بنك الإمارات دبي الوطني
Emirates NBD

Egypt
Quarterly
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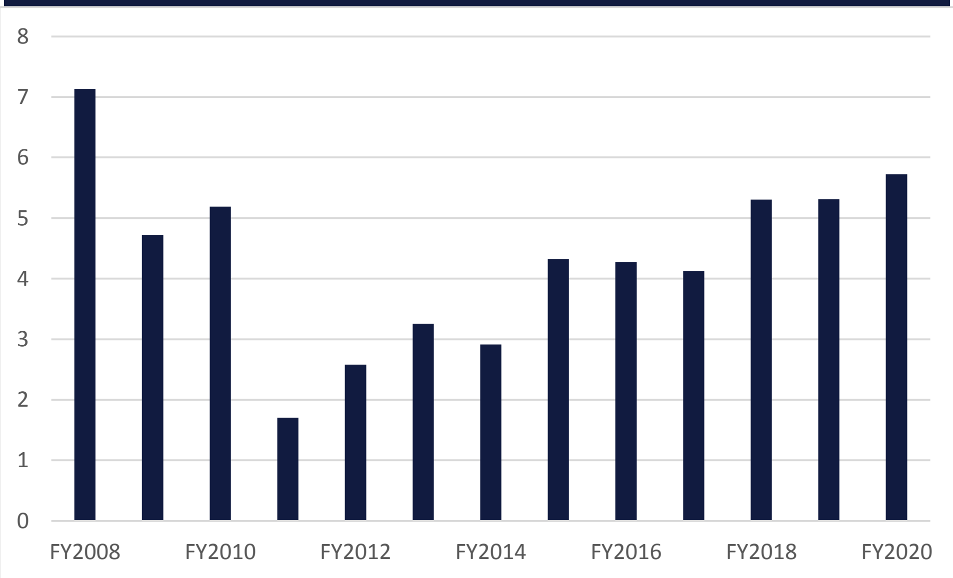
Egypt Quarterly

- **Growth outlook:** We forecast real GDP growth of 5.3% in Egypt in the current fiscal year (ending June), rising to 5.7% in 2019/20 and 5.9% in 2020/21. This is moderately less bullish than the government's projections, which envisage growth of 6.0% next year.
- **Fiscal policy:** Over the coming years we expect a further narrowing in Egypt's budget deficit, forecasting a shortfall equivalent to 7.2% of GDP in 2019/20 and 6.3% in 2020/21, down from a projected 8.5% in 2018/19 (ending June 30) and an average 10.6% over the previous decade.
- **Balance of payments:** Having narrowed markedly from 6.4% of GDP in FY 2016/17 to 2.5% last year, we expect a more moderate decline in Egypt's current account deficit, projecting a shortfall of 2.0% this year and 1.8% in 2019/20.
- **Monetary policy:** With the Central Bank of Egypt (CBE) having held its key benchmark rates static at its March 28 meeting, it seems likely that the overnight deposit and overnight lending rates will now remain at 15.75% and 16.75% respectively over the course of the summer months before cutting resumes later in H2.
- **Egyptian pound:** The Egyptian pound has strengthened to levels not seen since March 2016, trading at EGP 17.15/USD at the time of writing on May 6, compared to the EGP 17.90/USD around which it had hovered over the nine-month period from May through to January. While we do not anticipate that the trend will continue through the year, we have nevertheless revised our projections, and now envisage a year-end exchange rate of EGP 17.75/USD, compared to our previous outlook of EGP 18.00/USD.

Real GDP growth, % y/y



Source: Haver Analytics, Emirates NBD Research

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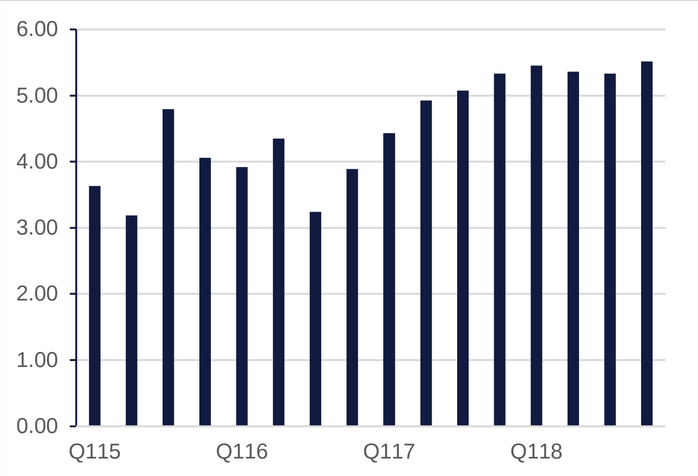
Growth Outlook

We forecast real GDP growth of 5.3% in Egypt in the current fiscal year (ending June), rising to 5.7% in 2019/20 and 5.9% in 2020/21. This is moderately less bullish than the government's projections, which envisage growth of 6.0% next year.

Real GDP growth, % y/y



Source: IHS Markit, Emirates NBD Research

Although the acceleration in growth seen at the start of Egypt's IMF-sponsored reform programme has slowed, the 5.5% expansion recorded in Q2 2018/19 was the fastest in years. Further, we still anticipate a moderate pick-up over the coming years as the growth-negative aspects of the programme ease, meaning the fruits of the hard work can finally be enjoyed. Growth is to now still driven by net external demand and government investment, but we anticipate an improvement in private sector activity and consumption over the coming years. With regards specific sectors, tourism remains a bright spot.

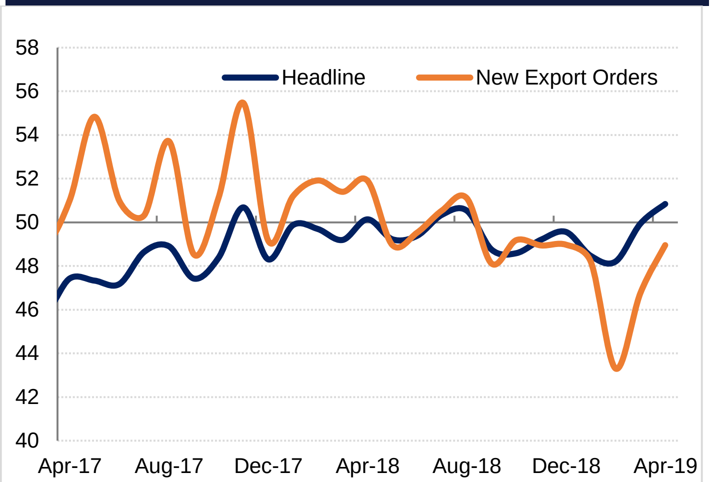
PMI turned positive in April

The private sector's contribution to growth in Egypt has been lackluster at best over recent years, as it has borne the brunt of government reform efforts. High inflation owing to currency depreciation and subsidy reforms, coupled with onerous borrowing costs as the CBE has maintained tight monetary policy, have impacted businesses and households alike. This has been reflected in the Emirates NBD Purchasing Managers Index (PMI), which has struggled to consistently post above the neutral 50.0 level. However, our expectation has long been that the private sector will start to improve this year as monetary policy slowly eases, and this appears to be being borne out by the most recent reading.

Egypt's non-oil private sector expanded at the fastest pace since August 2015 in April, as the PMI hit 50.8. This was the first time since August last year that the index has breached the neutral 50.0 level and the improvement from the first quarter – the PMI index averaged just 48.9 over January to March – was broad-based, with most of the index's subcomponents returning positive 50-plus readings. Significantly, output was positive for the first time in 18 months as firms noticed stronger demand, and a positive reading for new orders for the second month in a row bodes well for this continuing over subsequent readings. However, this uptick in new orders appears to be driven by domestic demand still, as new export orders remained in negative territory. Firms appear to be shoring up domestic demand by price discounting – output prices dipped back below 50, the third time this year they have declined.

With input prices increasing at a faster rate than seen in March, firms' margins will be squeezed by ongoing price discounting. Nevertheless, they appear to be more confident with regards future conditions as more respondents expect output to be greater in 12 months' time than they did in March, citing new projects and an improving tourism sector. This greater optimism is reflected in their hiring, as employment returned a reading above 50.0 – albeit marginally – for the first time since 2015. This reflects the Central Bank's assertion that unemployment has fallen to just 8.9%, the lowest level since Q4 2010, which should encourage greater household spending over the coming quarters.

Purchasing managers' index



Source: IHS Markit, Emirates NBD Research

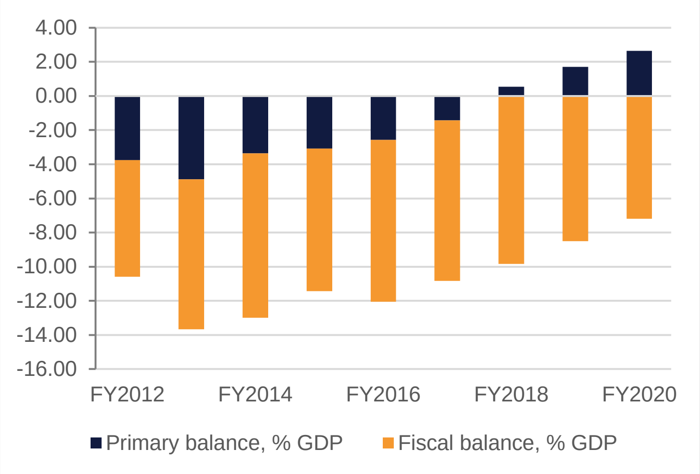
Tourism will outperform

One sector which we expect will have contributed to this decline in the jobless rate is tourism, which according to the World Travel & Tourism Council accounts for 9.5% of all Egypt's employment. The labour-intensive industry has been enjoying a remarkable recovery of late, with arrival numbers climbing 36.8% last year on top of a 53.6% increase in 2017. Not only that, but the average visit has also lengthened substantially. Although visitor numbers have not yet reached their pre-crisis levels of 14.7mn in 2010, we expect that further growth this year will see previous peaks approached once more. The Egyptian government has been striving for Russia and the UK to resume direct flights to Sharm el-Sheikh (they were ceased following the terrorist downing of a Russian plane in 2015), with British security experts helping in strengthening the airport's procedures. In the meantime, however, the resumption of Serbian flights to the resort after a six-year absence, along with a new Turkish airlines service from Moscow via Istanbul, will both support ongoing growth.

Fiscal Policy

Over the coming years we expect a further narrowing in Egypt's budget deficit, forecasting a shortfall equivalent to 7.2% of GDP in 2019/20 and 6.3% in 2020/21, down from a projected 8.5% in 2018/19 (ending June 30) and an average 10.6% over the previous decade. The government continues to make robust progress on fiscal consolidation through a comprehensive reform strategy that has, since its implementation in late 2016, slashed subsidies and hiked taxes such as VAT. This progress was recognised by ratings agency Moody's in April, when it upgraded Egypt's long-term foreign and local currency issuer ratings from B2 to B3. Nevertheless, its success remains constrained by elevated debt servicing costs that keep the headline balance deeply negative despite achieving a primary surplus in 2017/18.

Fiscal balance, % GDP



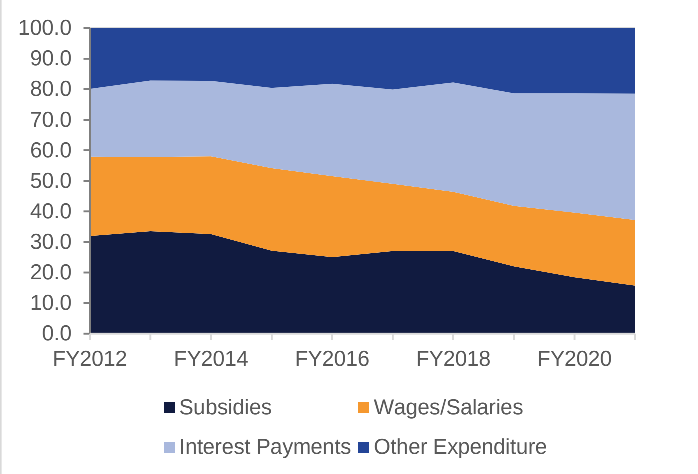
Source: Haver Analytics, Emirates NBD Research

Ongoing progress in curbing subsidies

Egypt's subsidy reforms have continued to make progress over the 2018/19 fiscal year, with July-February data showing a y/y decline of 9.1% in subsidy payments. Indeed, from 24.5% of total expenditure in 2015/16 (just prior to the IMF-sponsored programme), subsidy payments have fallen to just 18.8% of total expenditure over the year-to-date, and they are set to fall further next year as the fuel indexation mechanism is scheduled to come in from September. Wages have not seen quite the same decline, with wage payments expanding 15.1% y/y as of February – and a new minimum wage hike of 66.7% for public servants agreed in April will exert further pressure – but the political will for curbing government spending remains for the most part intact.

On the other side of the fiscal equation, there has been fairly robust growth in government revenues, which expanded by 23.0% ytd, bolstered by a 16.4% increase in tax revenues. We expect tax revenues to expand more rapidly in the coming years on the back of higher tax rates and greater private sector activity which we expect will follow anticipated rate cuts later in the year. The sale of state assets across 23 companies over three years, such as a stake of around 20% in Banque du Caire planned for later this year, will also bolster government finances by around EGP 80bn according to projections.

Expenditure, % of total



Source: Haver Analytics, Emirates NBD Research

Debt servicing will keep balance negative

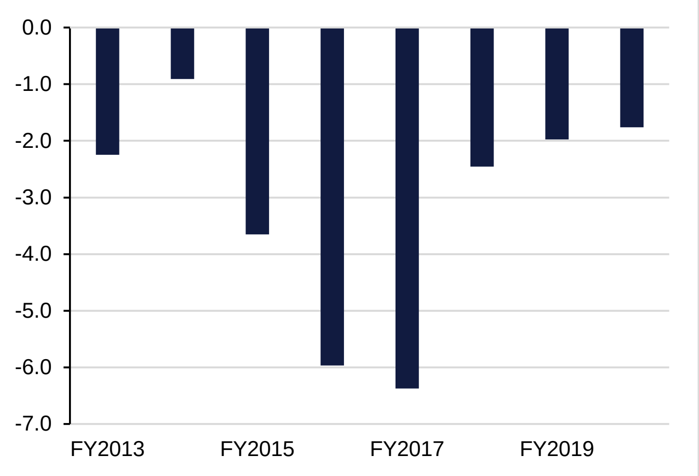
The above is undoubtedly strong progress, and has led to a primary surplus of 0.5% of GDP in 2017/18 which we forecast to expand to 1.7% this year and 2.6% next year. However, the headline deficit will remain deeply negative owing to the onerous debt servicing costs incumbent on Egypt. These accounted for 36.5% of spending over July-February, and increased 16.7% y/y. The government has been held back in its debt reduction through slower-than-anticipated monetary policy normalisation which has kept the cost of its local debt high. The 2019-2020 budget announced in March lays out a goal of 15.5% average for local debt, compared to an average of around 18% currently. Provided the CBE is able to cut rates later in the year – and we believe it will have room to do so – this should fall.

Debt servicing costs should also be constrained by ongoing diversification of Egypt's debt pile, in particular as the government looks to move its burden onto more longer-dated and foreign-denominated borrowing. In February, Egypt issued USD 4bn worth of Eurobonds with five-, 10- and 30-year maturities, and followed this up in April with EUR 2bn in six- and 12-year issuances.

Balance of Payments

Having narrowed markedly from 6.4% of GDP in FY 2016/17 to 2.5% last year, we expect a more moderate decline in Egypt's current account deficit, projecting a shortfall of 2.0% this year and 1.8% in 2019/20. According to the latest data, there was an ongoing narrowing in the trade deficit in Q2 2018/19 (ended December) compared to the previous quarter, although a seasonal decline in travel receipts negatively impacted the surplus in services. The continued improvement in Egypt's external position is contributing to positive investor perceptions – reaffirmed by a ratings upgrade from Moody's in April – and portfolio investors have returned to the country following the EM rout seen in H2 2018.

Current account balance, % GDP



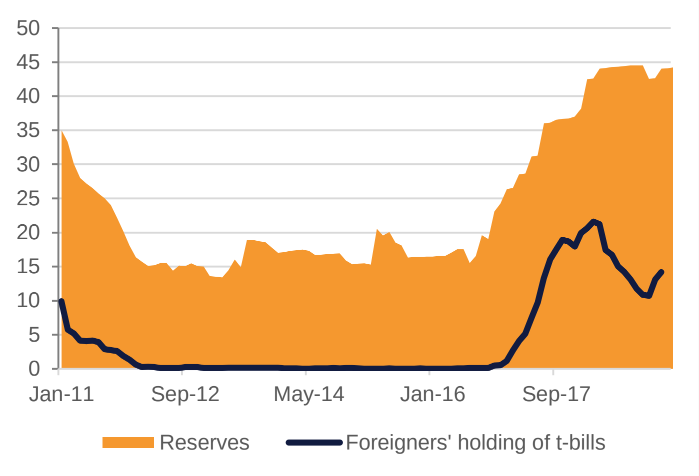
Source: Haver Analytics, Emirates NBD Research

Gas bonanza bolstering trade account

The offshore gas bonanza which turned Egypt into a net exporter in Q2 2018/19 has bolstered net exports, as the hydrocarbons component of the current account enjoyed a 57.6% y/y boost in exports in the quarter, while imports declined 24.4% – despite higher oil prices compared to Q4 2017. While the Zohr field remains the primary contributor of Egypt's natural gas, other fields such as Noras are also seeing rapid growth in output, and there are new exploration agreements for oil and gas fields both on and offshore in Egypt. With targeted investments of USD 8.1bn in the current fiscal year, the likelihood is that the sector will continue to drive an improvement in Egypt's current account.

This should help offset what has been anaemic growth in non-hydrocarbons goods exports. Despite the massive currency depreciation seen in 2016, Egypt has failed to capitalise on the opportunity to boost goods shipments abroad, and after declining 2.0% y/y in Q1 2018/19, other exports managed growth of just 2.0% in Q2. This has been reflected in the PMI survey data, which shows a decline in new export orders from the non-oil private sector every month since August last year. Goods imports, meanwhile, expanded at a double-digit pace over the same period, and capital goods related to hydrocarbons and infrastructure investment will likely maintain this disparity.

Reserves, USDbn



Source: Haver Analytics, Emirates NBD Research

Tourism supporting services balance

Although Egypt's services surplus narrowed compared to the previous quarter in Q2 2018/19, it nevertheless posted y/y growth of 20.8%, driven by a 16.3% increase in receipts. Travel receipts remain the star performer, growing 25.3% y/y – not only are visitors returning to Egypt but they are spending longer in the country, and we expect this trend to continue as travel bans are relaxed and tourists look to take advantage of the comparatively cheap pound. On the other side of the equation, the weaker spending power of Egyptians abroad means that travel payments remain a fraction of what they were prior to the 2016 devaluation.

Portfolio inflows have picked up again

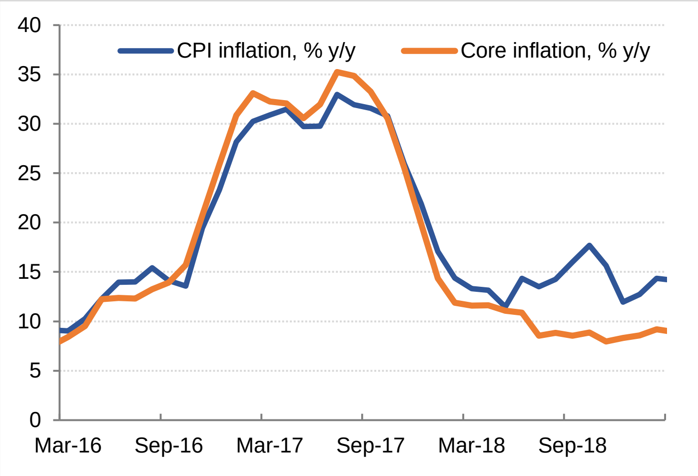
Looking at the wider balance of payments, Egypt recorded its first negative reading in nearly three years in Q2 2018/19, leading to a USD 2.0bn decline in reserves. This was owing in large part to a sharp reversal in portfolio inflows in the second half of 2018. We anticipate that this will have turned positive again in the second half of the fiscal year, however, as more contemporaneous data has shown a pick-up in foreign ownership of t-bills once more, and reserves have recovered to USD 44.2bn in April, from a 10-month low of USD 42.6bn in December. The ongoing decline in the current account deficit, coupled with fiscal consolidation efforts, a stable currency and improved security, have all bolstered international portfolio investors' perceptions of Egypt.

However, despite ongoing efforts to improve the operational environment in Egypt, with new investment laws and ongoing tape-cutting, FDI continues to lag. In the last reported quarter it was down 9.3% y/y, following a 2.7% decline in 2017/18. Further, the bulk of foreign investment remains targeted at the hydrocarbons sector, which will have limited impact on employment and sustainable growth.

Monetary Policy

With the Central Bank of Egypt (CBE) having held its key benchmark rates static at its March 28 meeting, it seems likely that the overnight deposit and overnight lending rates will now remain at 15.75% and 16.75% respectively over the course of the summer months. The bank's cautiousness will be reinforced by renewed inflationary pressures and the IMF's vocal support for ongoing tight monetary policy. While this will continue to weigh on both government finances and private sector activity, our expectation is for 100-200 bps of cuts over the final meetings of the year, which should help stimulate activity in FY 2019/20.

Inflation will remain prone to spikes



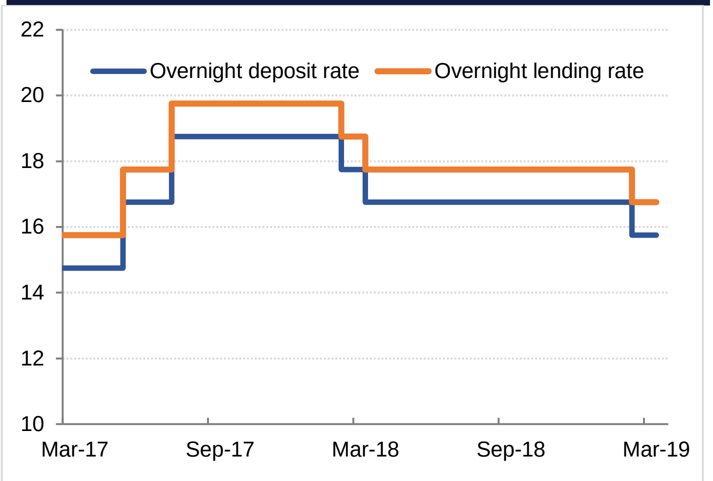
Source: Haver Analytics, Emirates NBD Research

Inflationary pressures remain

Price growth in Egypt will remain prone to spikes over the coming months, as ongoing subsidy reforms offset the deflationary effects of a moderately stronger currency. CPI inflation has fallen dramatically from the 33.0% peak seen in July 2017, but it remains susceptible to upturns, as seen in February when inflation rose to 14.4%, from 12.7% the previous month. While some of the subsidy reforms implemented in 2018 will pass through the base over the summer – for instance the average electricity tariff hike of 24% seen in July last year – there are new price hikes coming which will keep inflation at similar levels. The upcoming fuel indexation mechanism in particular – which will likely see its first price adjustments implemented in September – will keep CPI inflation from any meaningful decline as it drives fuel prices up to come in line with international prices.

We forecast an average inflation rate of 13.5% over calendar 2019, and think the CBE's inflation target of 9.0% ± 3 percentage points by Q4 2020 well within their means – but the above factors will likely see the MPC err on the side of caution through mid-2019. Further, keeping inflation down is not the bank's only concern, but it will likely be watching portfolio inflows into Egypt also. Foreign ownership of Egyptian treasury bills saw remarkable growth up to mid-2018, but Egypt was not immune to the EM rout that started with Argentina and Turkey and saw portfolio outflows across emerging markets. Inflows have begun ticking up again in recent months, and a more cautious US Fed and riskier-looking EM peers (Argentina, Turkey and South Africa all have salient ongoing domestic issues) will keep Egypt attractive, but the CBE will be wary of cutting too sharply and prompting renewed hot money flight.

Rates, %

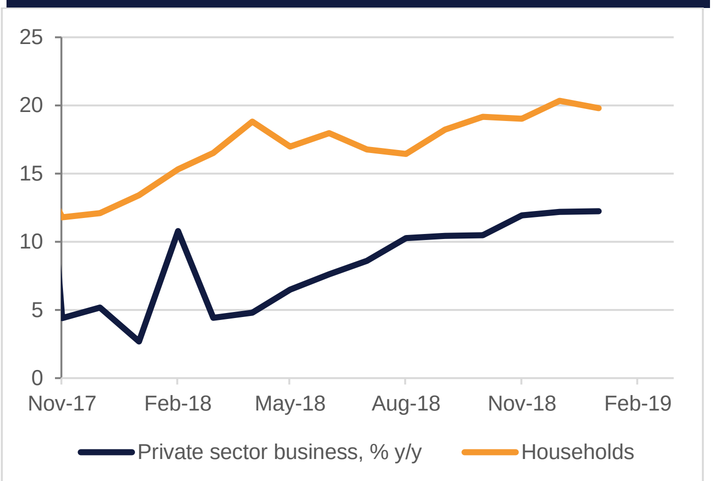


Source: Haver Analytics, Emirates NBD Research

Rate-cutting will resume in H2

While we expect that the rate-cutting cycle will remain on hold over the next several meetings, we remain of the view that it will resume later in 2019. Our expectation is that price pressures will ease – in part with lower oil prices as production picks up – which will give the CBE room to maneuver, especially in light of the more dovish global outlook for rates as compared to at the end of last year. Cutting rates will become increasingly important as the government seeks to curb its debt servicing costs and boost private sector activity, both of which have been negatively impacted by the necessitated tight monetary policy.

Credit demand is recovering



Source: Haver Analytics, Emirates NBD Research

Egyptian Pound

The Egyptian pound has strengthened to levels not seen since March 2016, trading at EGP 17.15/USD at the time of writing on May 6, compared to the EGP 17.90/USD around which it had hovered over the nine-month period from May through to January. While we do not anticipate that the trend will continue through the year, we have nevertheless revised our projections, and now envisage a year-end exchange rate of EGP 17.75/USD, compared to our previous outlook of EGP 18.00/USD.

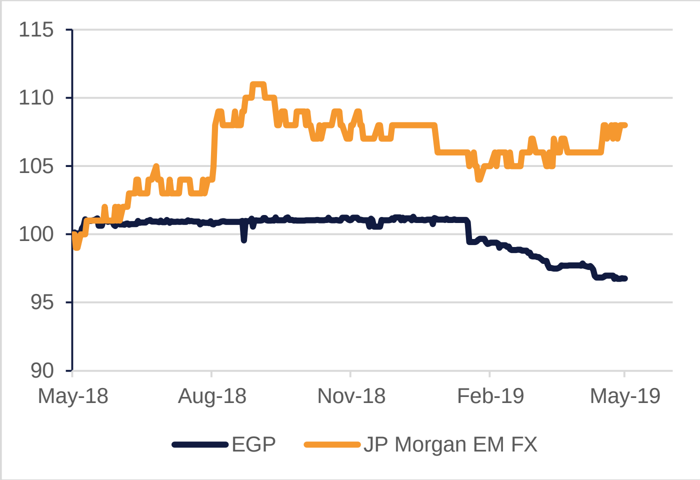
EGP/USD 6-months

Source: Bloomberg, Emirates NBD Research

The increased volatility anticipated as the CBE removed its repatriation mechanism in late 2018 has certainly been borne out as the pound has strayed from its previous long-held levels. However, fears over a renewed depreciation of the like seen in 2016 have been dispelled as the currency has put on a show of strength not seen for some time. The return of international portfolio investors since the start of the year is widely held to be responsible for the appreciation in recent months. Foreign portfolio investors had exited the market during the EM sell-off in H2 2018, but have since returned, contributing to a recovery in the CBE's FX reserve levels.

Relying on these hot money inflows for currency strength is a risk for Egypt, especially as stickier FDI inflows have lagged; the outflow last year demonstrated the capital flight risk involved with such a strategy. We expect that the resumption of the rate-cutting cycle later in the year will prompt some renewed weakness, leading to our expectation of a year-end rate of EGP 17.75/USD.

EGP, EM FX, rebased 12 months



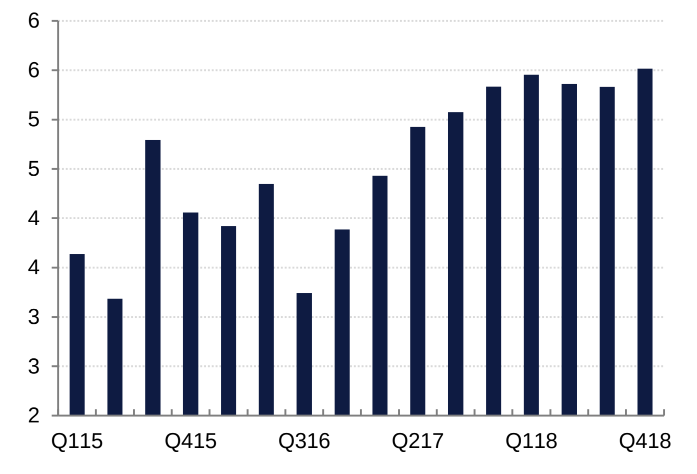
Source: Bloomberg, JP Morgan, Emirates NBD Research

This is closer to the government's budgeted level of USD 18.00/USD, and an overly strong pound would indeed pose risks to the economic recovery in Egypt. While it would be beneficial from an inflation perspective, helping to support household spending levels which have been constrained by rapid price growth since 2016, it would make Egyptian exports less competitive. The strong recovery in the tourism sector has in part been prompted by the cheaper currency, and the authorities will not wish to jeopardise this.

EGP/USD 5-years

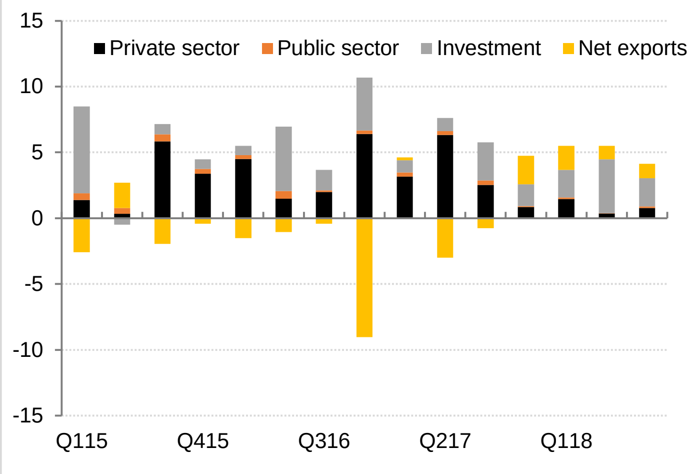
Source: Bloomberg, Emirates NBD Research

Real GDP growth, % y/y



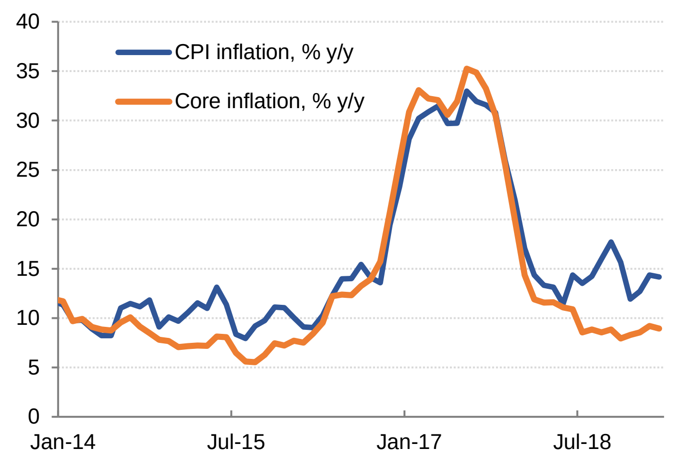
Source: Haver Analytics, Emirates NBD Research

Real GDP growth by expenditure



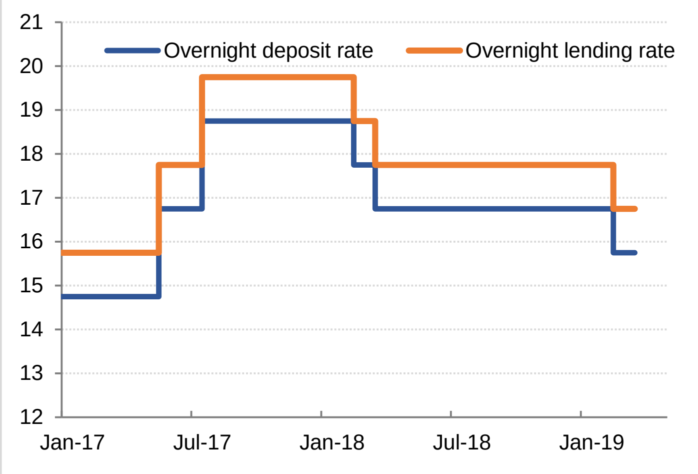
Source: Haver Analytics, Emirates NBD Research

Inflation



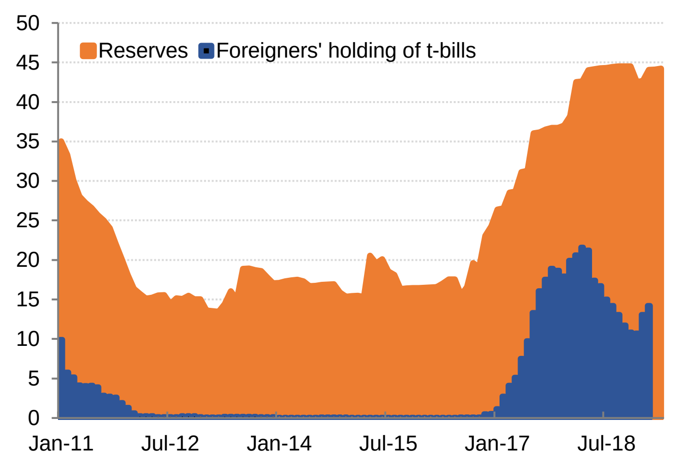
Source: Haver Analytics, Emirates NBD Research

Rates, %



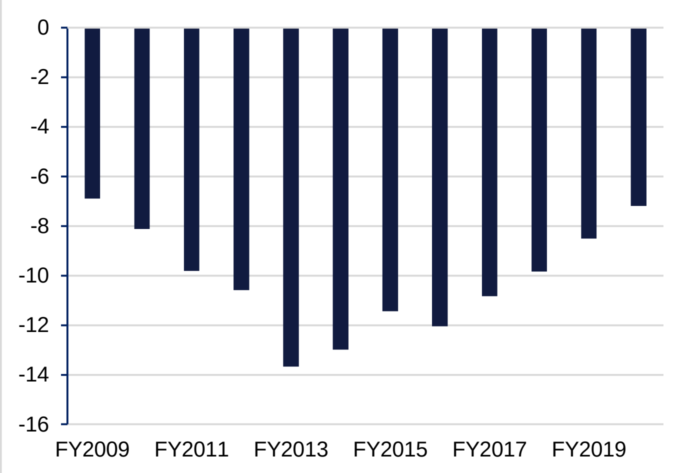
Source: Haver Analytics, Emirates NBD Research

Reserves, USDbn



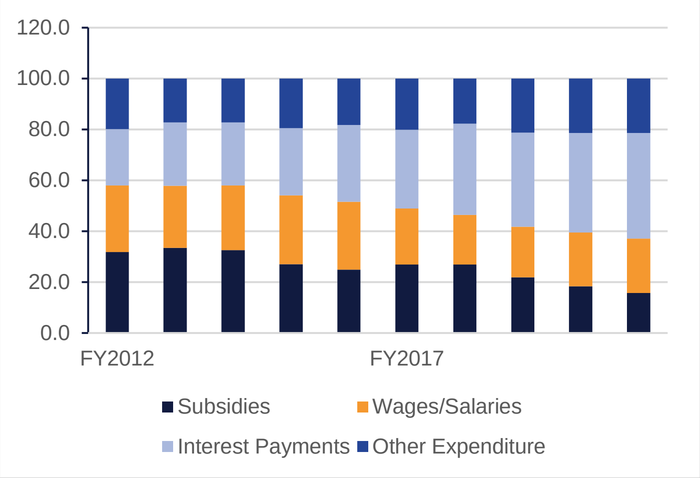
Source: Haver Analytics, Emirates NBD Research

Fiscal balance, % GDP



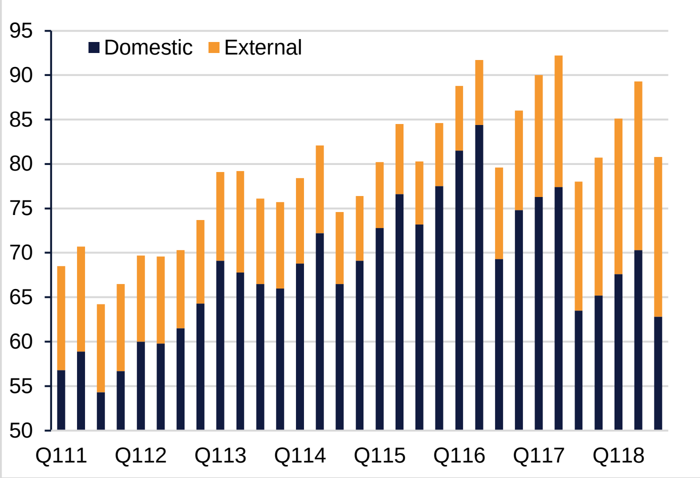
Source: Haver Analytics, Emirates NBD Research

Expenditure, % of total



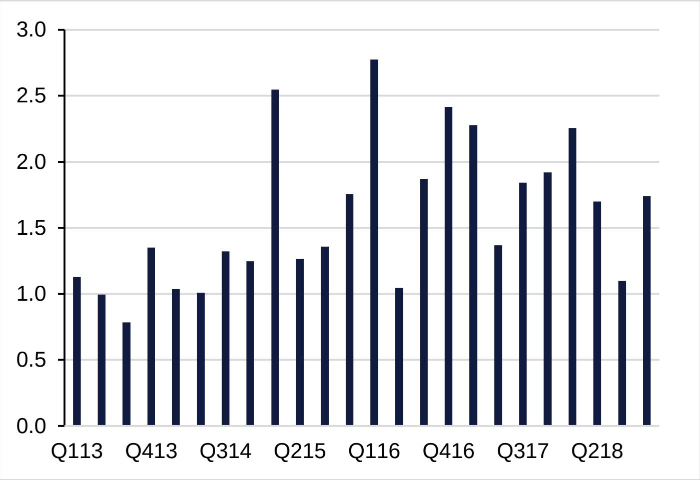
Source: Haver Analytics, Emirates NBD Research

Government debt, % GDP



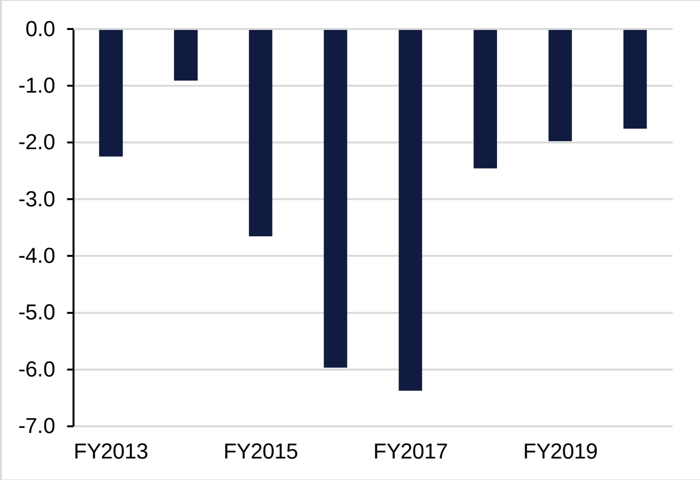
Source: Haver Analytics, Emirates NBD Research

Net FDI, USDbn



Source: Haver Analytics, Emirates NBD Research

Current account, % GDP

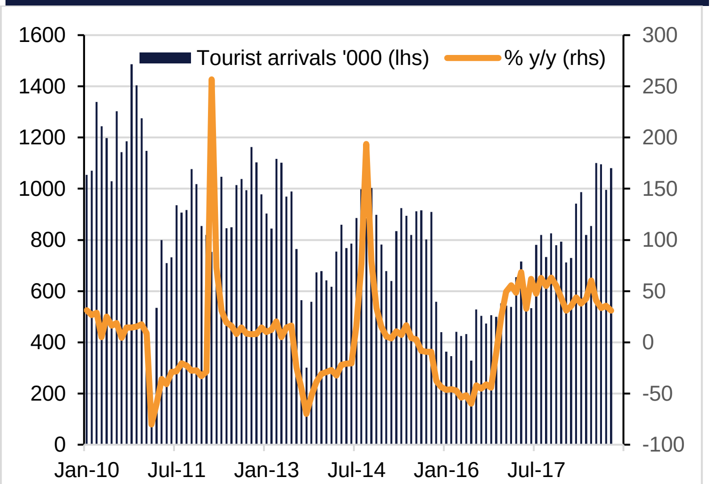


Source: Haver Analytics, Emirates NBD Research

EGP/USD

Source: Bloomberg, Emirates NBD Research

Tourist arrivals



Source: Haver Analytics, Emirates NBD Research

Key Economic Forecasts: Egypt

National Income*	2016	2017	2018	2019f	2020f
Nominal GDP (EGP bn)	2709.4	3442.0	4303.8	5138.8	6074.6
Nominal GDP (USD bn)	332.4	225.8	241.5	295.3	339.8
GDP per capita (USD)	3473	2314	2431	2919	3301
Real GDP Growth (% y/y)*	4.3	4.1	5.3	5.3	5.7
Monetary Indicators (% y/y)					
M2	18.6	39.3	19.7	17.8	17.7
CPI (average)	13.7	29.6	14.4	12.5	12.0
External Accounts (USD bn)*					
Exports	18.7	21.7	25.8	26.8	31.2
Imports	57.4	59.0	63.1	75.3	78.9
Trade Balance	-38.7	-37.3	-37.3	-48.6	-47.7
% of GDP	-11.6	-16.5	-15.4	-16.4	-14.0
Current Account Balance	-6.4	-2.8	-6.0	-6.0	-6.2
% of GDP	-6.0	-6.4	-2.5	-2.0	-1.8
Reserves	17.6	31.3	44.3	42.0	42.0
Public Finances*					
Revenue (EGP bn)	491488	659184	805741	985252	1092689
Expenditure (EGP bn)	804704	1025109	1219826	1422685	1530323
Balance	-326355	-372758	-423391	-437433	-437634
% of GDP	-12.05	-10.83	-9.84	-8.51	-7.20
Central Government Domestic Debt (EGP mn)	2285644	2685898	3121804	4000000	4500000
% of GDP	84.4	78.0	72.5	77.8	74.1
Total Debt, % GDP	104	105.9	102.3	93.6	93.2

*Source: Haver Analytics, Emirates NBD Research. *Fiscal*

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