بنك الإمارات دبي الوطني
Emirates NBD

# Egypt Quarterly

Egypt Quarterly
7 February 2019

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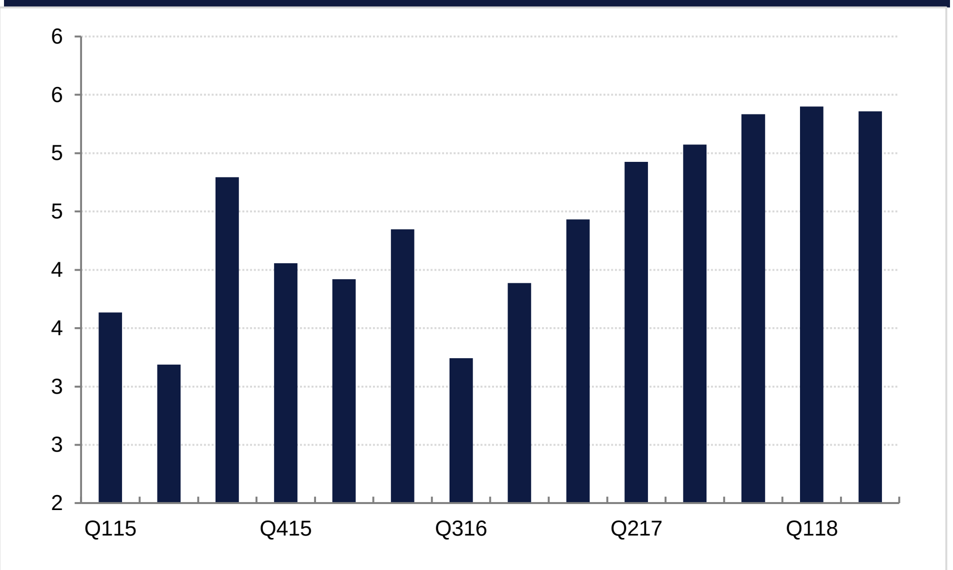
- **Growth outlook:** We have made moderate downward revisions to our Egyptian real GDP growth forecasts since last quarter; we now project an expansion of 5.3% in the current fiscal year (ending June 2019), rising to 5.9% in 2019/20. This compares to our previous expectation of 5.5% and 6.1% respectively, and would see flat growth this year following the 5.3% growth recorded in 2017/18. While no quarterly GDP data for the current fiscal year has as yet been released, we expect that the first half will have seen fairly stagnant activity at best as EM aversion and rising oil prices exacerbated domestic growth impediments related to subsidy reform and investor uncertainty.
- **Fiscal policy:** We forecast a budget deficit equivalent to -9.6% of GDP in Egypt this year, down only modestly from -9.8% in 2017/18, and despite ongoing government commitment to fiscal consolidation and economic reform. High borrowing costs, combined with a spike in oil prices in the second half of calendar 2018, will have weighed on deficit reduction efforts this fiscal year, but we project an improvement to -8.2% of GDP in 2019/20.
- **Balance of payments:** Having narrowed markedly in 2017/18, we anticipate that there will be a further reduction in Egypt's current account deficit this year, if not quite to the same degree. From 6.1% of GDP in 2016/17, the implementation of the IMF-sponsored reform programme since November 2016 helped bring it down to 2.5% last year. This year we forecast it will be equivalent to 2.3%, and to 2.0% in 2019/20. Declining energy imports as offshore gas fields come online and oil prices average lower will be a major driver, aided by growth in services exports related to the tourism sector, although non-oil goods exports have underperformed.
- **Monetary policy:** Despite the likely negative effect of such a move on the government's fiscal balance and private sector activity, we expect that the Central Bank of Egypt will keep its benchmark interest rates on hold at its next two meetings – February 14 and March 28 – with the cutting cycle likely to be resumed at the May or July meetings.
- **Egyptian pound:** The start of 2019 has already seen greater movement in the Egyptian pound, in the wake of the CBE's move away from its repatriation mechanism at the close of 2019.

**Real GDP growth, % y/y**




*Source: Haver Analytics, Emirates NBD Research*

## Content

## Growth Outlook

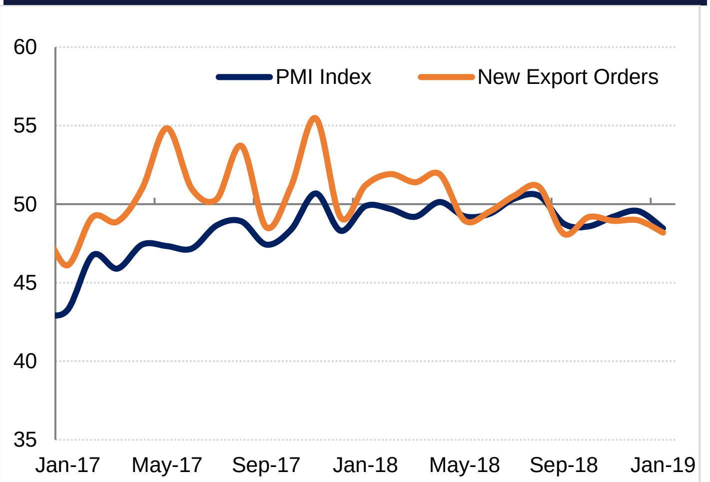
We have made moderate downward revisions to our Egyptian real GDP growth forecasts since last quarter; we now project an expansion of 5.3% in the current fiscal year (ending June 2019), rising to 5.9% in 2019/20. This compares to our previous expectation of 5.5% and 6.1% respectively, and would see flat growth this year following the 5.3% growth recorded in 2017/18. While no quarterly GDP data for the current fiscal year has as yet been released, we expect that the first half will have seen fairly stagnant activity at best as EM aversion and rising oil prices exacerbated domestic growth impediments related to subsidy reform and investor uncertainty.

As we enter the new calendar year the outlook is moderately brighter, and we continue to see bright spots in the Egyptian economy which should elevate its performance hereafter – namely potentially looser monetary policy, strong performances from tourism and offshore gas, and ongoing government investment.

### Private sector should improve

Although the Emirates NBD Purchasing Managers' Index for Egypt's non-oil private sector enjoyed two months of over-50.0, expansionary readings in Q1 2018/19, the index has been relatively weak thereafter, remaining below the neutral 50.0 mark which delineates expansion and contraction. We believe that this will have weighed on headline GDP growth over the start of the year, contributing to our growth downgrade. Nor has H2 started well, as the index fell from 49.6 in December to 48.5 in January, the lowest level since December 2017. Weighing on the headline figure in January were the outsize output and new orders components, which both fell on the previous month. Respondents cited a number of factors behind this, including adverse weather conditions and generally poor market conditions. External demand was also weak, as export orders experienced a fall for the fifth month in a row, and business optimism among respondents fell to the lowest level since October 2016.

**Purchasing managers' index**




*Source: IHS Markit, Emirates NBD Research*

Nevertheless, in spite of the weak headline data, there were some improvements in the January survey, not least in prices. Input prices fell to a series low in January, led by a marked slowdown in purchase costs. These had spiked in mid-2018 as subsidy reforms led to a rapid increase in utility costs and other expenses for firms, but these inflationary pressures have begun to weaken in recent months. This in turn enabled firms to cut output prices, which posted a sub-50.0 reading for the first time. Despite upcoming inflationary pressure from subsidy reform – especially the fuel indexation mechanism - this should contribute to an ongoing moderation in CPI inflation, which fell to 12.0% in December. This potentially paves the way for the central bank to begin loosening monetary policy later in the year, which would give a much-needed boost to the private sector.

### FDI underperforming

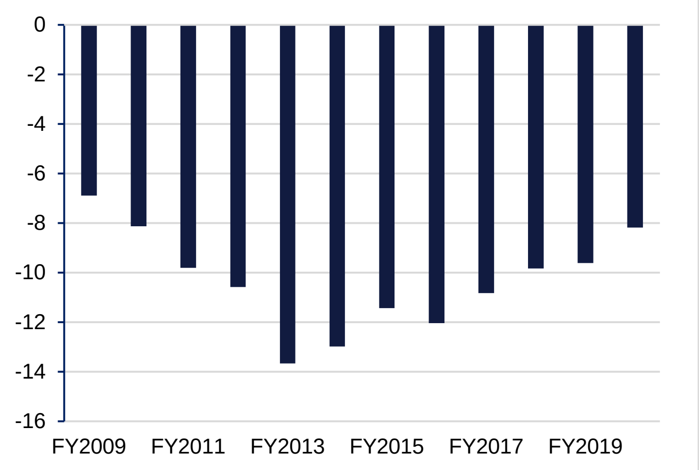
Another contributing factor to our growth downgrade has been weaker-than-anticipated FDI into Egypt. Investment generally has been the strongest growth component of GDP by expenditure, but this has been driven by government investment and foreign investment into the hydrocarbons sector, while FDI into other parts of the economy has lagged. Indeed, in 2017/18, FDI actually fell y/y, from USD 7.9bn to USD 7.7bn, and the current fiscal year has seen some negative developments; talks with international developers over the development of the new administrative capital project – China's CFLD and the UAE's Emaar – reportedly broke down in recent months. With disagreements over pricing and revenue-sharing apparently behind the collapses, their withdrawal could colour other potential investors' perceptions of Egypt, despite ongoing efforts to cut red tape. As such, we believe the government's target of USD 11bn in FDI unlikely to be met.

Nevertheless, we do anticipate that there will be an improvement in FDI this year and next, more likely in the region of USD 9bn. Much of this will continue to be driven by the offshore gas sector, but we also anticipate that ongoing growth in visitor numbers should entice greater FDI into the tourism sector also. We believe that tourism generally will be a bright spot this year, despite the terrorist bombing in December which killed three tourists and their Egyptian guide in Giza in December 2018. Provided such incidents do not become more widespread, we expect further strong growth in 2018/19, following the 47.6% y/y increase recorded last year. It is not only the volume of visitors that has increased; the average night stay by tourists last year was 10.9, up from 7.8 in 2017/18. As travel restrictions introduced in 2015 are relaxed, there is potential for even stronger growth.

# Fiscal Policy

We forecast a budget deficit equivalent to -9.6% of GDP in Egypt this year, down only modestly from -9.8% in 2017/18, and despite ongoing government commitment to fiscal consolidation and economic reform. High borrowing costs, combined with a spike in oil prices in the second half of calendar 2018, will have weighed on deficit reduction efforts this fiscal year, but we project an improvement to -8.2% of GDP in 2019/20. It was reported in January that President Sisi had directed the ministerial economic committee to continue working towards narrowing the budget deficit through ongoing implementation of the economic reform programme.

**Fiscal balance, % GDP**



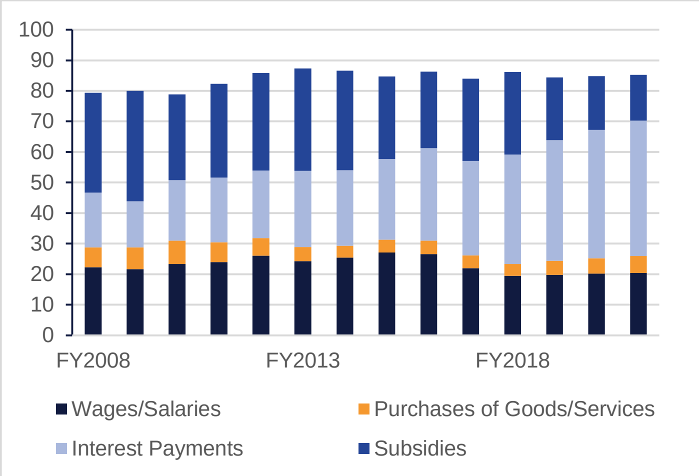

*Source: Haver Analytics, Emirates NBD Research*

While the headline deficit figure remains wide, this belies somewhat the progress that the government's reform efforts have made, illustrated by our expectation that Egypt will continue to post primary surpluses. After turning positive for the first time in a decade last year at 0.5% of GDP, we forecast a primary surplus of 1.5% of GDP this year, climbing to 2.5% in 2019/20. Given the yawning gap between the primary and headline budget balances, reducing debt servicing costs will likely be a priority of the government. Although they will be aided in this endeavour by a probable loosening of monetary policy by the CBE later in the year, we expect that alternative borrowing channels on international debt markets will also be increasingly explored.

We anticipate fairly robust growth in government revenues this year, borne out by July-November data showing a y/y increase of 27.1% over the period – this follows 22.2% growth in 2017/18. Ongoing efforts to widen the tax base, coupled with fairly robust GDP growth, will contribute to this, as will the offshore gas boon. On the expenditure side, spending over August-November showed a y/y increase of 16.7%, a marked slowdown on the 32.0% expansion recorded over the same period a year earlier. There has been substantial progress in curbing subsidy payments as part of economic reform efforts, which were down 5.0% on the previous year, but spending on wages and salaries – nearly a quarter of total spending – recorded growth of 19.1%.

Interest payments also saw substantial growth, of 18.3%, and these will likely continue to keep Egypt's headline deficit figure in negative territory. Debt servicing costs now account for 36.8% of total expenditure, compared to just 26.3% in fiscal 2014/15. In 2018/19 in particular, high benchmark interest rates in Egypt will keep this cost burden especially high, through its impact on local debt. The 2018/19 spending plan reportedly budgeted for interest rates on government debt securities to average 14.7%, down from the 18.5% budgeted in last year's plan. Renewed foreign interest over the past several months as EM aversion has waned saw average local debt yields fall 44 basis points on January 28, but at 17.6% they are still high.

**Expenditure, % of total**



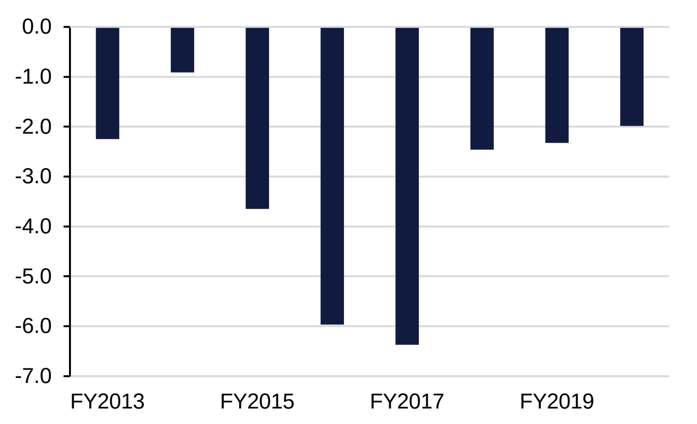

*Source: Haver Analytics, Emirates NBD Research*

Given that local debt costs will remain substantial over the next six months, we anticipate ongoing efforts by the authorities to broaden their debt pile through issuance of longer-dated and international debt. Finance minister Mohamed Maait said in January that there would be an offering in February or March to raise as much as USD 3bn- USD 7bn in dollar- and euro-denominated bonds, and the ministry of finance has said that further green bond issuances in an unspecified Asian currency would follow before the end of the fiscal year. Egypt's 2028 eurobond currently trades with a yield of 7.9%, meaning that moving more of the debtload onto these lower yields would help reduce the debt servicing costs.

# Balance of Payments

Having narrowed markedly in 2017/18, we anticipate that there will be a further reduction in Egypt's current account deficit this year, if not quite to the same degree. From 6.4% of GDP in 2016/17, the implementation of the IMF-sponsored reform programme since November 2016 helped bring it down to 2.5% last year. This year we forecast it will be equivalent to 2.3%, and to 2.0% in 2019/20. Declining energy imports as offshore gas fields come online and oil prices average lower will be a major driver, aided by growth in services exports related to the tourism sector, although non-oil goods exports have underperformed.

**Current account balance, % GDP**

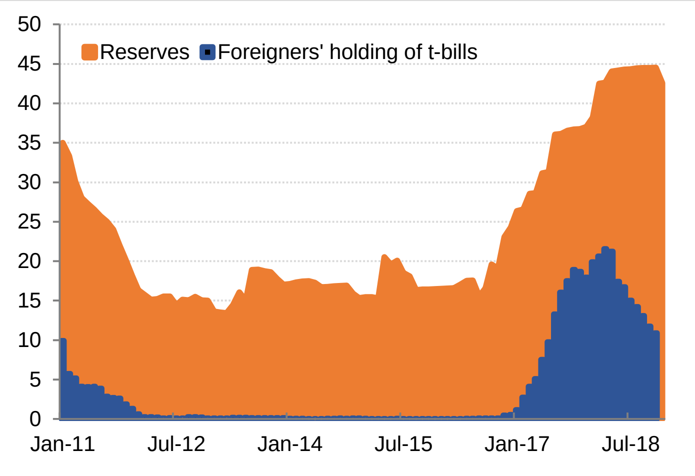



*Source: Haver Analytics, Emirates NBD Research*

The release of Q1 2018/19 balance of payments data (ended September 2018) shows that services remain the bright spot in Egypt's current account, with tourism in particular generating strong income growth. Travel receipts were up 45.7% y/y, and we expect an ongoing robust expansion as not only are more visitors coming, but the length of the average stay is also increasing. The continued relaxation of travel restrictions by origin countries as security improves will likely support further growth this year. Equally, Egypt's travel payments abroad will likely remain constrained by the after-effects of the pound's depreciation in late-2016. Although payments were up 10.4% y/y in Q1, they remain a third off levels seen in Q1 2016/17.

Looking at trade in goods, petroleum imports weighed heavily on Q1's current account, climbing 27.1% y/y. However, while they have seen continued strong growth at the start of Q2, the collapse thereafter will have been a positive for Egypt's trade balance, as will our forecast for Brent crude to average USD 65/b this year, following USD 72/b in 2018. Looking further ahead, President Sisi's calls for Egyptians to convert their cars to run on natural gas rather than petrol could be a major boon for the trade balance, and an effective import substitution to a product which Egypt is increasingly rich in. The launch of the Zohr gas field last year has negated Egypt's need to import, and petroleum minister Tarek el-Molla said in January that Egyptian natural gas production would hit 8bn cubic feet/day this year. The laggard in the trade data remains Egypt's non-oil exports, which actually declined 2.0% y/y in Q1, and which have not rebounded as quickly as the authorities might have liked, given the substantially cheaper pound. This is reflected in our PMI data for Egypt, wherein new export orders have averaged a contractionary 49.3 since the fiscal year began.

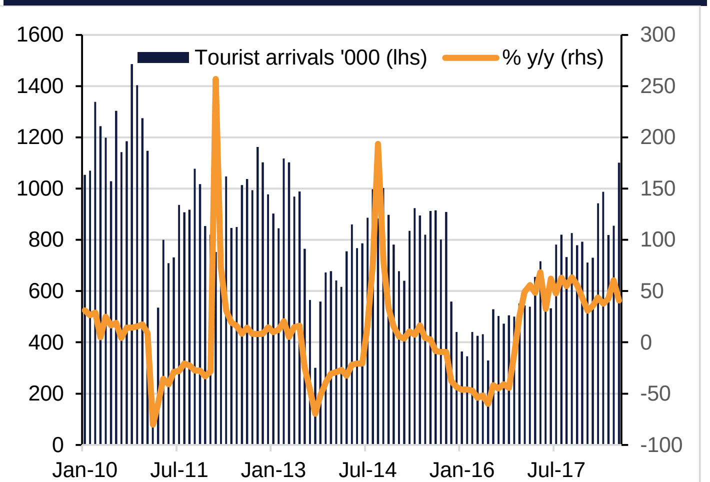
**Reserves, USDbn**




*Source: Haver Analytics, Emirates NBD Research*

Of the other components of the balance of payments, we anticipate an improvement in the financial account. This will be driven by stronger portfolio investment in Egypt over the second half of the fiscal year, after it turned negative in Q4 2017/18. Egypt was hit by the global EM aversion which saw a substantial reversal in the foreign inflows into treasury bills it had enjoyed over the previous 12 months, but the outlook is substantially improved now, as foreign investors are reportedly once more piling in to Egyptian debt. FDI should also see an improvement thanks to ongoing improvements in security and the business environment, although it lagged in the Q1, falling 40.3% y/y.

**Tourism**

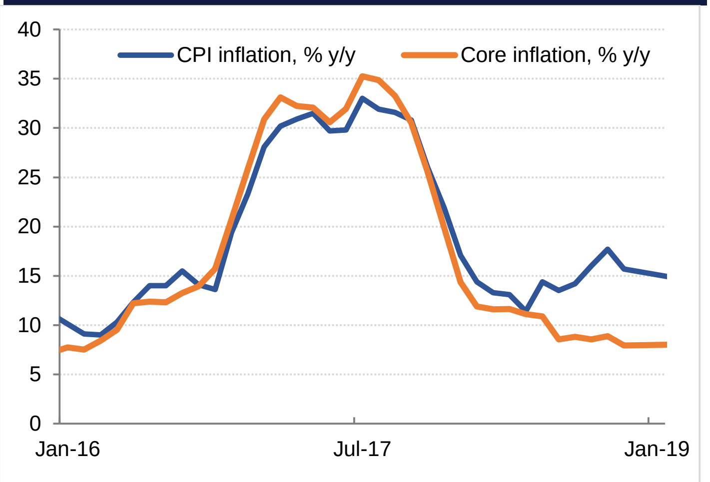



*Source: Haver Analytics, Emirates NBD Research*

# Monetary Policy

Despite the likely negative effect of such a move on the government's fiscal balance and private sector activity, we expect that the Central Bank of Egypt will keep its benchmark interest rates on hold at its next two meetings – February 14 and March 28 – with the cutting cycle likely to be resumed at the May or July meetings. The external outlook certainly looks more favourable than it did in mid-2018, as concerns over EM weakness in the face of global monetary tightening and higher oil prices have dissipated – as evidenced by renewed foreign interest in Egyptian local debt. Domestically too, the conditions look more in favour of a rate cut, as inflation fell to its lowest point in seven months in December, at 12.0%.

**Inflation stabilising**

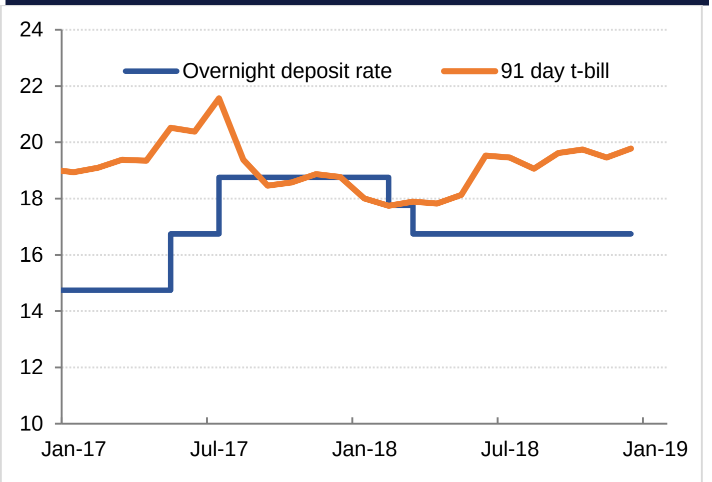



*Source: Haver Analytics, Emirates NBD Research*

Nevertheless, we believe that with a potential uptick in inflation as a new fuel indexation mechanism is introduced in April. As the central bank moves away from its repatriation mechanism, opening the Egyptian pound up to more volatility, the CBE will maintain its cautious stance for the time being. At its last meeting in December, the MPC kept rates on hold for a fifth consecutive meeting, maintaining the overnight deposit and the overnight lending rates at 16.75% and 17.75% respectively. In its communiqué, it affirmed that it would 'not hesitate to adjust its stance to achieve its mandate of price stability over the medium term.'

The major inflationary shock which saw CPI inflation hit a peak of 33.0% y/y in July 2017 in the wake of 2016's depreciation of the pound is now behind us, and it is highly unlikely that such levels will be seen again over the next several years. Indeed, average inflation in 2018 was 14.4%, compared to 29.6% in 2017, and we forecast a further decline to 12.0% this year. That being said, we do not expect a linear decline in inflation from December's reading; there will be some support for slower price growth from a moderately stronger pound in the near term, but demand pressures will likely pick up in the coming months, and the key determinant of inflation levels will remain government reforms. Aside from the removal of the pound's peg to the dollar in late 2016, other government policies including hikes to VAT rates and the gradual removal of subsidies have driven inflation over the past two years, and it looks likely that the delayed fuel indexation mechanism will now be introduced in April, which will exert inflationary pressure. Once this has bedded in, the CBE will be in a better position to resume the rate-cutting cycle it put on hold in 2017.

**Rates, %**




*Source: Haver Analytics, Emirates NBD Research*

If domestic factors were all that counted, the CBE might be in a position to cut rates in February should there be another substantial fall in inflation, but the MPC will also have an eye on the wider global context, not least portfolio inflows. These remain particularly important for Egypt's balance of payments given the lag there has been in FDI inflows.

Pressure on EM has eased significantly since the rout seen last year as tightening in global DM looks somewhat less assured, and foreign ownership of Egyptian treasury bills has reportedly started to pick up again after its marked decline which started in Q2 last year. Speaking to Bloomberg in January, CBE governor Tarek Amer said that January was set to be the first month of positive net inflows since May 2018. Nevertheless, the CBE will likely be wary of jeopardizing this positive turnaround by cutting too early. This is especially the case given the caution it has displayed to date, and in light of ongoing tight monetary policy stances in Turkey, Nigeria, South Africa and Argentina.

After they declined for the first time in the course of the IMF programme in December, the CBE will also have an eye on reserves, especially as it has moved away from the repatriation mechanism which previously kept a significant proportion of hot money inflows in a separate account. One factor cited as being behind this was the delay to the IMF's disbursement of its loan tranche, which was finally approved on February 5.

# Egyptian Pound

The start of 2019 has already seen greater movement in the Egyptian pound, in the wake of the CBE's move away from its repatriation mechanism at the close of 2019. Indeed, the pound has appreciated around 1.7% since January 23, from the EGP 17.90/USD level around which it sat fairly consistently through the course of 2018, to EGP 17.60/USD at the time of writing on February 4. While it seems likely that there will be some higher volatility in the exchange rate over the coming months, we do not anticipate that there will be a significantly larger move in either direction from current levels. For the time being we maintain our projection for a year-end exchange rate of EGP 18.00/USD, implying a modest depreciation over the year.

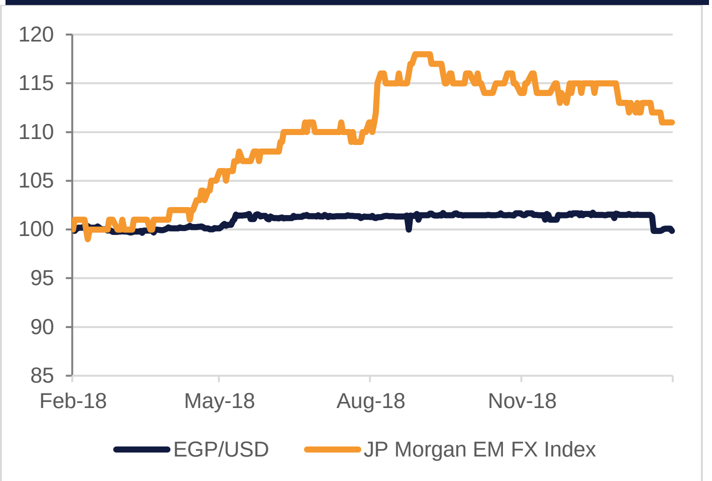
**EGP/USD 5-years**


*Source: Bloomberg, Emirates NBD Research*

Throughout the turmoil which impacted EM currencies globally through mid-2018, the Egyptian pound remained remarkably stable, despite facing many of the same challenges as countries more obviously affected, such as Argentina and Turkey. These included higher oil prices, global monetary tightening, and wide current account deficits. Indeed, Egypt was not immune from investor aversion, as evidenced by the dramatic turnaround in foreign ownership of t-bills over the period. Nevertheless, the pound maintained its EGP 17.90/USD level throughout, in part owing to the repatriation mechanism which kept much of what the CBE had deemed to be hotter investment inflows in a separate account in order to maintain dollar stability.

The repatriation mechanism was closed in December as the authorities judged that the Egyptian recovery and reserves accumulation have been robust enough to ensure dollar availability hereafter. Indeed, while non-oil goods exports and FDI has been sluggish, there is strong growth in remittances and tourism income, and IMF support and the issuance of dollar-denominated debt will also be supportive. Crucially, it appears to be renewed interest in local debt that sparked the recent appreciation. Speaking to Bloomberg just before this took place, central bank governor Tarek Amer said that greater volatility was probable as banks now have to go through the interbank market.

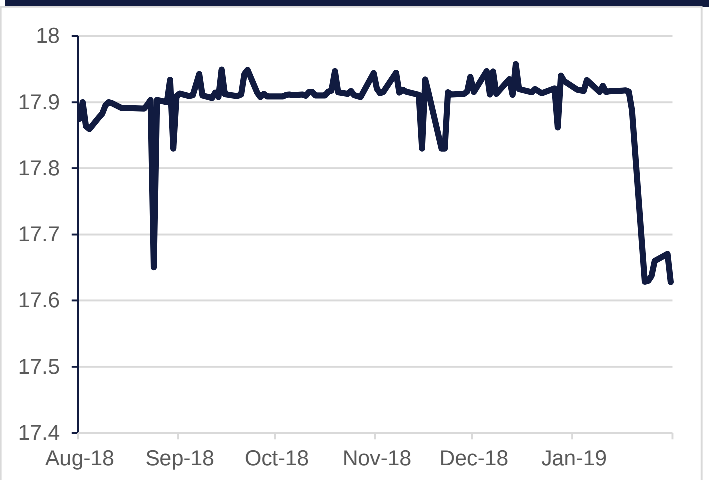
**EGP, EM FX, rebased 12 months**




*Source: Bloomberg, JP Morgan, Emirates NBD Research*

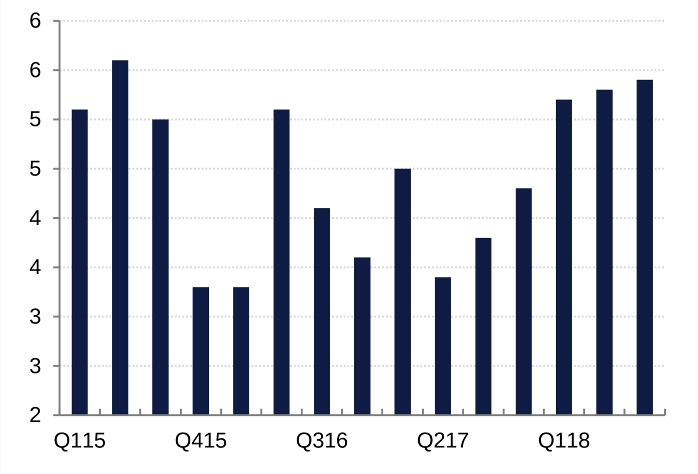
Nevertheless, we anticipate that the CBE will continue to keep the pound fairly stable, as evidenced by Amer's statement that 'we have reserves that help us to confront any speculators or disorderly market practices.' Large moves in either direction are unfavourable to the recovery at present, given the ongoing need to encourage FDI into sectors other than hydrocarbons.

**EGP/USD 6-months**



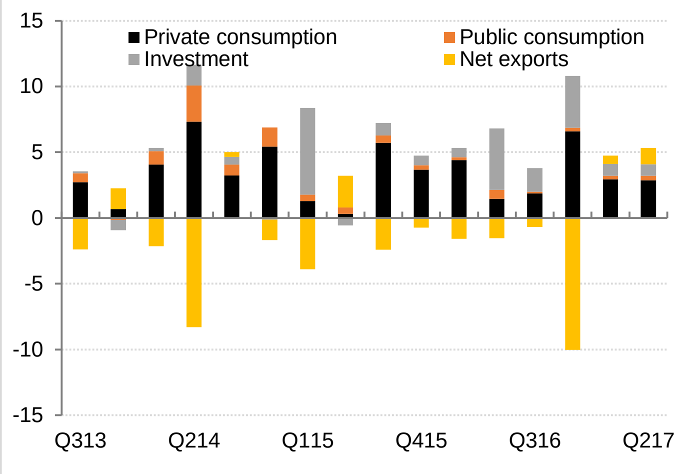

*Source: Bloomberg, Emirates NBD Research*

## Real GDP growth, % y/y



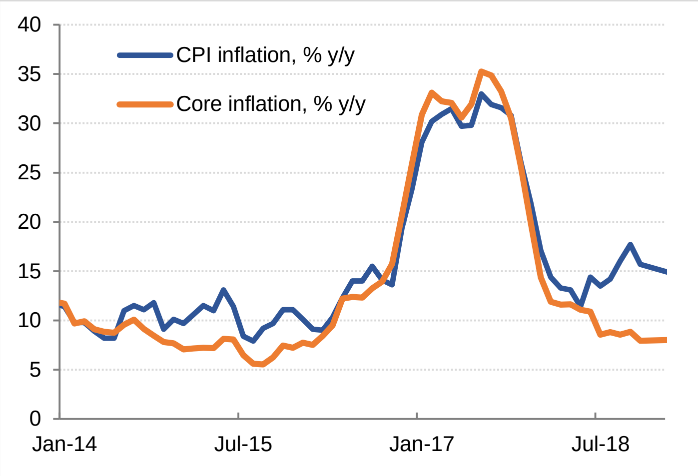

*Source: Haver Analytics, Emirates NBD Research*

## Real GDP growth by expenditure



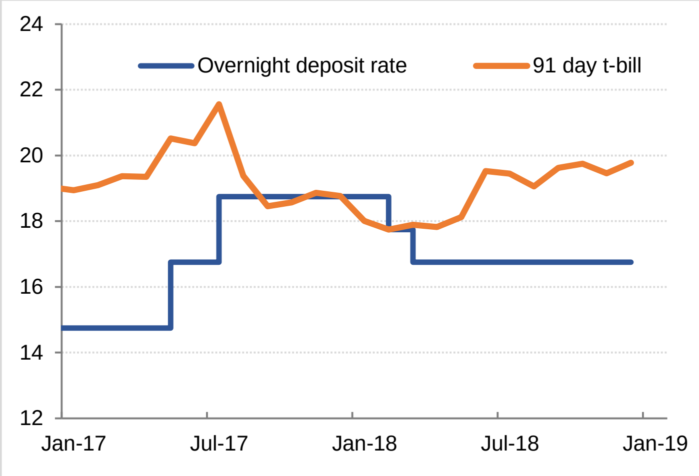

*Source: Haver Analytics, Emirates NBD Research*

## Inflation



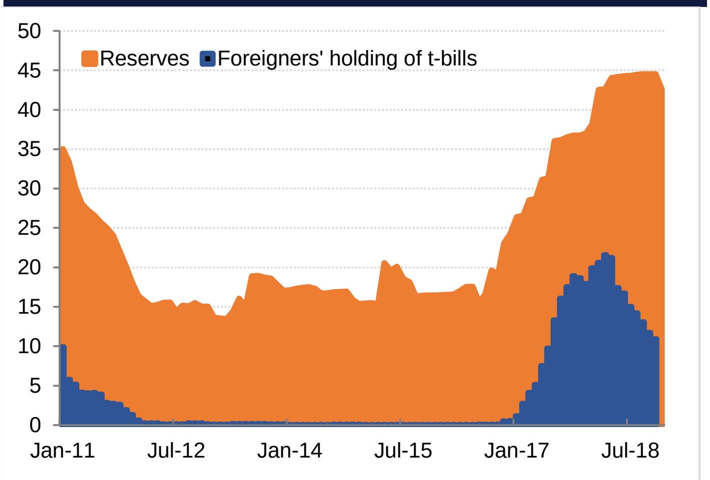

*Source: Haver Analytics, Emirates NBD Research*

## Rates, %



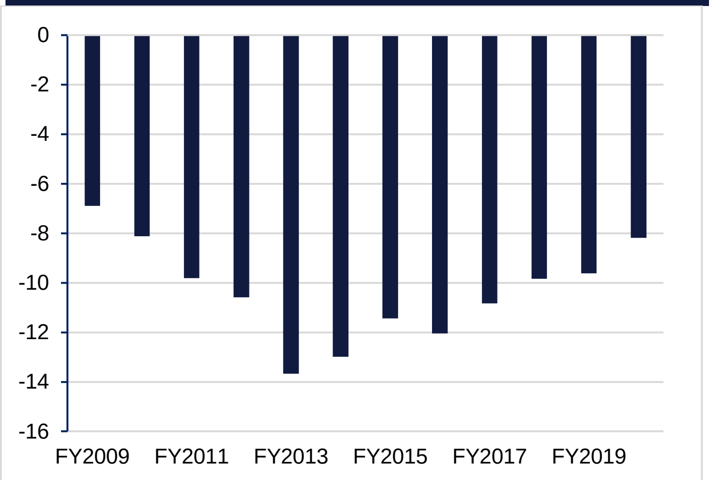

*Source: Haver Analytics, Emirates NBD Research*

## Reserves, USDbn



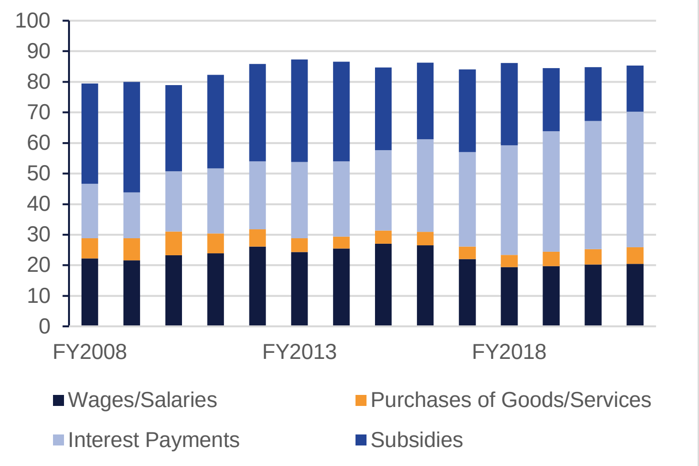

*Source: Haver Analytics, Emirates NBD Research*

## Fiscal balance, % GDP



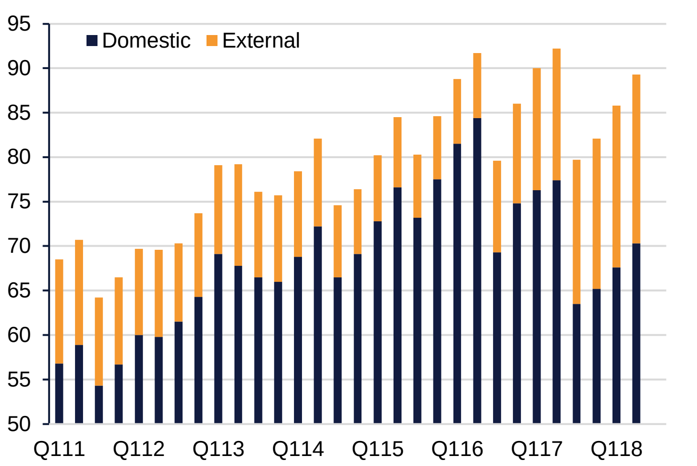

*Source: Haver Analytics, Emirates NBD Research*

## Expenditure, % of total



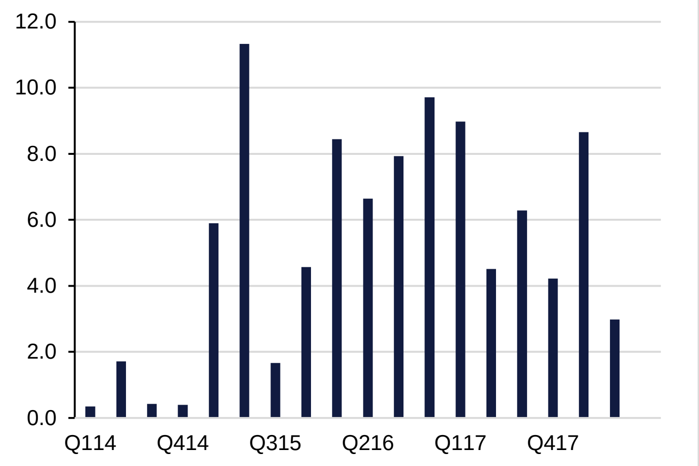

*Source: Haver Analytics, Emirates NBD Research*

## Government debt, % GDP



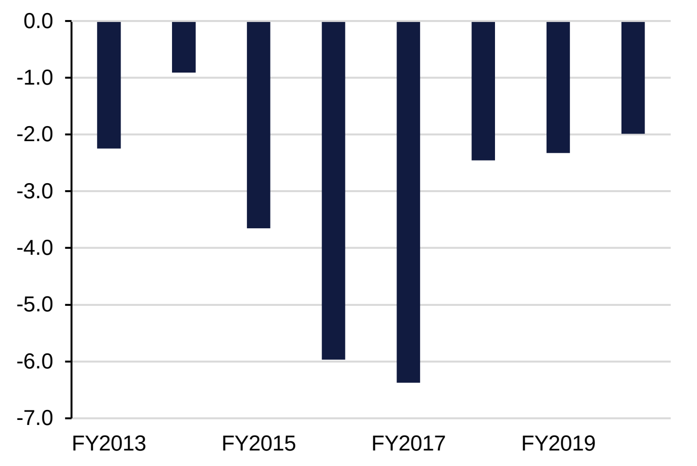

*Source: Haver Analytics, Emirates NBD Research*

## Net FDI, USDbn



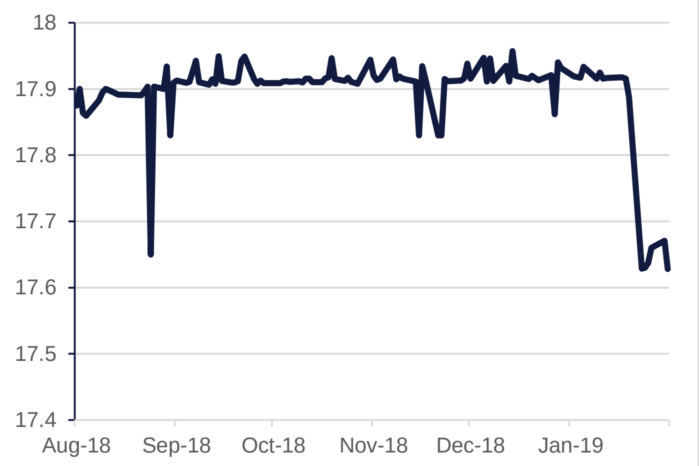

*Source: Haver Analytics, Emirates NBD Research*

## Current account, % GDP



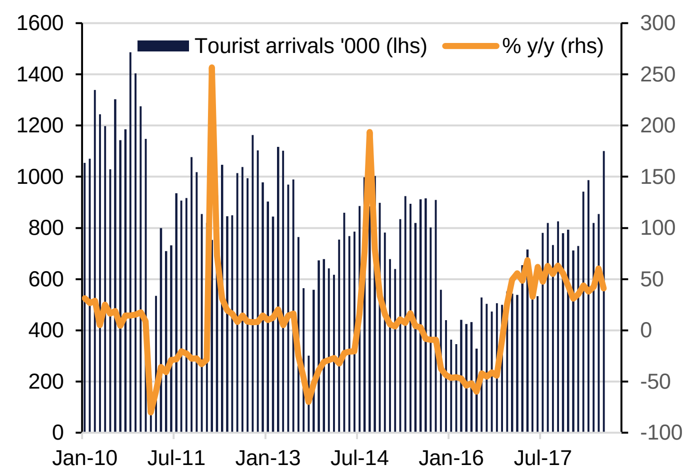

*Source: Haver Analytics, Emirates NBD Research*

## 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 | 4303.5 | 5125.7 | 6058.4 |
| Nominal GDP (USD bn) | 332.4 | 225.8 | 241.5 | 285.4 | 335.6 |
| GDP per capita (USD) | 3473 | 2314 | 2430 | 2821 | 3261 |
| | | | | | |
| **Real GDP Growth (% y/y)*** | 4.3 | 4.1 | 5.3 | 5.3 | 5.9 |
| | | | | | |
| **Monetary Indicators (% y/y)** | | | | | |
| M2 | 18.6 | 39.3 | 19.7 | 17.3 | 17.9 |
| CPI (average) | 13.7 | 29.6 | 14.4 | 12.0 | 12.0 |
| | | | | | |
| **External Accounts (USD bn)*** | | | | | |
| Exports | 18.7 | 21.7 | 25.8 | 28.4 | 33.1 |
| Imports | 57.4 | 59.0 | 63.1 | 77.0 | 80.8 |
| Trade Balance | -38.7 | -37.3 | -37.3 | -48.6 | -47.7 |
| % of GDP | -11.6 | -16.5 | -15.4 | -17.0 | -14.2 |
| Current Account Balance | -6.4 | -2.8 | -6.0 | -7.0 | -7.0 |
| % of GDP | -6.0 | -6.4 | -2.5 | -2.3 | -2.0 |
| Reserves | 17.6 | 31.3 | 44.3 | 42.0 | 42.0 |
| | | | | | |
| **Public Finances*** | | | | | |
| Revenue (EGP bn) | 491488 | 659184 | 805741 | 946141 | 1048627 |
| Expenditure (EGP bn) | 804704 | 1025109 | 1219826 | 1440317 | 1546008 |
| Balance | -326355 | -372758 | -423391 | -494176 | -497382 |
| % of GDP | -12.05 | -10.83 | -9.84 | -9.64 | -8.21 |
| Central Government Domestic Debt (EGP mn) | 2285644 | 2685898 | 3120304 | 4000000 | 4500000 |
| % of GDP | 84.4 | 78.0 | 72.5 | 78.0 | 74.3 |
| Total Debt, % GDP | 104 | 105.9 | 102.3 | 93.8 | 93.4 |

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

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