EGYPT

Significant progress has been made under the authorities' reform program. Robust economic growth is expected to continue over the forecast period, and inflation, having come down from its highs in 2017, should trend lower, although it could inch up due increases in electricity tariffs and fuel prices. The budget deficit and the external current account have also improved. High domestic interest rates, large debt service, and unemployment are risks to the otherwise promising outlook.

Egyptian economy on the right path

As Egypt continues to implement its ambitious economic reform program, GDP growth accelerated from 5.3% in FY17/18 (July-June) to 5.6% by the end of March 2019. Looking forward, we expect growth to remain robust at around 5.2% in FY19/20 and 5.0% in FY20/21. (Chart 1) Growth will be driven by a strong pick-up in capital spending, a recovery in the tourism sector and continued increases in natural gas production, which turned Egypt into a net gas exporter in the second quarter of FY18/19.

The IMF has supported the authorities' reform program since end-2016. The intention now is to move to a non-financial program where the IMF will play an advisory role that could help the authorities in their reform efforts.

Easing inflation could support further rate cuts

Since the most recent energy subsidy cuts in mid-2018, urban inflation started to decelerate, albeit, at a slower than expected, standing at 14.1% y/y in May 2019. In this context, prices will likely remain susceptible to upward pressures in the second half of 2019 due mainly to the increase in average electricity tariffs (14.9%) and the elimination of fuel subsidies (16-30%). We expect inflation to average 12.5% in FY19/20 and 9% in FY20/21, down from 20.9% in FY17/18. (Chart 2.) These projections are subject to uncertainty linked to movements in oil prices and the exchange rate as well as to volatile food prices, given the latter's large weight in the consumer basket.

Easing inflation has provided some comfort to the Central Bank of Egypt to cut its interest rate by 100 bps in February 2019. (Chart 3.) With further easing, we expect 100-200 bps of cuts by mid-2020, which should help curb Egypt's debt service cost and boost private sector activity.

High debt service is weighing on the fiscal position

Egypt's government continues to consolidate its fiscal position through higher tax revenues and cuts to energy subsidies. This has led to a primary budget surplus of 0.2% of GDP in the FY17/18, for the first time in 15 years. (Chart 4.) Nevertheless, the deficit will likely remain relatively high due in part to high debt service. For FY19/20, Egypt's parliament just approved the country's largest ever budget of EGP1.6 trillion ($95bn), which includes an 11.4% hike in the wage bill. Still, the government is targeting a deficit of 7.2% of GDP for the year, thanks to the reduction in fuel subsidies from $5.37bn in FY18/19 to $3.18bn next fiscal year. We believe these targets are achievable, especially if oil prices remain close to the budget's benchmark oil price ($65-$67/bbl; in line with our assumption) and if government reforms remain on track.

The public debt ratio has declined from 108% of GDP in FY16/17 to an estimated 86% of GDP in FY18/19, driven by fiscal consolidation and strong economic growth. We expect the debt-to-GDP ratio to move up to around 90% of GDP next fiscal year. The government planned to issue about $7.0 billion in international bonds in different currencies with a view to diversifying its debt instruments, improving the debt structure and reducing borrowing costs, benefiting from the downward trend in global interest rates. With domestic rates remaining high, borrowing in EGP is a burden on public finances.

The external sector to improve further

The external sector has continued to strengthen as the trade deficit narrows and remittances and tourism continue to recover as the economy has become more competitive following the depreciation of the EGP. Fiscal consolidation has also played a role in reducing the current account deficit, which narrowed to 2.4% of GDP from 6.1% of GDP a year ago. It is expected to shrink further to 2% of GDP in the FY18/19 and to 1.5% of GDP in FY20/21 if gas exports continue strong. (Chart 5.)

Favorable outlook, but challenges remain

While significant progress has been made, a number of challenges need to be addressed so as not to derail the reform program in the medium and long term. Higher interest rates would dampen economic growth and add to the already-high public debt burden. With the number of entrants into the workforce soaring, boosting private sector growth and employment is critical. As macroeconomic stability is taking root, attention needs to now shift to structural reforms to reduce poverty, lift the standard of living of the population and ensure that the benefits of these reforms are more widely shared.

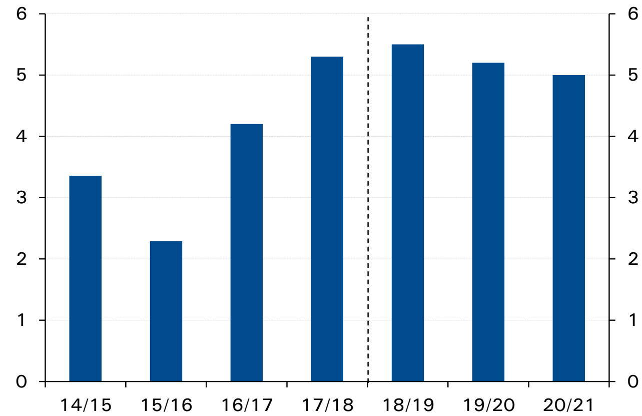
Table 1: Key economic indicators

		FY16/17	FY17/18	FY18/19	FY19/20	FY20/21
Nominal GDP	$ bn	251	248	296	349	398
Real GDP	% y/y	4.2	5.3	5.5	5.2	5.0
Inflation	% y/y	23.5	20.9	14.0	12.5	9.0
Budget balance	% of GDP	-10.7	-9.7	-8.5	-7.4	-6.5
Primary balance	% of GDP	-1.6	0.2	1.8	2.4	3.1
Current account	% of GDP	-6.1	-2.4	-2.0	-1.7	-1.5

Source: Official sources, NBK estimates

Chart 1: Real GDP

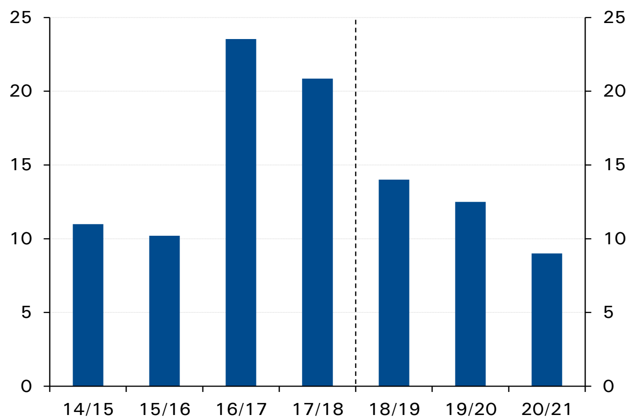
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

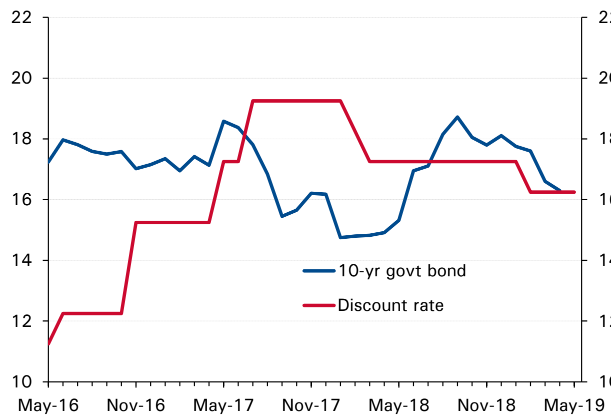
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

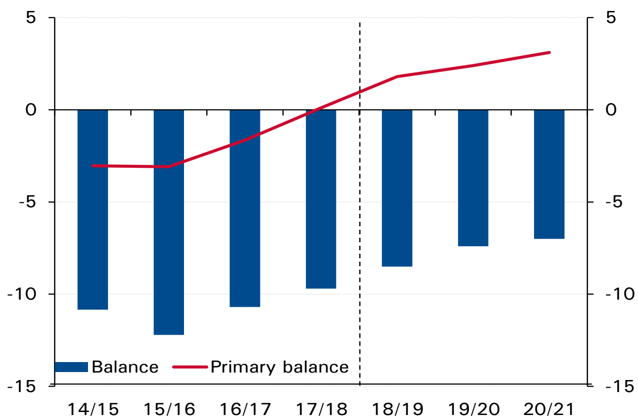
(%)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

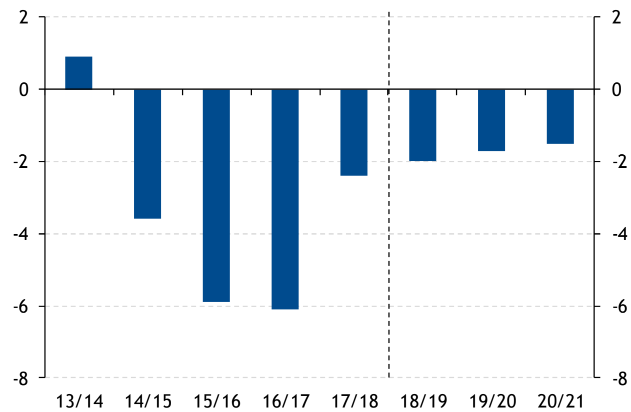
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates