Egypt: A report card after the IMF

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- **While there has been strong growth, declining inflation and fiscal account deficits, the private sector has remained under pressure and remittances into Egypt and net FDI are lower than in peak years.**
- **Egypt's next moves should be to focus on additional structural reforms, including integrating the informal sector into the formal economy.**
- **Spurred on by being the largest oil and gas consumer in MENA, Egypt is on track to achieve its target of generating 20% of its electricity by 2022 through developing the renewables sector.**

First time completing an IMF programme

The IMF loan has been fully disbursed without any delays, highlighting progress made by the government in implementing agreed reforms since the programme was approved in November 2016. But metrics such as government debt and private sector surveys of business activity highlight areas of ongoing concern.

- In concrete actions, the government has adopted VAT, introduced a flexible exchange rate, reduced fuel and electricity subsidies, and passed new laws covering industrial licensing, investment, company structures and insolvency.
  - Other measures, such as cash transfer programmes and raising minimum wage, have also been taken to shield the poor from the adverse impact of such economic reform measures.
- This has already paid dividends. Central Bank of Egypt (CBE) data shows growth of 6.8% for the fiscal year 2018/19, the highest since 2007/08.[1]
  - Growth was driven by higher offshore gas production, sustained government investment, and looser monetary policy.
  - The 6.8% growth was in line with both the IMF and government forecasts for that period, significantly higher than the 4% range before the IMF programme.
  - The government expects growth at 6% in 2019/20, close to the IMF's forecast of 5.9%. We have no reason to believe this is not achievable.
- Inflation has been brought down but remains too high -- the highest in MENA bar troubled Iran, Sudan and Yemen.
  - Annual urban inflation declined to 9.4% in June from 14.1% in May while core inflation -- which strips out volatile factors such as food and energy -- slowed to 6.4% from 7.8% in May. The latter compares favourably with its peak of 35.3% in July 2017.
  - Annual core inflation is expected to drop to 10.7% by the end of 2019/20, compared with 14.5% for 2018/19 and 20.8% in 2017/18.
  - But with fuel subsidy cuts that came into effect at the beginning of July, the inflation rate is expected to pick up slightly. As a result, we could see the CBE holding back on its easing cycle.

Table 1 – Egypt Macroeconomic Indicators[2]

	2015/16	2016/17	2017/18	2018/19	2019/20f
Real GDP Growth (%)	4.3	4.2	5.2	5.5	5.9
CPI Inflation (%)	14.0	29.8	14.4	14.5	10.7
Fiscal Balance (% of GDP)	-12.5	-10.9	-9.8	-8.3	-6.7
C/A Balance (% of GDP)	-6.0	-5.6	-2.4	-2.5	-1.8
Total Gov't. Gross Debt (% of GDP)	96.9	103.2	92.6	86.0	83.3
Total Gross Extrn'l Debt (% of GDP)	18.3	41.3	37.4	34.4	31.3
Gross Official Reserves (Mos. of Imports)	3.0	5.0	6.6	6.6	6.3
Nominal GDP (USD B)	332.0	256.0	250.0	303.0	336.0
Population (Millions)	90.2	94.8	97.0	99.2	101.5

- On 26 June, the Egyptian parliament approved the state's 2019/20 budget which aims to lower the deficit to 7.2%, down from the 8.4% in 2018/19. We note, however, that Egypt has had difficulty in the past in lowering the deficit below 10% of GDP and maintaining it there.
- Although foreign reserves are expected to rise to USD 45.4B in 2019/20 from USD 44.9B in 2018/19, they will cover fewer months of imports (6.3 months versus 6.6 months). But both are far healthier than the USD 17B (3 months of import cover) in 2015/16 before the devaluation of the pound.

The laggards need to be addressed

Government debt, non-oil private sector activity, net FDI inflows to Egypt, and remittances are lagging behind.

- Gross government debt declined to 86% of GDP in 2018/19 from 92.6% of GDP in 2017/18, while external debt stood at 34.4% of GDP during the same period from 37.4% in the previous fiscal year.
  - But this remains costly. According to the African Development Bank, servicing the debt accounts for about 30% of fiscal spending -- almost 10% of GDP.
  - Note, though, that the bulk of Egypt's external debt is owed to "friendly" lenders in the GCC, and organisations such as the African Development Bank and the World Bank. This limits its impact on financial markets and overseas investors.
- Egypt's non-oil Purchasing Manager's Index contracted in May, driven by moderate declines in both output and new orders. It fell to 48.2 after inching up to the mild growth level of 50.8 in April.
  - We find it significant that Egypt's recovery over the past two years has largely been driven by external rebalancing and public investment, while the private sector has remained under pressure.
  - The latter is in part a result of the ongoing reforms, however, and there has been modest improvement.
- FDI -- always a volatile indicator that needs to be interpreted over time -- has not been as initially forthcoming as the government might wish.
  - Data released by the CBE for the first nine months of the 2018/19 points to a total inflow of USD 10.2B during the period, only a 1% YoY increase from the same period a year earlier.
  - However, net FDI was USD 4.6B during this period, 23% lower than the same period in 2017/18. Net FDI peaked at USD 13.2B in 2007/08.

[1] Fiscal year beginning 1 July.

[2] Arabia Monitor; IMF.

- The government is targeting a gross USD 11B in FDI for the full fiscal year 2018/19, compared with a peak of USD 11.6B in 2007/08 and an average of USD 6B over the last decade.

➢ Remittances were down 6% YoY in the first nine months of 2018/19 to USD 18.2B (6% of GDP), compared with USD 28.9B in 2017/18 (11.6% of GDP).
  - Although no geographical breakdown is presented in the data, we believe this is largely due to the drop in transfers from Saudi Arabia, where the kingdom imposed fees on expats earlier in the year, and has an ongoing Saudisation drive.
  - Saudi Arabia has accounted for around 25% of total remittances to Egypt (roughly 1.7% of GDP), on average over the last ten years.

In our view, Egypt's next moves should be to focus on additional structural reforms, some of which need to tackle entrenched challenges.

➢ Investors will want to see greater efforts at fighting corruption, improved access to finance, and stronger management of state-owned enterprises.

➢ Integrating the informal sector into the formal economy remains another challenge. Estimates of the volume of Egypt's shadow economy vary from between 20% to more than 50% of the official economy.

➢ Other key reforms that the government plans to complete as recommended by the IMF for "higher and more inclusive growth" include improving the availability and access to industrial land, streamlining public procurement, and revamping competition law.

The winds of change

Egypt has been pushing for more investments in the renewable energy sector -- part of a plan to supply 20% of the country's electricity needs by 2020.

➢ The 250MW Ras Gharib wind farm in the Gulf of Suez is 85% completed, ahead of schedule, and should start commercial operations by October 2019.
  - It is expected to generate power for around 500,000 households. Electricity produced by Ras Gharib farms will be sold to the Egyptian Electricity Transmission Company under a power purchase agreement of 20 years.
  - The joint venture is owned by Orascom Construction, French utility company Engie, Toyota Tsusho Corporation and Eurus Energy Holdings Corporation. It is being developed on a build-own-operate basis with an estimated investment of USD 400M.
  - The project is financed by the Japan Bank for International Cooperation, Sumitomo Mitsui Banking Corporation, Société Générale, with insurance of finance covered by Nippon Export & Investment Insurance. Additionally, Egypt's private-sector Commercial International Bank is providing working capital while Morocco's Attijariwafa Bank is providing an equity bridge loan.

Table 2 – Renewable Energy Targets, North Africa[3]

Country	By 2022	By 2030
Algeria	6%	40%
Egypt	20%	N/A
Libya	7%	10%
Morocco	42%	N/A
Tunisia	N/A	30%

➢ Egypt's New and Renewable Energy Authority granted Lekela Power a new concession in February 2019 for the construction of another 250 MW wind farm in Ras Gharib. It is expected to be completed in 2021.
  - While the project is still in the development phase, the US Overseas Private Investment Corporation has approved a loan of USD 87M for development, and the project is currently seeking further financing from the International Finance Corporation and the European Bank for Reconstruction and Development, which are expected to contribute USD 82M and USD 81M, respectively.
  - Lekela Power plans to finalise financial agreements of the project, including a similar 20-year power-purchase deal by the end of August 2019 in order to commence the construction phase.

➢ Projects contributing to Egypt's 20% renewable energy generation mission extend to investments and construction in solar plants. Benban Solar Park in Aswan, the largest solar park in the world, has also initiated operations and connected 27 of the 32 solar power plants to the national electricity grid, sourcing 1.2GW of total planned capacity 1.48 GW.

China's widening Egyptian footprint

Sino-Egyptian bilateral trade relations are strengthening while Chinese companies are becoming increasingly involved in the country.

➢ Bilateral trade between Egypt and China grew by 5.8% YoY to USD 5.4B in the first five months of this year, with Chinese exports to the country rising 13.2% YoY to USD 3.7B. Two-way trade increased by 27.6% YoY during 2018, to USD 13.8B.

➢ Domestic car manufacturers are expected to face competition with the growth of Chinese players.
  - In July, China's automaker Dongfeng Motor Corporation expressed keenness on entering the Egyptian market.
  - In June, China's auto industry SAIC Motor and Egypt's largest car sales company Mansour Automotive Group signed a joint venture agreement to manufacture MG brand cars in Egypt. The Chinese company's total global vehicle exports in 2018 were 277,000 units up 62.5% YoY.

➢ There are opportunities for scaling up, domestically. Vehicles account for about 5% of Egypt's total imports while auto goods only account for 0.5% of Egypt's total exports.

[3] Arabia Monitor; International Renewable Energy Agency.

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