بنك الإمارات دبي الوطني
Emirates NBD

Egypt
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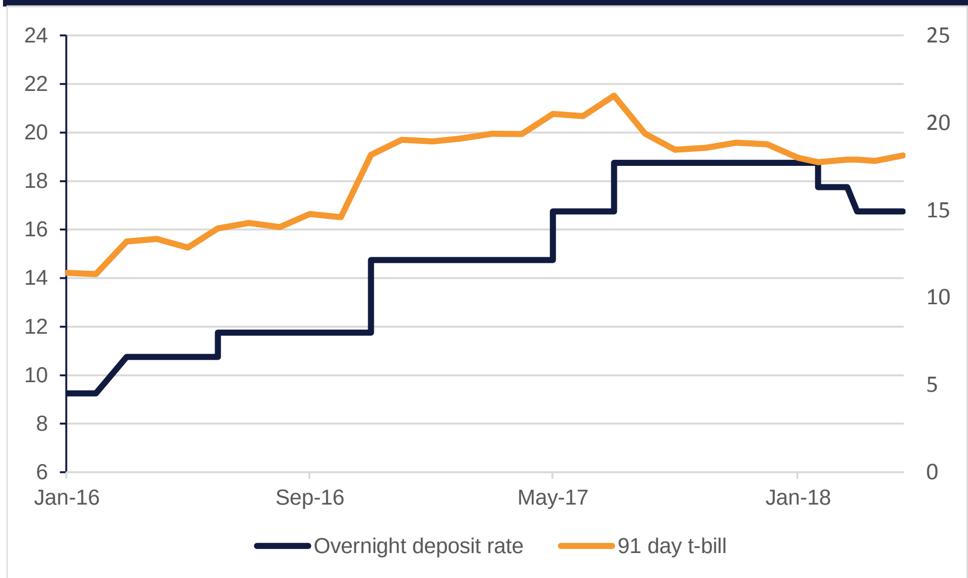
Egypt Update

MPC holds rates

The Central Bank of Egypt kept its benchmark interest rates unchanged on Thursday, as concerns over rising oil prices and upcoming subsidy cuts trumped the desire to stimulate private consumption. The hold followed two interest rate cuts in February and March which took the overnight lending rate and the overnight deposit rate to 17.75% and 16.75% respectively. With the fall in y/y inflation slowing in April, and the m/m rate rising to levels last seen in mid-2017, a hold was always a possibility. However, we had anticipated that with the latest annualised inflation print of 13.1% well within the target range of 13.0% ± 3, the bank would take the opportunity to make one more cut before the new fiscal year brought further subsidy cuts in July.

According to the MPC's communiqué, higher global oil prices were a primary factor behind its reasoning, given they have led to the 'materialisation of an upside risk to the domestic inflation outlook.' Brent crude has risen to USD 78.5/b at the time of writing, from USD 53.9/b a year earlier. While we expect prices to moderate, we have revised up our average forecast for 2018 to USD 69/b, and given the ongoing fuel subsidy reform in Egypt, this will impact more directly upon consumers than it would have done in previous years. **The MPC also cited the 'pace of tightening financial conditions', highlighting the risk that the normalisation of monetary policy in developed markets poses to emerging markets globally.**

Egyptian interest rates



Source: Bloomberg, Emirates NBD Research

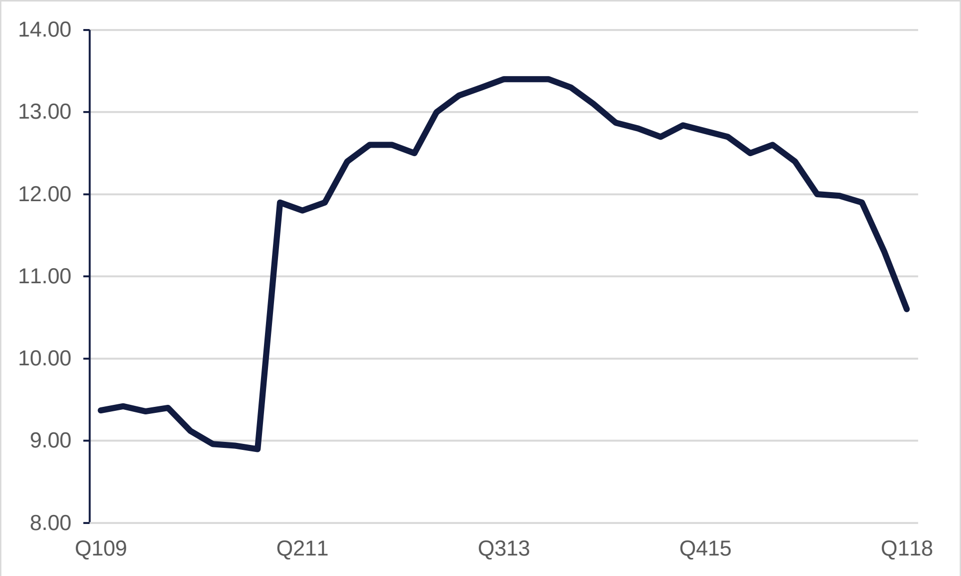
Given that the CBE passed on the opportunity to implement a rate cut last week, we expect that rates will now be held over at least the next two meetings in June and August, and potentially also September, with two further cuts likely in the final months of the year. The bank will want to wait and see the effect the higher oil prices and the upcoming subsidy cuts have on inflation. A key determining factor will also be whether the portfolio inflows that were enticed by high interest rates over the past 18 months will be maintained as the CBE cuts rates. Foreigners' t-bill holdings actually increased 10.1% m/m in January (after declining 3.1% in December), despite widespread anticipation of rate cuts, but with Turkey and Argentina both engaged in rate hiking, and the more general tightening conditions highlighted by the bank, Egypt's attractiveness to international investors could begin to wane.

We anticipate that other inflows – exports, remittances, FDI, equity investment – will begin to offset slower inflows into treasury bills, and that the greater political and economic stability in Egypt would in any case mitigate some of the fall in yield. Nevertheless, with the Egyptian pound having fallen to EGP 17.9254/USD last week, a level not seen since August, the CBE will be especially wary over the next several months**. Oil prices and the dollar have traditionally moved in lockstep, but with this relationship currently broken, the risks from both a stronger dollar and higher oil prices to oil-importing emerging markets such as Egypt are profound.**

Unemployment falls to lowest level since 2010

The MPC's communiqué also stated the latest unemployment rate, which has fallen to just 10.6% in March. This is the lowest level since December 2010, just prior to the 'Arab Spring' protests which roiled Egypt and the wider region, and is testament to the progress being made by the ongoing reform programme. That being said, job creation will be a major challenge to Egypt over the coming years, and this was highlighted by the IMF's deputy managing director David Lipton in a speech to the Cairo government in May. The Egyptian labour force is expected to increase by 20% by 2028, rising to 80mn people. If this population boom is to be a dividend rather than a burden, greater efforts to stimulate the private sector and employment-generating industries are sorely needed.

Unemployment, %



Source: Haver Analytics, Emirates NBD Research

IMF passes Egypt on its third review

The IMF announced on May 17 that it had reached staff-level agreement on the disbursal of USD 2bn to Egypt as part of its Extended Fund Facility programme, after it passed its third review. This will take the total funding allocated to USD 8bn, of a USD 12bn programme. In its statement, the IMF spoke highly of Egypt's reform efforts, citing the progress made on curbing inflation, bringing in its twin deficits, and stalling the growth in debt levels as a percentage of GDP – which it expects to decline for the first time in a decade. It did highlight, however, that ongoing 'steps to support exports and reduce non-tariff barriers, streamline and enhance industrial land allocation process, support small and medium enterprises, strengthen public procurement, improve transparency and accountability of state owned enterprises, and tackle corruption' were still necessary. The statement also recognised that ordinary Egyptians had borne much of the brunt of the ongoing reforms, and supported the government's 'strengthening the social security net' through the Takafol and Karama programmes.

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