EGYPT

Egypt has achieved its key objective of macroeconomic stability under the authorities' reform program. Economic growth is expected to remain robust, and inflation should trend lower over the forecast period. The budget deficit and the external current account are expected to improve further in 2020-2022. Large debt servicing costs and a relatively weak private sector are major risks to the otherwise promising outlook.

Egypt's economy is on a favorable trajectory

Egypt has successfully completed its 3-year IMF supported reform program, achieving its key objective of macroeconomic stability. Economic growth has continued its robust trend, reaching 5.6% in the first quarter (July-September) of the current fiscal year (FY19/20). Looking ahead, we expect growth to improve but at a slower pace compared to recent years. Real GDP growth will remain strong at around 5.5% in FY19/20 and average about 5% for the next couple of years. (Chart 1.) It will be supported by a strong pick-up in capital spending, a further improvement in the tourism sector and continued increases in natural gas production, which could turn Egypt into a net gas exporter in the short-run.

Egypt will likely move to a new precautionary non-financial program in which the IMF will play an advisory role, providing important policy and technical support. Coupled with the authorities continued commitment to reforms, such a program should help sustain Egypt's economic gains.

Slowing inflation supports a looser monetary policy

Despite the energy subsidy cuts adopted at the start of the fiscal year in July 2019, urban inflation started to decelerate faster than expected. It stood at 3.1% y/y in October 2019, the lowest reading since October 2005. This was driven by the state's efforts to ensure an adequate food supply and by continued strengthening of the EGP, which gained about 10% against the USD in 2019, helping to curb import price pressures. We expect inflation to remain low in the single digits by 2022. (Chart 2.) These projections, however, are subject to uncertainty related to movements in the oil price, the exchange rate, and food price volatility, which has a large weight in the consumer basket.

Slowing inflation has provided some space for the Central Bank of Egypt (CBE) to cut its interest rate four times in 2019 by a cumulative 450 bps. (Chart 3.) And while there is still more room for further cuts, we do, however, expect the CBE to remain prudent and move cautiously—perhaps cutting the rate by 300-400 bps in 2020—if inflation remains subdued.

High debt servicing costs weaken the fiscal position

The authorities continue to make progress in fiscal consolidation. Despite the recent increase in government salaries and pensions in July 2019, the primary budget surplus is estimated to have reached 1.5% of GDP in FY18/19 from 0.2% a year ago. We expect this trend to continue, with the primary surplus averaging 2.5% of GDP over the next couple of years. (Chart 4.)

The overall budget deficit remains relatively high standing at 8.2% of GDP in FY18/19, due mainly to high debt service costs. In fact, interest payments have increased in recent years, reflecting both the rise in outstanding public debt and higher domestic funding costs. We expect the fiscal deficit to narrow further to 7.5% of GDP in FY19/20 and reach 6% by FY21/22, thanks to higher revenues (taxes and gas) and energy subsidy reforms. Public debt declined from 108% of GDP in FY16/17 to an estimated 92% of GDP in FY18/19, driven by cuts to benchmark interest rates and the move towards more international debt that carries lower interest rates. With lower budget financing needs, public debt is expected to fall to around 80% of GDP by FY21/22, but the structure of the debt will be tilted more toward external debt. In this context, the government plans to issue during the current fiscal year about $7.0 billion multi-currency denominated international bonds to benefit from the historically low global interest rates.

The external sector to improve further

Egypt's external current account improved following the adoption of the reform program, with the deficit dropping from 6.1% of GDP in FY16/17 to 2.7% in FY18/19. It should shrink gradually to around 2% of GDP in FY21/22 on account of further growth in remittances and tourism as well as increase in gas revenue. (Chart 5.)

Promising outlook, but challenges remain

Egypt made commendable progress under its bold adjustment program and was able to restore macroeconomic stability in a relatively short time. Egypt's unwavering commitment to reform should now translate into a second-generation set of measures that focus on deep-rooted structural rigidities reflected mainly in the still dominant public sector. Egypt will need to focus on improving the business environment and developing the private sector to become the primary driver of economic growth. Addressing poverty and strengthening social safety nets will make it easier to forge ahead with the rest of the agenda over the next three years.

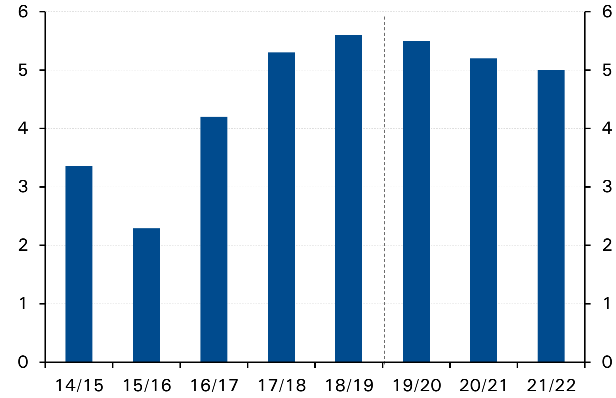
Table 1: Key economic indicators

		FY17/18	FY18/19	FY19/20	FY20/21	FY21/22
Nominal GDP	$ bn	248	297	335	382	432
Real GDP	% y/y	5.3	5.6	5.5	5.2	5.0
Inflation	% y/y	20.9	14.0	7.4	9.0	8.0
Budget balance	% of GDP	-9.7	-8.2	-7.5	-6.5	-6.0
Current account	% of GDP	-2.4	-2.7	-2.5	-2.0	-2.0

Source: Official sources, NBK estimates

Chart 1: Real GDP

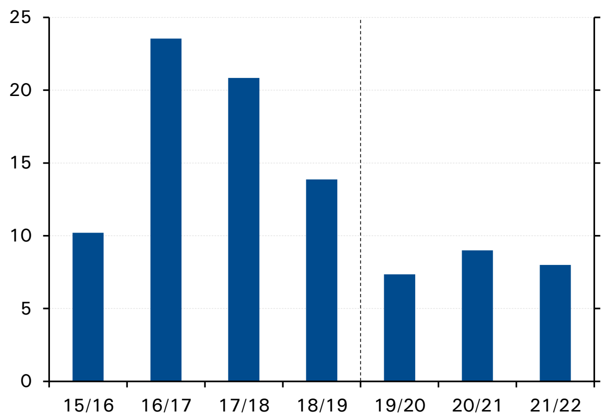
(% y/y)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 2: Inflation

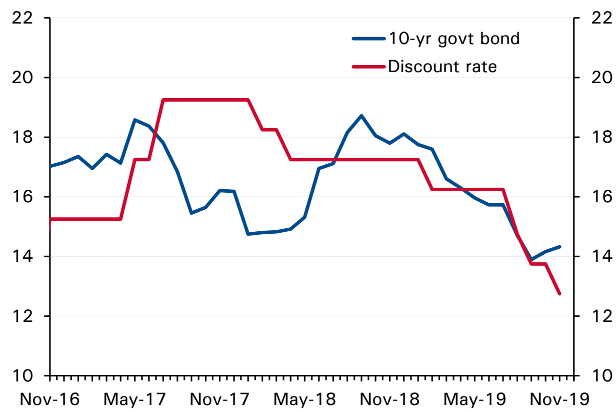
(% y/y)



Source: Capmas, Central Bank of Egypt, NBK estimates

Chart 3: Interest rates

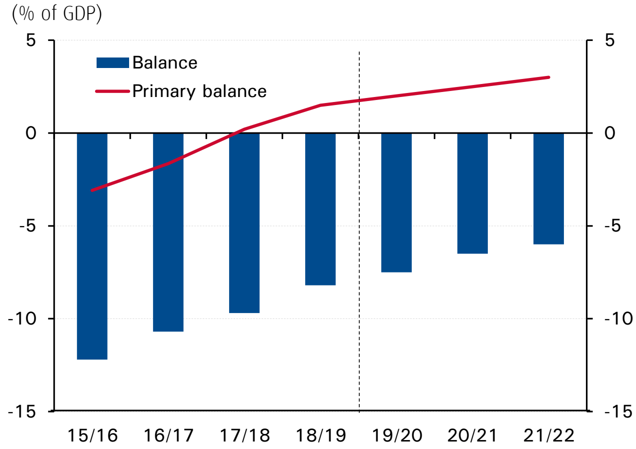
(%)



Source: Refinitiv / Central Bank of Egypt

Chart 4: Fiscal balance

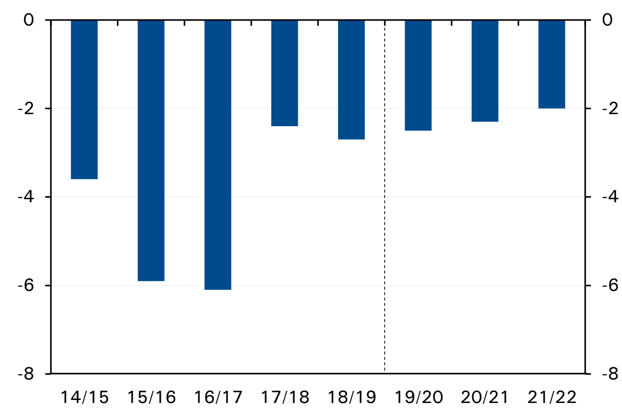
(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates

Chart 5: Current account balance

(% of GDP)



Source: Refinitiv / Central Bank of Egypt, NBK estimates