Quarterly Economic Brief
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Egypt

# Relatively good economic performance during difficult times bodes well for the outlook

> Assil EL MAHMAH
Senior Economist
+965 2259 5365
assilelmahmah@nbk.com

## Highlights

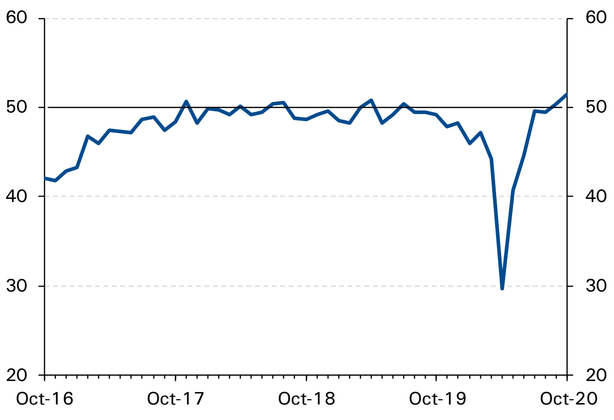
- **Economic activity slowed in 2Q20 amid lockdown measures, pushing growth down to 3.6% y/y in the fiscal year ending in June 2020, from 5.6% one year earlier.**
- **Egypt continued to make progress on its public finances, putting the budget deficit on a downward trend, despite the impact of the pandemic on the fiscal position in the first half of 2020.**
- **The external sector is under pressure as the pandemic ravaged some of Egypt's main sources of foreign currency.**
- **As inflation remains low, the CBE may continue cautiously its monetary policy loosening to boost economic growth.**

### Favorable signs of an economic recovery

Despite the pandemic's fallout, preliminary figures showed that real GDP grew by 3.6% in FY19/20 (July-June) compared to 5.6% a year earlier. The lockdown measures implemented to contain COVID-19 caused a contraction of 1.7% in 2Q20 (Last quarter of FY19/20), down from 5.0% in 1Q20, and contributed to the increase in the unemployment rate to 9.6% in 2Q20 (up from 7.7% in 1Q20).

**Chart 1: Egypt's PMI**

(Index)



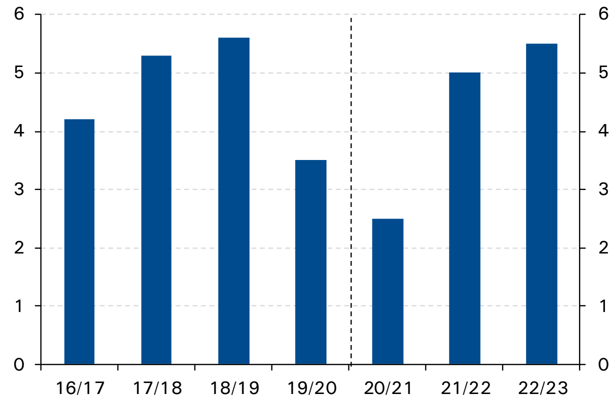

Source: Markit

Meanwhile, some leading economic indicators continue to show gradual signs of recovery, suggesting that the worst of the COVID-19 impact on Egypt's economy may have passed. The headline PMI index has been on an ascending trend, accelerating to 51.4 in October (near six-year high) from 50.4 in September, after averaging 49.8 and 38.3 in 3Q20 and 2Q20, respectively. The latest index also signals a continued improvement in 4Q20. Another indicator is the fall in the unemployment rate to 7.3% in 3Q20, reflecting a healthy return to close to normal business activities with the gradual lifting of the coronavirus restrictions.

As a result, we expect growth to improve starting the first half of next year, on hopes for rolling out vaccines by the end of this year. However, Egypt's economic growth is projected to slow further to around 2.5% in FY20/21, and to rebound strongly to about 5% over the medium term, benefitting from the authorities' commitment to reforms and a renewed IMF support.

**Chart 2: Egypt's economic growth**

(y/y, %)




Source: Central Bank of Egypt, IMF, and NBK estimates

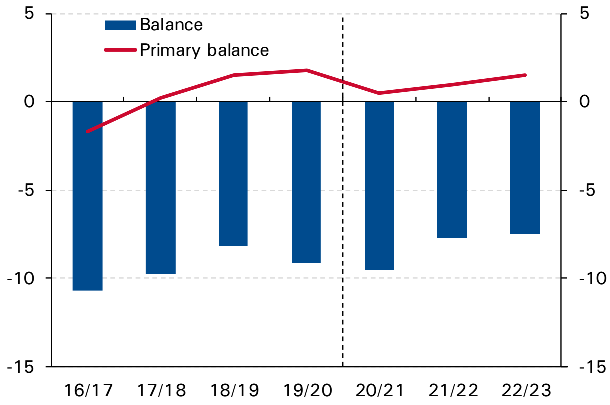
### Fiscal reforms on the right path

Egypt continued to address its public finances through a combination of fiscal measures, including Taxes (mainly through a broadening of the tax base) and subsidies reform. The primary surplus stood at 1.8% of GDP by end-June, slightly lower than targeted, with an overall fiscal deficit of 7.9% of GDP, down from 8.2% of GDP in FY18/19, despite the impact of the pandemic on the fiscal position in 1H20. The debt to GDP ratio reached 87% in FY19/20, compared to 90.4% and 108% in the previous two fiscal years.

For FY20/21, the government aims to reduce its budget deficit further to 7.5%, with a targeted primary surplus of 0.5%. The fiscal outcome for the first four months of the current FY20/21 (July – October) showed an overall budget deficit of about 2.6% of GDP, driven by an 18% increase (y/y) in revenues, mainly on account of a 13.4% y/y rise in tax revenues. This augur well for a favorable outcome for FY20/21 though it would be premature to draw firm conclusions on the basis of this outcome as the budgetary transactions do not necessarily follow a smooth trend in addition to the still uncertainty regarding the end of the pandemic.

**Chart 3: Egypt's Fiscal balance**

(% of GDP)



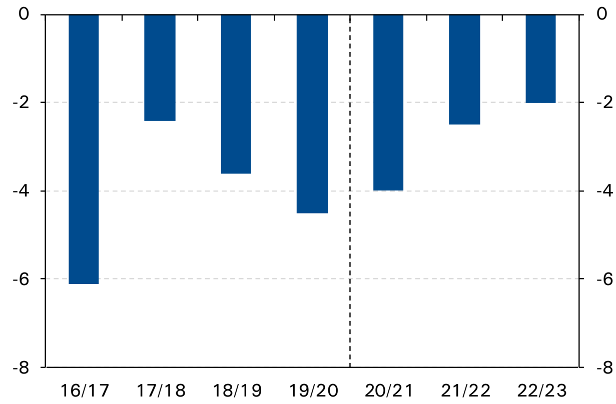

Source: Ministry of Finance, and NBK estimates

## The external sector is set to improve

Egypt's current account balance is still under pressure, notwithstanding the improvement of some external indicators. Revenues from the Suez Canal rose from $470.7 million in September to $490.2 million in October, which is higher than the pre-pandemic February's revenues of $458.2 million. For FY19/20, remittances (transfer by Egyptians working abroad) rose 33.7% y/y, reaching $27.8 billion, its highest ever, compared to $25.2 billion a year ago. This is likely due to the rush to transfer their savings amid the uncertainty regarding the future of labor markets in the GCC. Egypt's current account deficit could reach 4.0% of GDP in FY20/21, before improving to around 2.5% of GDP in the coming years, as the global economy recovers and with it trade, and tourism, which is a major source of foreign reserves.

**Chart 4: Egypt's current account**

(% of GDP)

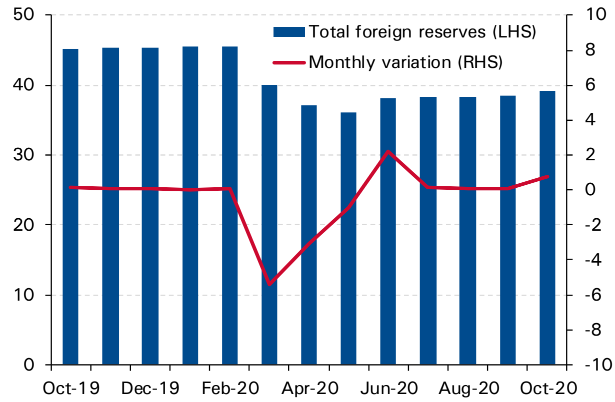



Source: Central Bank of Egypt, and NBK estimates

Egypt's foreign reserves continued to improve for the fifth consecutive month, supported by Egypt's move to secure more financial buffers and the recent acceleration of the capital inflows. The reserves increased by about $795 million in October 2020, recording $39.2 billion coming from $36 billion in May, when it reached its lowest level during the height of the pandemic.

**Chart 5: Egypt's foreign reserves**

($ billion)




Source: Central Bank of Egypt

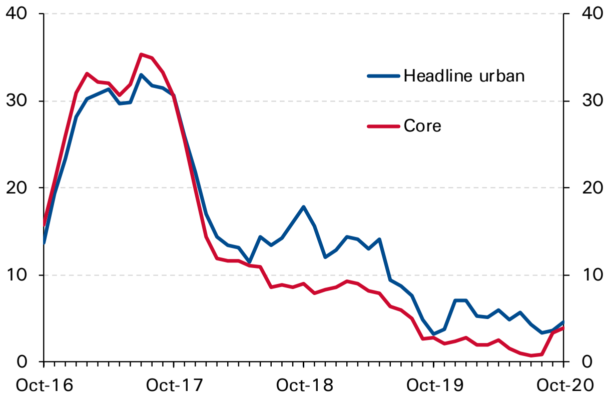
The Egyptian pound (EGP) appreciated further against the US dollar in 2H20, supported by an increase in foreign capital flows and a gradual economic recovery following the easing of lockdown restrictions starting in July. The US dollar traded at around EGP 15.6 in November against EGP 16.2 in June. Barring any major exogenous shocks, the EGP is likely to remain relatively stable and any intervention in the exchange market should be limited to cases where fluctuations in the rate are not warranted by economic fundamentals.

## Monetary policy easing amid low inflationary pressures

Since the onset of macroeconomic reforms in late 2016, Egypt's urban inflation has been on a downward trend making Egypt one of the few countries to experience such a significant drop in inflation (from about 33.1% in July 2017) in a relatively short period. This trend is prone, however, to some fluctuations due to seasonal and other factors. In October, for example, the inflation rate accelerated to 4.5% y/y from 3.7% y/y in September, driven mainly by an increase in the prices of vegetables, education, and services. Core inflation also rose to 3.9% y/y in October, up from 3.3% y/y in September. In the coming months, Inflation could increase given the recent increase in energy tariffs and the potential pick-up in demand as restrictions are eased.

**Chart 6: Egypt's inflation**

(y/y %)




Source: Central Bank of Egypt

As the inflation rate remains well below the target of 9% (±3%), the Central Bank of Egypt (CBE) cut interest rates by 50 basis points in November for a second consecutive time to offset some of the negative impacts of the coronavirus pandemic on economic activity. Given that the real interest rate in Egypt remains higher than most emerging markets (the second highest after India), the CBE will continue cautiously its monetary policy loosening to boost economic growth, while avoiding acceleration of capital outflows. In the meantime, it would not be surprising if the CBE revised down its inflation target range given that recent inflation rates have fallen outside this range.

## Remaining Challenges require continuous vigilance

Egypt is doing relatively well under the circumstances and one of the few emerging countries to record positive growth this year. The macroeconomic reforms over the past four years are paying off. A commitment to forging ahead with macroeconomic and especially structural reforms, a diversified economic base, big markets and a large young population all bode well for the future. However, besides the uncertain outlook of the COVID-19 and its impact on global growth, tourism and remittances, other challenges remain. The dependence on foreign capital could push the debt to GDP ratio to unsustainable levels unless the debt is put to very productive uses that bolster economic growth to rates that exceed the interest on the debt. At the same time, the private sector needs to play a much bigger role in driving growth, reducing poverty and creating jobs for a large number of entrants into the labor force.

## Head Office

**Kuwait**
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

## International Network

**Bahrain**
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

**United Arab Emirates**
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

**Saudi Arabia**
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

**Jordan**
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

**Lebanon**
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

**Iraq**
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

**Egypt**
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

**United States of America**
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

**United Kingdom**
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

**France**
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

**Singapore**
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

**China**
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

## NBK Capital

**Kuwait**
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

**United Arab Emirates**
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

## Associates

**Turkey**
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353