Trip Notes

Egypt

Aktia

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Egypt

We made our first in-person country visit since the start of the pandemic by going to Cairo in February. Over two days we met representatives from the government, central bank, supranational organisations, international financial institutions, thinktanks, embassies, members of the media, as well as local and foreign businesses. Our team has met with Egyptian authorities several times in the past, and our positive view of Egypt was reaffirmed. Despite this, vulnerabilities regarding the high government debt burden need to be monitored and there is an elevated risk of a marginal currency devaluation.

Growth to remain robust

President Abdel Fattah Al-Sisi has been leading Egypt since June 2014 after a turbulent and brief presidency of Egypt's first democratically elected president Mohammed Morsi. Al-Sisi along with the military government brought needed political stability to the country which has enabled economic growth. Egypt was one of the few countries having positive real GDP growth in 2020 (+1.5%) due to limited lockdown measures during the pandemic. In Q3 2021 (Q1 FY2022) real GDP growth reached all-time high of 9.8% year-on-year partly due to favourable base effects. Growth is expected to remain robust in Egypt and the IMF raised forecast for GDP growth to 5.6% for FY2021/2022.

Egypt's growth potential is built on reforms and needed policy changes and is conditional on these being implemented. Egypt has a very ambitious drive towards developing its infrastructure. Currently, Egypt has ongoing megaprojects in power generation, transportation, telecommunications among others, which lay the groundwork for economic growth. Egypt has managed to resolve issues regarding the energy sector so that irregular power outages lasting for several hours at a time should now be in history. We visited the new administrative capital site, which has been under construction since 2015. It was a surreal experience to see a huge city meant for seven million people being built in the middle of desert about 45 kilometres east of Cairo. In addition, there are plans to build 14 new smart cities throughout the country to meet the needs of a growing population. The big challenge for Egypt is in implementing structural reforms which requires the creation of a conducive business environment for private sector-led growth that will foster jobs creation. Currently, the military is extensively involved in the economy across sectors, which often makes it difficult for private sector companies to succeed in competition. This might slow down the realisation of the full economic potential of the country.

Egypt's New Administrative Capital about 45 km east of Cairo. Photo: Ulla Huotari

	2015	2016	2017	2018	2019F	2020	2021E	2022F
Real GDP (%, end of period)	4.4	4.3	4.1	5.3	5.6	3.6	3.3	5.2
Inflation (%, end of period)	11.3	14.0	29.8	14.4	9.4	5.7	4.9	7.0
GDP Per Capita (USD)	3731	3654	2485	2577	3057	3601	3852	4177
Current Account Balance (% of GDP)	-3.7	-6.0	-6.1	-2.4	-3.6	-3.1	-3.9	-3.7
General gov. financial balance (% of GDP)	-11.6	-12.0	-10.4	-9.5	-8.4	-7.5	-7.3	-6.3
General Government Gross Debt (% of GDP)	88.3	96.8	103.0	92.5	84.2	89.8	91.4	89.5
Population (million)	89.0	91.0	95.2	97.1	98.9	100.9	102.9	105.0
Population growth	2.5 %	2.2 %	4.6 %	2.0 %	1.9 %	2.0 %	2.0 %	2.0 %

Sources: IMF

Country Visit: Egypt

Recovery has been solid but risks for devaluation

The economy has been recovering, so have imports

One of the main topics discussed on several occasions during the trip was the rising import bill. The current account recorded a deficit of US$4bn in Q3 21 and the widening current account deficits from previous years is an area of concern. Some of the positives included recovering tourism revenues (US$2.8bn), high worker remittances (US$8.14bn), and Suez Canal earnings recovering with global trade. Tourism revenues were nearly at 70% of the pre-pandemic levels. Considering that 30% of tourists come from Russia and Ukraine further recovery might take longer but it should be noted that tourism accounts for only 1.6% of total GDP. Non-oil exports rose hitting a record high in Q3 21. Egypt has reached an energy balance close to zero as it has hydrocarbons to export, but still imports petroleum. The authorities explained that the spike in imports reflected pandemic-related pharmaceuticals and capital goods for large infrastructure projects. However, considering the current global environment, the import bill may continue to rise should food prices continue on an upward trend and the Egyptian pound is kept strong. Especially now following the repercussions of Russia's invasion of Ukraine. Egypt is the world's largest wheat importer providing low-income earners government-subsidised bread. About 30% of Egypt's inflation basket is food. The Central Bank of Egypt (CBE) has kept interest rates on hold since November 2020 (deposit rate at 8.25%; lending rate at 9.25%) and is expecting that inflation will continue to stay within the target range of 7% +/-2%. The CBE is adamant on keeping its credibility and refuses to embark on a reversal of this cycle without deviating from its inflation target.

The CBE recently surprised markets by announcing new rules for importers requiring them using letters of credit which will create bureaucracy and delays. Some were saying that the high import bill scared authorities who also want to substitute imports with local production. It also gives the CBE an additional way to control FX market. We were told that new import rules will diminish suboptimal practices by some importers and ensures quality of imported goods to be of European and international standards.

Risk of devaluation at some point

Since the summer of 2020, the Egyptian pound has fluctuated only slightly against the dollar around its current level of 15.7. Many market participants seem to be of an opinion that the pound is overvalued and there will be a devaluation sooner or later. In the latest finalised IMF programme completed in June 2021 Egypt committed to a flexible currency which would be key on finding external balance. However, the CBE is very keen on keeping the exchange rate stable and, therefore, the market is expecting a gradual devaluation. The CBE said it is committed to provide liquidity and policy support through non-FX targeting measures as well.

Foreign portfolio investment continues to be a main source of funding, as real yields are attractive at their currently high levels. Furthermore, a stable currency is attractive to foreign portfolio investors. Therefore, it has been important for the CBE to keep foreign portfolio investors satisfied rather than let the currency depreciate from a balance of payments perspective.

Egypt's inclusion into the JP Morgan GBI EM bond index on January 31st was perceived positively. Exact inflow figures were not yet available, however, and should there be inflows these are likely to be flows from investor to investor rather than fresh fund flows. The share of foreign investments in local T-bills and bonds is still low at around 12 percent.

International reserves remain at comfortable levels

A lot of questions have been raised about the deterioration of commercial banks' net foreign assets (NFA) by US$-9.4bn in December. It was explained that the decline in NFA was driven by commercial banks' net foreign liabilities. Banks are preparing to secure foreign currency means to finance growth and expansion of client projects in hard currency involving foreign activity. Nonetheless, the CBE did not see any concern. Additionally, comfort can be taken that the CBE's foreign reserves have remained at around US$40bn providing solid liquid buffers to withstand any exogenous shock. Furthermore, it was explained that bank oversight in Egypt is strict and Egyptian banks cannot lend in foreign currency unless the project has foreign currency revenues, a clear positive in our opinion.

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Country Visit: Egypt

Credibility is still there

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Diversifying sources of financing – big question is engagement with the IMF going forward

Egypt has a high debt burden of nearly 91.6% of GDP in June 2021 and GDP growth going forward will continue to keep funding needs high. Egypt is hard trying to diversify its sources of funding: sustainability framework is in the making for enabling tapping green and sustainable bonds, an infrastructure bond is in the pipeline, sukuks, negotiating different bilateral arrangements. Egypt enjoys good relations with international financial institutions, which is crucial in times of market turmoil. Egypt hinted going to the market with an issuance in Q2 this calendar year most likely with local currency denominated bonds. The Eurobond market is not on the cards for this year due to the current market environment of elevated interest rate levels.

The IMF's latest economic reform program was a clear success. The outlook and projections would not probably warrant further IMF financing unless Egypt's debt sustainability is of greater concern. It is crucial for Egypt to keep its debt-to-GDP ratio on a downward trend. The authorities said they are aiming to reach debt levels below 85% of GDP by June 2025. Furthermore, a funded IMF programme would come with strict conditions on policies. Also, the direct financial support from a new IMF programme would not be large due to currently outstanding programmes. There are other alternatives to continue engagement with the IMF which would enable quickly Egypt moving to a funded programme should the need arise. Egyptian authorities continue to be committed to reforms and are keen on making Egypt a further success story.

Green investments leading the way to COP27 in Sharm El-Sheikh

Egypt is a proud host of upcoming the United Nations' climate talks in November. As an emerging economy Egypt is eager to set itself a role model for other developing nations when it comes to climate action. During COP26 in Glasgow, Egypt launched its National Climate Change Strategy 2050 with five main objectives, including cutting emissions in various sectors to maintain sustainable economic growth, promoting the use of renewable energy sources, producing energy from waste, and using alternative energy like green hydrogen. Egypt has set renewable energy targets of 20% for its electricity mix by 2022 and 42% by 2035. COP27 is an opportunity to furnish their reputation and host the largest international gathering in Egypt's history. Although Egypt is serious about the climate, there are still significant human rights issues under the authoritarian government that require correction.

Our view

The Egyptian authorities' commitment to bringing down government debt remains intact. Egypt's large FX-reserves lend credibility to the country's capability in managing portfolio flows. The good relationship with the IMF and other IFIs offers a buffer against market turmoil. Nonetheless, the large financing needs in the coming years are a clear source of risk. Also, the evolving war in Ukraine brings a further twist to Egypt's recovery, due to large grain imports and Russian tourism to Egypt.

External debt: We remain overweight Egyptian bonds, especially as risk premiums have risen more than for comparable countries

Local currency debt: The index inclusion will make foreign participation less opportunistic, while real yields remain attractive, coupled with a large and fairly liquid market. The high food component in Egypt's CPI-basket presents a growing risk to the inflation outlook due to rising wheat prices globally.

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This report is produced by

HENRIK PALDYNSKI
Head of EMD

TIMO LEINONEN
Portfolio Manager

KAJ PAULAMÄKI
Portfolio Manager

JUUSO ATRILA
Portfolio Manager

MIKKO KUISMA
Portfolio Manager

ULLA HUOTARI
Portfolio Manager

ROBERT SUOMI
Analyst

OSKAR MURTO
Analyst