

Egypt Quarterly Economic Brief | 28 November 2024

## Economic climate improves though geopolitical factors weigh on outlook

- Macro-financial indicators have stabilized since the currency devaluation in March amid large foreign investment flows and the introduction of critical reforms including a more flexible exchange rate regime, subsidy cuts and moves to privatize some state assets.
- Improving high-frequency indicators augur well for economic growth prospects, to be helped by falling inflation and interest rates. GDP grew by only 2.4% in Q4 FY23/24 but could improve to 4% this year.
- The government may negotiate a revision to some key points in the IMF program updated earlier this year, possibly including extending the period for key subsidy cuts. A first sovereign credit rating upgrade by Fitch since 2019 capped the economic and fiscal progress the authorities have made in 2024.
- The most significant downside risk to the outlook is the unstable regional geopolitical environment, with Egypt dependent on valuable Suez Canal receipts, gas imports and pressured by refugee inflows.

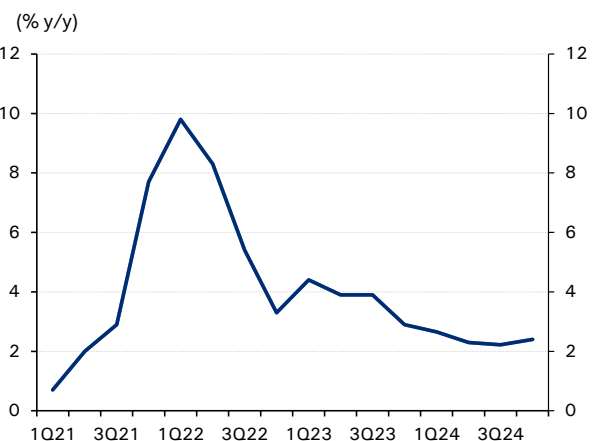
Nine months on from the sharp currency devaluation in March, Egypt's macro-fiscal situation has substantially stabilized. Foreign inflows and financing catalyzed by the Ras El-Hekma deal with the UAE have transformed the economic climate, restoring fiscal and external buffers and setting off a fiscal reform process, centered initially on hikes to energy prices, that shows promise in terms of bringing the country's public finances under control. Inflation, meanwhile, has trended lower as the central bank (CBE) has maintained interest rates at elevated levels, with policy rate cuts expected before long. Finally, the pound has been fairly valued with the virtual elimination of the parallel market so far. There are also signs from the credit and PMI numbers that economic growth is finally accelerating.

Risk factors stem largely from the external front, with ongoing regional conflict and tensions spilling over into Egypt on various fronts including via the impact on Red Sea shipping trade. Egypt's Suez Canal receipts slumped 50% y/y to \$6 billion in H1 2024, imports of natural gas from Israel are being pressured, while inflows of refugees from Sudan, Libya, Palestine and elsewhere are estimated at around 10 million. To contain the repercussions, the authorities have asked the IMF for some leeway on the pace of reform implementation.

### Economic growth to accelerate to 3.5-4.0% in FY24/25

GDP growth in the final quarter of the fiscal year (Apr-Jun FY23/24) ticked up to 2.4% y/y from 2.2% in Q3. (Chart 1.) This is amid improved FCY liquidity ensuing from the devaluation in March.

**Chart 1: Real GDP growth**



Source: Ministry of Planning.  
Note: Fiscal year quarters, so Q1 24 = Q1 FY23/24

In the months that followed the initial devaluation, the pound stabilized at around EGP48/49/\$1, which helped lower inflation and facilitate the recovery in household purchasing power that has lifted consumer spending and credit activity. We expect growth to accelerate from Q2

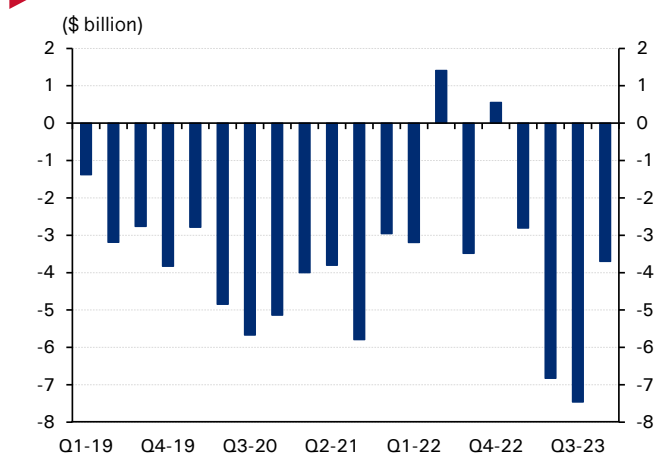
FY24/25 onwards. The PMI gauge of private sector activity rose to 50.4 in August from an average of 48.9 in Q4, surpassing the 50-neutral benchmark for the first in about four years (although it has edged back down since). This was mainly driven by a recovery in local order books, boosted by cooling inflation. Business optimism is on the rise as well, with firms looking ahead to interest rate cuts that would boost the outlook. With this in mind, we think growth could accelerate in the current year (FY24/25) to 4.0% from 2.4% in FY24 – albeit still below what we believe is Egypt’s long-term potential rate.

**Current account deficit balloons in FY23/24**

The current account deficit more than quadrupled in FY23/24 to \$20.8 billion from \$4.7 billion in FY22/23 as Egypt’s energy exports plummeted by almost 60% due to gas production declines, especially at the giant offshore Zohr field, and as Suez Canal receipts fell by 24% (\$2.1bn) amid ongoing troubles in the Red Sea. Tourism revenues, however, surprised on the upside, growing by a strong 5% y/y despite elevated regional tensions.

A closer look at the impact of the EGP devaluation on the current account in Q4 FY23/24 shows the effect was most pronounced in (1) remittances, where volumes rose by 50% y/y as more Egyptians living abroad transferred money back through official channels, and (2) in non-petroleum exports, which rose 17%. These gains resulted in a sharp narrowing of the current account deficit to \$3.7 billion from \$7.4 billion in Q3 FY23/24. (Chart 2.)

**Chart 2: Current account balance**



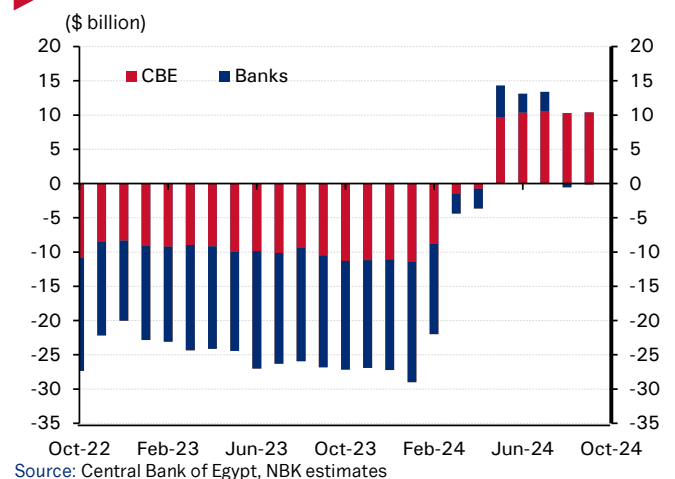
That said, the improvement was likely an immediate response to the devaluation and not likely to be repeated in the immediate future. We therefore expect the deficit to remain large at \$15-20 billion in FY24/25, mainly on the back of an inflated energy import bill. Moreover, as

interest rates drop and consumption picks up, imports will likely increase, by a minimum of 10-15%. Critical to preventing the deficit from spiraling out of control is the maintenance of a more flexible exchange rate.

**No further rises in foreign reserves expected – or needed**

In our last quarterly report, we hinted that further improvement in foreign reserves and banks’ net foreign assets will be limited as repeating investments of the magnitude of the giant \$35 billion Ras El Hekma deal and the large post-devaluation portfolio inflows would be unrealistic. The latest data confirm this to an extent, with CBE FX reserve levels in October at \$46.9 billion unchanged since June (\$46.4 billion). In addition to commercial banks’ NFAs declining by \$2.96 billion (-118% m/m) in September, the first decrease in eight months (with a small recovery in October), which reflects the large energy import bill. (Chart 3.)

**Chart 3: Net foreign assets at banks**



While we maintain our view that there is no need to raise foreign reserves and NFAs to higher levels, we reiterate that a sustained government commitment to a flexible exchange rate is imperative to prevent these external buffers from eroding and to allow Egypt to negotiate a path through the current and future geopolitical landscape – especially given what we forecast will be a high net cumulative financing gap of \$10 billion to FY25/26. These external buffers, in tandem with progress on reforms made so far including fuel and utility price hikes, have managed to limit the impact of recent external shocks on key risk indicators. Yields on Egypt’s 5-yr Eurobonds remain at 8.6%, unchanged since July, and 5-yr CDS levels (a measure of default risk) were also mostly unchanged at 578 bps from 570 bps in mid-July. We believe this is much lower than would have been the case had reforms and investor optimism in Egypt’s

economic prospects not been forthcoming. Indeed, as a vote of confidence, Fitch in November upgraded Egypt's credit rating to 'B' (outlook stable) from 'B-', and other agencies could follow with upgrades of their own reflecting the move towards a more flexible exchange rate, the significant improvement witnessed in the NFA position and the strong external support the sovereign has received this year.

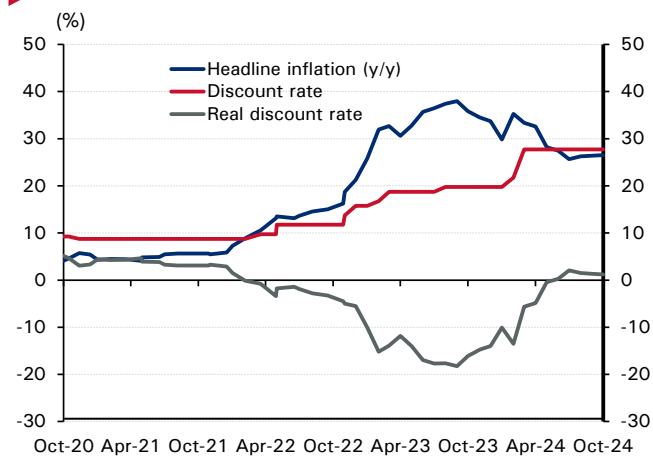
### Inflation easing to a possible 24% by December

Inflation has so far met our expectations, continuing to trend lower and we think it is on track to end the year at 24% or below. It averaged 25.9% y/y in Q1 FY24/25, down from 29.4% in Q4 FY23/24 as the impact of the devaluation fades, and price dynamics now only reflecting subsidy cuts and regular economic activities. Inflation's broadly downward trend occurred even as fuel and electricity prices were hiked during the summer (these two account for 4% of the CPI basket). For full year FY24/25, we expect inflation to end the year at 19% from 34% in FY23/24. We continue to wait for the central bank to amend the inflation target timeline to Q4 2025 from Q4 2024; a target of around 10% would be met based on current dynamics, in our view.

### Countdown to interest rate cuts has started

The CBE kept policy rates unchanged in Q1 FY24/25 at 27.75% for the discount rate. (Chart 4.) However, we sense a change in tone that could signal monetary easing. In its latest statement, the CBE mentioned that inflation will remain at the current level (26%) until year-end before dropping significantly in Q1 CY25 helped by favorable base effects. This is in line with our own view.

**Chart 4: Real and nominal policy interest rates**



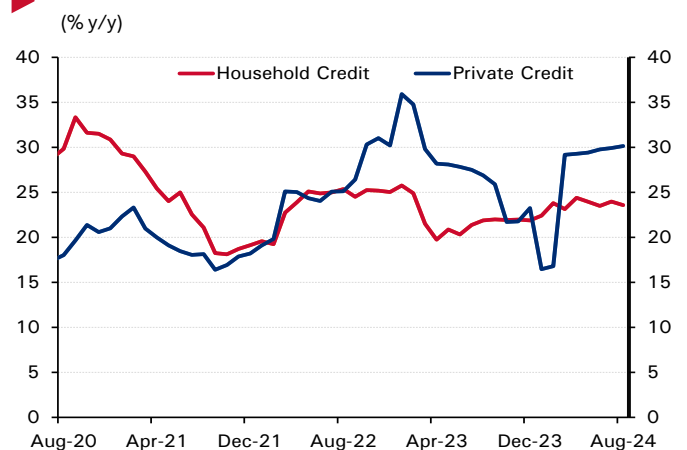
With the fall in inflation, real policy interest rates turned positive in June and have remained so since. They are

currently at 1.5%. We think there is a chance that rates could be cut by the MPC at its December meeting.

### Credit continues to grow even as inflation cools

Bank credit to private businesses expanded by a robust 30% y/y in June-August (+29% in the previous 3 months). (Chart 5.) Similarly rapid was household credit growth at a largely unchanged 23.7% y/y over the same period. In inflation-adjusted terms, corporate credit was up 3.8% y/y (4.0% for April-June) and improving significantly from -14% for the period Dec 23-Feb 24. As for household credit, it also improved, to -2.5% from -7.2% for the previous period. This data, recorded several months after the March devaluation, better reflects the current, improving state of economic activity.

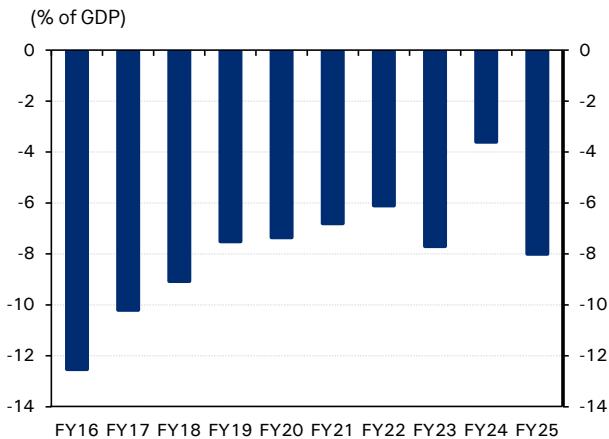
**Chart 5: Bank credit by sector**



We continue to see strong nominal and real credit growth even as inflation cools down as a clear sign that businesses are starting to recover, which reiterates our view that interest rate cuts will further boost growth. This should also help in kickstarting a new and potentially stronger capex cycle. We expect credit to grow by 25% in FY24/25 (year-end) in nominal terms, which, while lower than the 32% recorded in FY23/24, will at least be up 6% or more in real terms, compared to the previous -2%.

### Fiscal deficit normalized, but likely to widen this year

The final public finance accounts for FY23/24 revealed a deficit of EGP505 billion (3.6% of GDP), the lowest on record and well down on the previous fiscal year's EGP610 billion (7.7% of GDP). (Chart 6.) The primary balance (i.e. excluding debt interest) saw a huge improvement as well, posting a surplus of EGP857 billion (6.0% of GDP) on the realization of 50% of the fresh proceeds from the Ras El Hekma deal, totaling about \$12 billion.

**Chart 6: Fiscal balance**

Source: Ministry of Finance, NBK forecast

Nevertheless, we expect the deficit to widen in the current fiscal year, to around 8.0% of GDP, which would be above the government's target of 7.3% but contained relative to previous years. Part of the underlying (ex Ras El Hekma) widening will be linked to loss of revenues, especially corporate taxes from Suez Canal operations.

These account for around 33% of corporate tax revenues and 7.8% of total tax revenues but have declined by 50% y/y due to the disruptions to Red Sea shipping. The negative impact on the public finances could be offset by lower interest rates if the CBE eases monetary policy in the months ahead. Interest payments accounted for 49% of all government expenditures in FY23/24. Lower interest rates could also indirectly boost corporate tax revenues if they help facilitate faster economic growth.

On the expenditures side, the government has rolled out key measures to reduce the subsidy bill, including raising petrol prices (these were up 10-15% in July and by similar amount again in October) and electricity prices (up by around 20-50% since September). The government, while cognizant of the need to contain the deficit, also wants to keep key public entities, such as the state petroleum company EGPC, in good financial health and is allocating EGP154 billion (likely to end up higher at around EGP210bn) in energy subsidies in each quarter in FY24/25 to that end. These extra subsidies could add EGP60 billion (0.6%) to the fiscal deficit.

**Table 1: Data and forecasts**

	FY20/21	FY21/22	FY22/23	FY23/24	FY24/25f
<b>Real Indicators</b>					
Nominal GDP (EGP billion)	6,663	7,940	10,337	13,810	16,656
Real GDP (% y/y)	3.3	6.7	3.8	2.4	4.0
<b>External Indicators</b>					
Current account balance (\$ billion)	-18.4	-16.6	-4.7	-20	-15
Current account balance (% of GDP)	-4.4	-3.6	-1.6	-6.3	-4.5
Gross official reserves (\$ billion)	39.4	31.5	34.8	43	-
<b>Fiscal Indicators</b>					
Fiscal deficit (% of GDP)	7.1	6.1	7.7	3.7	8.0
Primary balance (% of GDP)	1.4	1.1	1.5	6.2	2.5
<b>Monetary Indicators</b>					
Inflation (period average, % y/y)	4.5	8.4	24.1	33.5	19.0
Interest rates (end of period, %)	8.2	11.7	19.7	27.8	17.8
Exchange rate (EGP per USD, end of period)	15.6	16.2	25.8	48.6	-

Source: Central Bank of Egypt, Bloomberg, NBK forecasts

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