EGYPT

Egypt's economy experienced a rough start to 2023 with the return of FX shortages and surging inflation. Progress on key reforms under the IMF deal agreed last December – especially the move to a flexible exchange rate and the privatization program – remains critical to restoring investor confidence and covering the external funding gap. We expect growth to slow to 3.7% this year as these pressures play out and the pound weakens further. The cheaper currency, falling inflation and interest rate cuts will provide a platform for improved growth of 4.5% next year, conditional on the authorities showing stronger reform commitment. Once the current reforms are implemented, we see strong growth potential in tourism, manufacturing and real estate.

A tougher economic path than initially expected

Since the IMF approved a $3bn loan agreement in December, the economic situation in Egypt has turned out tougher than initially expected and the major pillars of the program are not materializing smoothly – a key risk that we flagged earlier. This includes weak commitment to a flexible exchange rate with the pound still hovering at EGP31/$1 (mid-April). Additionally, implementation of the crucial privatization program has been very slow with no deals executed so far, despite the clear importance of stake sales especially to GCC investors to help cover a gross external financing requirement of $90bn over the coming 3-4 years.

GDP growth slipped to 3.9% y/y in 2Q22/23 (Oct-Dec) versus 4.4% in Q1 and we expect growth to range 3.0-3.5% for Q3 and Q4 of the same year, with FY22/23 full-year growth at 3.7%. We note that the Ministry of Planning has revised its growth projections downwards to 4.2% from 5.0% previously and the IMF to 3.7% from 4.3% last October. The evident slowdown comes as inflation rates have spiraled, interest rates rise, and the FX shortage takes its toll across the economy. We see a gradual improvement in FY2023/24 with growth recovering to 4.5%, but highly conditioned on faster progress on reforms, a stronger commitment to a flexible exchange rate and materialization of the privatization program. The IMF restated the importance of both conditionalities along the sidelines of the Spring 2023 meetings, which may also be needed to successfully conclude the (currently delayed) first review of its loan program.

Slow privatization progress poses risks to external outlook

Progress on privatization is facing major obstacles both related to debates on asset pricing mechanisms and an obvious reluctance by the authorities to commit to the program. Due to limited current alternatives to GCC investments, Egypt's external sector, which faces a gross financing need of $27bn over the coming 12 months, is highly exposed to the success of the privatization program.

The main upside on the external front is a narrowing current account deficit (and possible surplus), evident by the latest estimates for Q2FY22/23 which saw a surplus of $1.4bn on the back of strong tourism revenues. In an event where the coming two quarters also post strong numbers, the gross financing gap could narrow by 25% to $20bn. Another key upside would be a possible external debt negotiation and/or multilaterals re-financing maturing loans. Egypt in April signed a five-year $7bn loan with the World Bank, which boosts the bank's lending to Egypt by 56% and allows for higher FX proceeds.

Despite these upside risks, current external pressures are high reflected in both market projections for a further decline in the pound and a continued fall in banks' net foreign assets, which dropped by $3bn over the period January-February 2023. But there is potential support in 2H23/24 from possible rate cuts by the US Fed, a recovery in foreign portfolio investments, and a return to the international bond market. This could assist in covering the large financing gap and limiting pressure on the EGP.

Fiscal austerity measures; crucial to balance rising expenses

We expect a widening in the budget deficit this year that is mostly attributed to a rise in treasury yields averaging 19% (July 2022-January 2023) versus the 13% budgeted by the Ministry of Finance. We expect interest expenses to rise to EGP913bn for the full year FY22/23 versus the EGP690bn initially estimated, pushing the fiscal deficit to 8.6% of GDP, well above the government's newly-revised target of 6.1%. As we expect yields to remain elevated and policy rates to rise further, we look for a similar overshoot in FY23/24 to 8.1% of GDP compared to the projected 5.1% in the latest budget presented to parliament. This would also be mostly attributed to higher treasury yields (18-20%) versus the budget (12.5%). Key measures on the revenue side could include further cuts in electricity and petrol subsidies, which could yield a combined 2.4% of GDP in receipts. On a positive note, the primary balance recorded a surplus of 0.4% of GDP during 1HFY22/23 and we expect a full-year surplus of 1% of GDP.

Central bank to raise interest rates amid very high inflation

Inflation accelerated to a six-year high of 32.7% y/y in March amid surging food prices and pass-through from the January currency devaluation. We see inflation peaking at 38-40% by August 2023 driven by a fresh round of currency depreciation and newly-introduced fiscal consolidation measures. Although the central bank's policy discount rate has risen 1000 bps since February 2022 to 18.75%, further monetary tightening could be needed to anchor both the currency and inflation expectations. The first window to cut rates could come as soon as 3Q-4Q23/24 as inflation starts falling below 25% and heads towards the CBE target of 7% (+/-2%) by 4QCY24.

Table 1: Key economic indicators

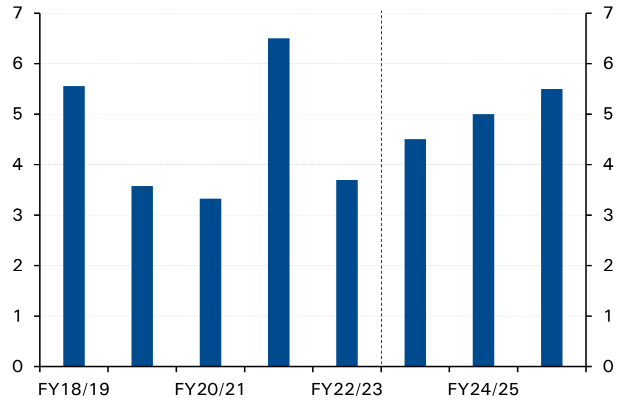
(year averages)

		FY21/22	FY22/23	FY23/24
Nominal GDP	$ bn	445	393	375
Real GDP	% y/y	6.5	3.7	4.5
Fiscal balance	% of GDP	-6.8	-8.6	-8.1
Inflation	% y/y	8.5	24	22
Current account	% of GDP	-3.4	-2.9	-3.1

Source: Official sources, NBK estimates

Chart 1: Real GDP

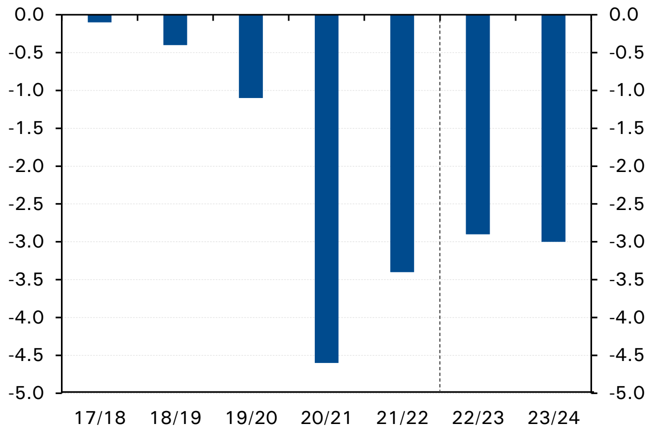
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Current account balance

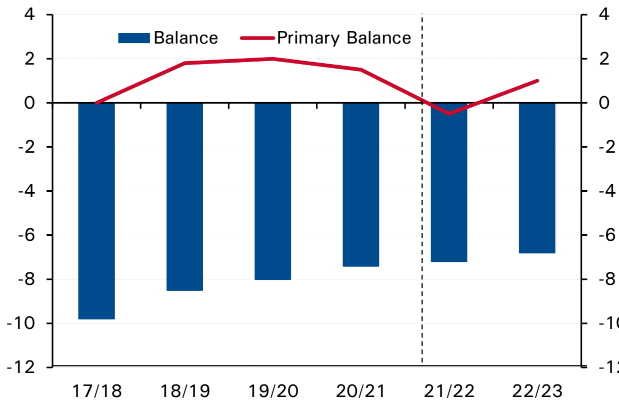
(% of GDP)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Fiscal Balance

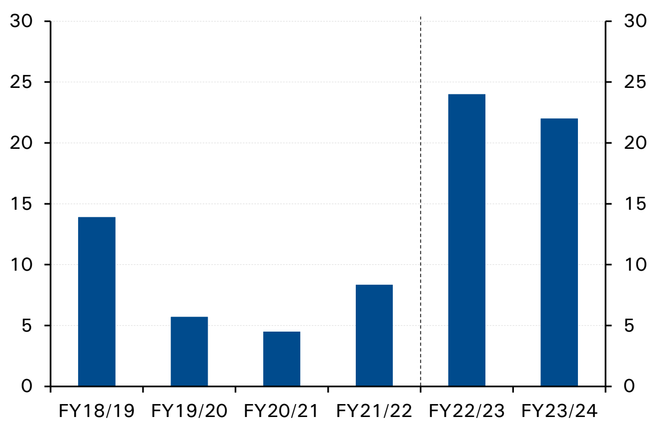
(% of GDP)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Inflation rate

(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Interest Rates

(%)

Source: Refinitiv / Central Bank of Egypt, NBK estimates