrastructure projects, reducing public debt and increasing FDI. These remain critical to sustaining strong rates of growth over the longer term.

Table 1: Key economic indicators

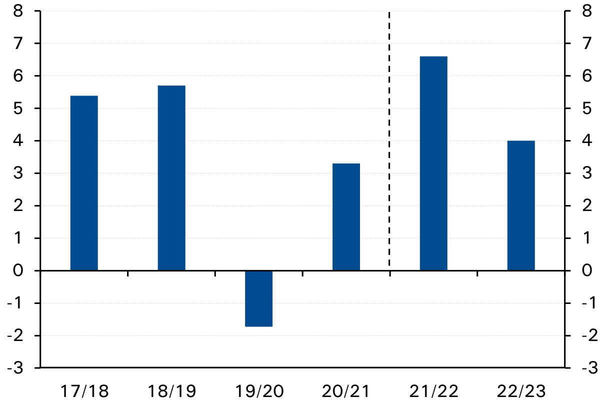
(year averages unless stated)

		FY20/21	FY21/22	FY22/23
Nominal GDP	$ bn	394	421	455
Real GDP	% y/y	3.3	6.6	4.0
Fiscal balance	% of GDP	-7.2	-8.6	-8.8
Public debt (eop)	% of GDP	90.6	86.0	80.0
Inflation	% y/y	4.5	8.3	10.8
Current account	% of GDP	-1.1	-2.9	-2.7

Source: Official sources, NBK estimates

Chart 1: Real GDP

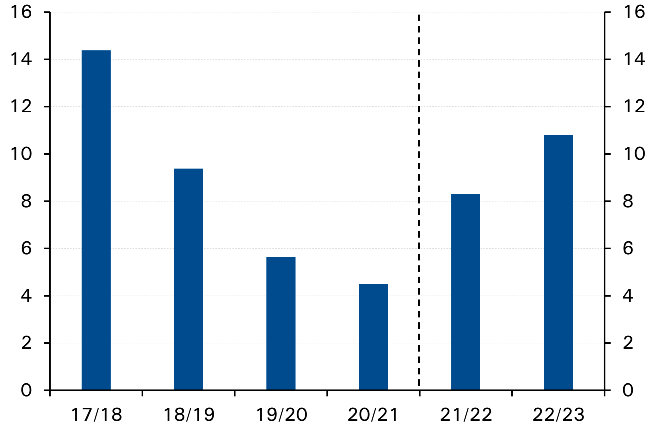
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

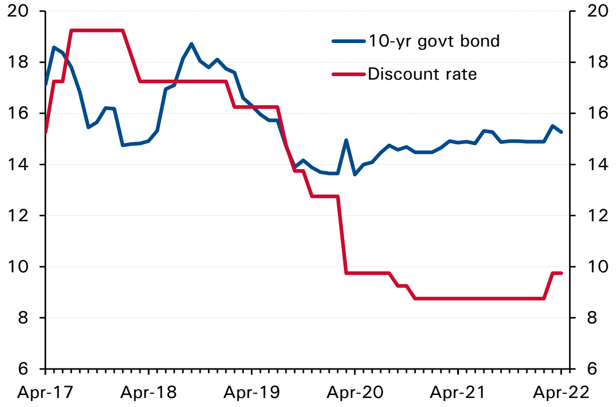
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

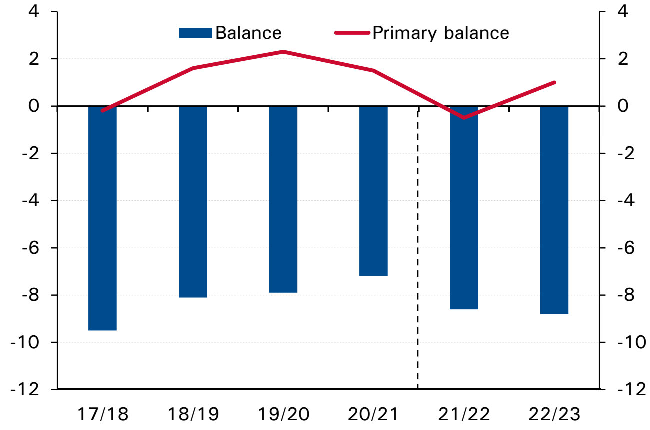
(%)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

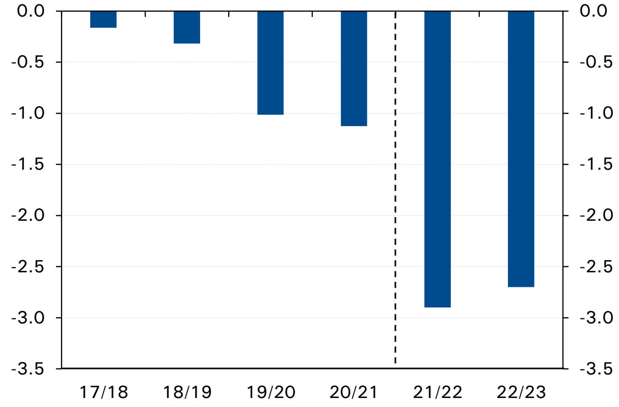
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates