EGYPT

Egypt's post-pandemic economic recovery is broadly on track, with growth seen averaging a solid 5% or so over the next few years. The fiscal deficit continues to narrow, benefitting from spending control and slower growth in debt-servicing costs. However, the external sector is still under pandemic-related pressure, with tourism having been hard hit. In the near term, uncertainty over the global economic recovery and potential new waves of virus cases are the main downside risks to the outlook, while Fed policy tightening could affect capital flows to emerging markets in general. The continued appetite and capacity to pursue ambitious structural reforms to bolster private sector activity will be critical for success in the long term.

The economic recovery is gaining momentum

With lockdown restrictions easing over the summer and businesses gradually reopening, economic growth has continued to recover. GDP growth accelerated to 7.7% y/y in 2Q21 (the final quarter of FY20/21) – albeit boosted by a base effect after weakness a year earlier – from 2.0% in 1Q21. This pushed growth to 3.3% during FY20/21 from 3.6% in FY19/20. However, the tourism sector (worth about 12% of GDP in 2019) is likely to remain under pressure due to continued international travel disruptions. We expect growth to recover to around 5.0% over the medium term based upon the authorities' continued commitment to crucial economic reforms, and assuming no major slowdown in the global economic recovery including due to the emergence of more contagious coronavirus strains.

Fiscal deficit narrows despite pandemic pressures

Despite huge pandemic pressures, the government still managed to trim the fiscal deficit again last year, helped by improved spending control and slower growth in debt service costs. The deficit narrowed to 7.4% of GDP in FY20/21 from 8.0% a year before, with the rise in revenues (+12% y/y) outpacing growth in spending (+9%). The primary balance (i.e. excluding interest payments) reached a surplus of 1.4% of GDP. As the economy recovers and the government pursues its debt restructuring strategies (including diversifying the debt structure and extending the average debt maturity), the overall budget deficit could narrow to 7.0% of GDP in FY21/22 and further to about 6.0% by FY23/24. This will help public debt decline to about 86% of GDP by the end of June 2022 and further in the medium term. Given prevailing low global interest rates and previous successful debt issues, the government is likely to utilize external borrowing to finance a major part of these projected deficits.

Drop in tourism revenue weighs on the external sector

Despite the gradual recovery of Egypt's external position, the current account is still under pressure as subdued international travel weighs on the tourism sector, the main source of foreign currency earnings. In fact, the drop in tourism revenues in FY20/21 (-50.7% to $4.9 billion) contributed to a widening of the current account deficit to $18.4 billion (4.6% of GDP) from $11.2 billion (3.1% of GDP) in the previous fiscal year. We expect the deficit to narrow to an average of 2.5% in future years on a recovery in tourism and trade. On the financial side, the recent acceleration of capital inflows combined with IMF support ($5.2 billion Stand-By Arrangement, Covid emergency financial assistance of $2.7 billion and $2.8 billion from an SDR allocation) and foreign borrowing have more than offset the increase in the current account deficit. This has helped the pound remain broadly stable against the US dollar at an average of EGP15.7/US$1 so far this year. Meanwhile, after dropping to a pandemic low of $36.0 billion in May 2020, net foreign reserves had recovered to $40.8 billion in September 2021, further supporting the external picture.

Monetary policy on hold amid moderate inflation

Amid rising commodity and energy prices, inflation accelerated to 6.6% y/y in September (4.5% in 1H21). Over coming months, the late-July increase in fuel prices and a potential rise in prices for subsidized bread could push up the headline rate. Still, inflation should remain under control in FY21/22, averaging about 5.8% compared to 4.5% in FY20/21, much lower than in the past, and still towards the lower end of the CBE's target range of 7% ±2%. So far in 2021, the central bank has kept its policy rates unchanged at relatively high levels (8.25-9.25%). Although a fresh rate cut is possible in Q4 to support the economy and lower debt financing costs, the bank will be mindful of the need to avoid triggering capital outflows, especially if as expected the US Fed starts to taper its asset purchases.

Credit growth is robust but beginning to moderate

Banking system liquidity and depositor confidence continue to improve, helped by the central bank's response during the pandemic. Domestic credit recorded double-digit growth of 11.0% y/y in July, though the pace has slowed from recent highs as the boost from earlier government measures to encourage lending during the pandemic has started to fade. Looking ahead, credit growth is expected to remain solid, supported by the economic recovery and by the clear guidance provided by a stable and consistent monetary policy.

Continued commitment to reforms is critical for success

Despite tremendous efforts over the past years to achieve macroeconomic stability and boost economic growth, Egypt is still facing several challenges in an uncertain global environment. The scale and longevity of the pandemic remain the main risks in the short-to-medium term, while Fed policy tightening could affect capital flows to emerging markets in general. In the long run, there is a risk that reform fatigue could set in before the most challenging structural issues are tackled, including reducing the government's role in the economy, containing population growth and making the business environment more conducive to investment. While these are ambitious, they are also critical for success.

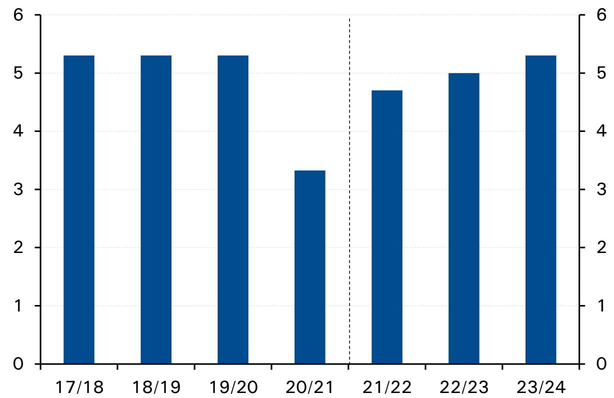
Table 1: Key economic indicators

		FY20/21	FY21/22	FY22/23	FY23/24
Nominal GDP	$ bn	356	393	437	486
Real GDP	% y/y	3.3	4.7	5.0	5.3
Fiscal balance	% of GDP	-7.4	-7.0	-6.5	-6.0
Public debt	% of GDP	90.6	86.0	80.0	73.0
Inflation	% y/y	4.5	5.8	6.2	6.0
Current account	% of GDP	-4.6	-3.0	-2.5	-2.3

Source: Official sources, NBK estimates

Chart 1: Real GDP

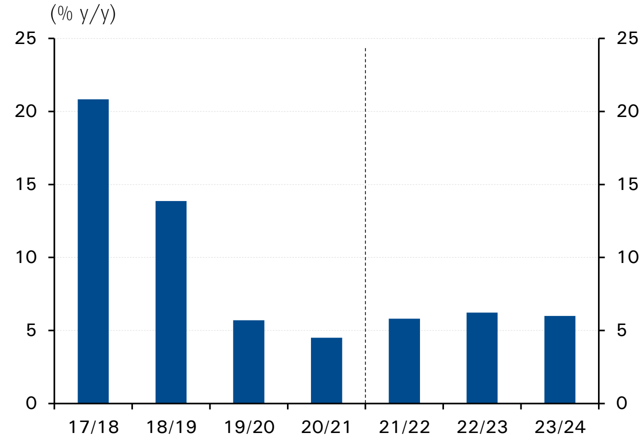
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

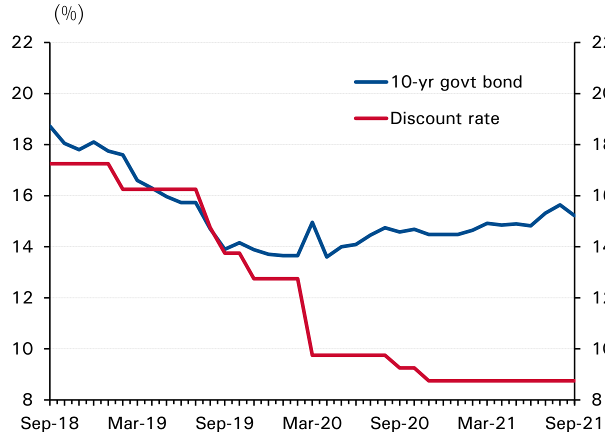
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

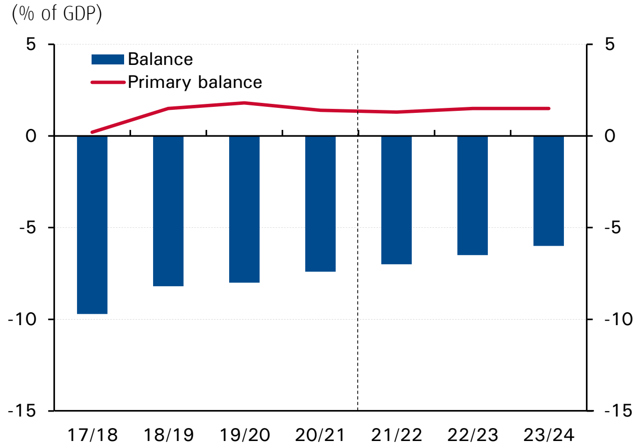
(%)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

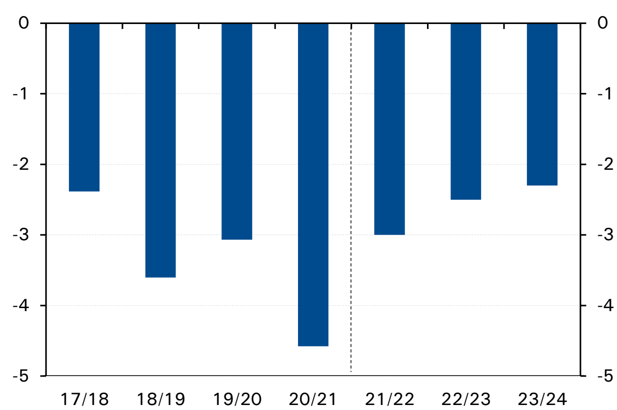
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates