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Egypt:
Economy
January 2019

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SUMMARY

Egypt to step back from IMF loans in 2019

The Egyptian government has no plans to seek a renewal of its $12bn financing agreement from the International Monetary Fund when the Extended Fund Facility expires in 2019. Finance Minister Mohamed Maait pointed to "some sort of cooperation" with the Fund. The IMF released the next tranche of $2bn in financing in November 2018 after holding meetings with the Egyptian authorities taking payments to $10bn. Mission chief Subir Lall said the economy had continued to perform well, despite less favourable global conditions, supported by the authorities' strong implementation of the reform programme. He said Egypt's fiscal policy in 2018/19 and beyond would continue to aim at keeping general government debt on a clearly declining path and achieving a primary surplus of 2% of GDP. Egypt has achieved its first primary budget surplus in 15 years for the fiscal year that ended in June 2018. The surplus, which excludes debt interest payments, came in at EGP4.0bn or 0.2% of GDP. The government is aiming for a 2% primary surplus (or $5.5bn) in the current fiscal year, which began in July. However, the overall budget deficit was 9.8% of GDP in 2017-18, about 10% lower than the previous financial year. The government approved its 2018/19 fiscal year budget in March 2018, targeting a budget deficit of 8.4% of GDP

Inflation back on downward path

Inflation looks set to resume a downward trend after recording its first fall in the annual rate for four months in November 2018. The headline rate fell to 15.7% from 17.7% in October and below a peak of 33.0% in July 2017. The fall was driven by weaker food inflation and a sharp fall in clothes price inflation offsetting minor falls in other groups. Food prices, which account for 40% of the inflation basket, fell to 18.7% from 20.2%, thanks to a slowdown in fruits and vegetables. The central bank decided in November 2018 to keep the overnight deposit rate on hold at 16.75%. The decision has been widely predicted by analysts. It marks the fifth month in a row that rates have remained on hold after being hiked by a cumulative 200 basis points (2 percentage points) over the past two years. Explaining its interest rate decision, the bank said current monetary policy remained in line with achieving single digit inflation. It added that it closely monitored all economic developments and would not hesitate to adjust its stance to achieve its mandate of price stability over the medium term.

Egypt looks East for debt

Egypt will go to the international capital markets in early 2019 to issue debt but could look to diversify into yen and yuan-denominated debt, finance minister Mohamed Maait said in December 2018. He told Bloomberg News the government was also expecting to issue its first green bonds linked to environmental projects in the 2018-19 financial year ending in June. However he said it was unlikely to launch its first Islamic bond, or sukuk, until the following year. The central bank scrapped its special foreign exchange repatriation mechanism in December 2018. It ended the use of a mechanism guaranteeing that foreign investors wanting to sell out of Egyptian securi-

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ties could pull out their money in dollars. It said that it had overcome its shortages of foreign currency and the move was seen as a sign it believed that investor confidence had been restored to the extent that the dollar guarantee was no longer needed.

Economic Forecasts

Subject Descriptor	Units	2016	2017	2018	2019	2020	2021
GDP, constant prices	% change	4.3	4.2	5.3	5.5	5.9	6.0
GDP, current prices	US dollars, billions	332.5	236.5	249.5	298.2	339.4	359.2
GDP per capita, current prices	US dollars	3,686	2,495	2,572	3,005	3,343	3,459
Total investment	%, GDP	15.0	15.3	15.5	16.8	18.2	19.2
Inflation, average consumer prices	% change	10.2	23.5	20.9	14.0	10.9	7.8
Volume of imports of goods and services	% change	5.0	-1.7	-0.5	5.7	6.9	4.7
Volume of Imports of goods	% change	7.2	-2.4	-2.1	5.0	6.6	4.6
Volume of exports of goods and services	% change	-10.1	1.6	17.5	12.8	8.9	7.1
Volume of exports of goods	% change	4.3	8.7	6.2	12.4	7.5	6.3
Unemployment rate	%, total labour force	12.7	12.2	10.9	9.9	8.3	7.8
Population	Millions	90.2	94.8	97.0	99.2	101.5	103.8
General government net lending	%, potential GDP	-12.5	-10.4	-9.3	-7.9	-6.5	-4.7
General government gross debt	%, GDP	96.8	103.0	92.5	87.1	84.1	81.5
Current account balance	%, GDP	-6.0	-6.3	-26	-2.4	-2.2	-1.8

Source: IMF, World Economic Outlook database, October 2018

Non-oil sector close to return to growth

Business conditions in the Egyptian non-oil private sector improved slightly in November 2018, raising hopes of a return to the expansion enjoyed in July and August. That two-month period had represented the first time since September 2015 that two consecutive months had returned positive readings. The continuation in contractionary territory, however, may indicate there remains some weakness in the recovery. The snapshot survey of private sector business managers recorded a figure of 49.2 from 48.6 in October on an index where any number above 50 indicates growth. The recovery to a three-month high reflected a slower decline in new orders in November. Similarly, output

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contracted for the third consecutive month but at a weaker pace. New export orders also fell, although here the rate of decreased slightly quicker than in October. In regard to prices, Egyptian non-oil private sector firms recorded the slowest uptick in input costs seen over the series, which began in April 2011. While firms mentioned increased raw material, electricity and transport costs, the majority of panellists experienced no change in outlays in November. Looking ahead, sentiment moderated to its weakest position in 25 months. Egypt's economy expanded 5.3% in the first quarter of the 2018/2019 fiscal year that ended in September 2018 compared with the same quarter last year. This marked only a slight slowdown from 5.4% in the previous quarter, which was the joint highest since the peak of the boom in 2008. The government had expected an economic growth rate of 5.0%-5.25% in the year to June 2018. Prime Minister Mostafa Kemal Madbouly said his government was looking for growth of up to 8% in fiscal year 2021-22. In its budget for the 2018/19 fiscal year that was published in March 2018, the government forecast growth of 5.8%. The International Monetary Fund used its October 2018 world economic outlook to upgrade its growth forecast for 2018 to 5.3% from the 5.2% it envisaged in April. The IMF then sees the economy accelerating in each of the following years to 5.5%, 5.9% and 6.0% in 2019, 2020 and 2021 respectively, slightly faster than it expected six months earlier. The positive tone came as the IMF's managing director Christine Lagarde said Egypt's economy was showing strong signs of recovery under the economic reform programme supported by the IMF's $12bn Extended Fund Facility. She said that she and Egypt president Abdel Fattah al-Sisi had agreed on the importance of capitalising on Egypt's macroeconomic gains to advance the authorities' home-grown structural reforms. The EFF programme aims to help Egypt restore macroeconomic stability and promote inclusive growth. Policies supported by the programme seek to: correct external imbalances and restore competitiveness; place the budget deficit and public debt on a declining path; boost growth; and create jobs while protecting vulnerable groups. In August 2018 Moody's changed the outlook on the Egypt's long-term issuer ratings to positive from stable and affirmed its B3 issuer ratings. It forecast GDP growth of 4.8% in the 2018/19 financial year. Private bank NBK said economic growth would remain at around 5% in the 2018/19 and 2019/20 fiscal years as the government pressed on with its reform agenda. They followed a more optimistic outlook from the World Bank in October 2018, which forecast 5.3% growth for 2018 fiscal year rather than 5.0% it had expected six months earlier. Growth then gradually increases to 5.8% by fiscal year 2020. It said growth would be driven by resilient private consumption and investment, in addition to a gradual pickup in exports, notably from tourism and gas. Assuming that Egypt sustains the momentum of reforms, a further pick-up in investment and a recovery in merchandise exports and tourism are expected to contribute positively to growth. The operationalisation of new gas fields is set to boost the extractives sector and improve fiscal and external balances.

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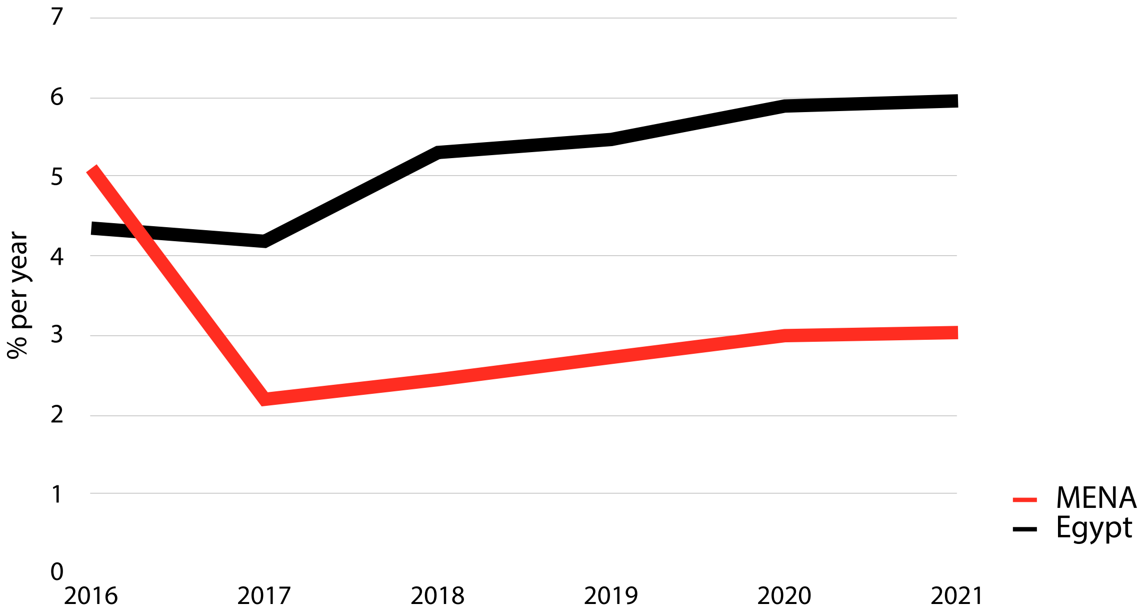
GDP growth



Source: IMF, World Economic Outlook database, October 2018

Egypt continues to attract investment

The government aims to increase net foreign direct investment (FDI) to $11bn in 2018/2019 and to gradually escalate to about $20bn in 2021/2022 from $7.9bn in 17/2018, according to the Minister of Planning Hala el-Saeed. FDI rose by 24% to $7.4bn during the first half of 2018, according to United Nations figures in October. It remains the largest destination for FDI in Africa. Egypt is "open for business," the country's minister of investment and international cooperation, Sahar Nasr, said in July 2018. The Central Bank of Egypt said European Union countries ranked first in terms of foreign investors with a total of $1.96bn in the first quarter of 2018. Within that, UK investments were worth $1.09bn, followed by Belgian investments of $526.1m, France at $105m, Luxembourg at $58m and Italian investments of $47.1m. Vikram Parmar, President and CEO of Lava Technology India in Egypt and Africa, said in August 2018 that Egypt had always been a strategic choice for foreign investors given by its unique geographical position, skilled and dedicated workforce, huge domestic market, and low labour costs. More than 160 French companies are operating in Egypt, with total investments exceeding €4.0bn ($4.7bn). In March 2018 Saudi Arabia and Egypt agreed a $10bn deal to develop a planned megacity and business zone that would span the border between the two countries. Egypt has committed more than 1,000 sq km sq of land in the southern Sinai Peninsula to Neom. Egypt has relinquished ownership of two Red Sea islands, Sanafir and Tiran, to the Saudis, opening access to the western shores of the Gulf of Aqaba and Red Sea. Egypt's constitutional court dismissed all outstanding legal challenges to the transfer of the islands in March 2018.

Egypt's gas industry looks to be enjoying a renaissance which will help power its economic recovery. In February 2018 President Sisi inaugurated the Zohr gas field that could provide add as much as

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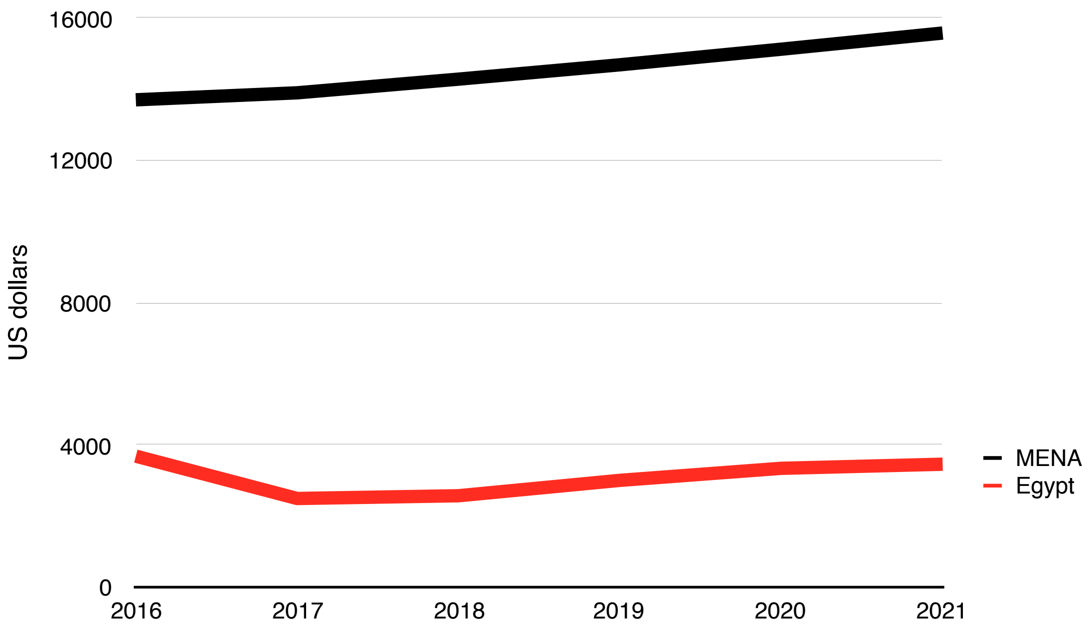
2.5% a year to GDP growth, according to some analysts. It will also help reduce the country's twin budget and current account deficits. The output of Egypt's Zohr natural gas field reached 2bn cubic feet per day (cf/d) in September 2018. Production is scheduled to reach 2.7bn cf/d in 2019, which private bank NBK said would add 2% to the level of GDP. Output from the West Nile Delta is expected to reach 350m-400m cf/d by 2019. On this basis Egypt will become a net gas exporter for the first time since 2014. In December 2017 Russia and Egypt signed an agreement for state-owned Rosatom to build a $21bn nuclear power reactor. BP has signed amendments to the Temsah, Ras El Barr and Nile Delta Offshore concessions in Egypt, allowing for the development of the Nooros field, the company said. Within industry, oil, gas and mines contracted by 1.8% in 2017, a much slower rate than the 5.3% in 2016, while manufacturing expanded by 2.1% after 0.8% growth in the previous year. Agriculture, which makes up 12% of the economy, posted growth of 3.2% in 2017, down from 4.2% in the previous year. In its Article IV assessment of the economy, the IMF said Egypt's economic outlook was favourable, provided prudent macroeconomic policies were maintained and the scope of growth-enhancing reforms was broadened. The IMF and the Egyptian authorities are confident the devaluation of the pound that accompanied the EFF loan package that was delivered in mid-November 2016 will encourage exports and create jobs in the export sector. The tourism sector has started to revive after a severe downturn in the wake of the terrorist downing of a plane in May 2016. The industry is likely to receive a boost after Russia agreed in December 2017 to the future resumption of direct flights more than two years after they were suspended in response to the downing of a Russian airliner over the Sinai desert that killed 224 people. Russia's transport ministry said flights could restart in February 2019 on both EgyptAir and Aeroflot. One of the biggest Egyptian travel companies, Travco Group, said in November 2018 that hotel bookings were rising as tourists returned to the country. CEO Hamed El Chiaty said it had raised its prices by 30%-35% at the beginning of this winter season. Egypt's tourism minister forecasts more than 8m visitors would arrive in 2018. Tourism minister Rania Al Mashat expects visitor numbers to return to pre-revolution levels of above 10m within two to three years. Egypt had 8.3m tourists in 2017. The latest figures show Egypt saw a 40% growth in the number of tourists in the first nine months of 2018 compared to a year earlier. Revenues from tourism jumped 77% year-on-year in the first half of 2018 to $4.8bn. The tourism sector represents 15% of the national economy. Inbound tourism dropped to 5.3m tourists in 2016 from around 9.3m in 2015, following the Russian Metrojet crash in October 2015 and the travel ban subsequently imposed by both Russia and the United Kingdom. The deaths of two British tourists in mysterious circumstances at a hotel in Hurghada in August 2018 may dent confidence among travellers. The Egyptian authorities have since said the cause of death was E. coli bacteria. Russia's President Vladimir Putin and Sisi discussed in October 2018 the resumption of direct charter flights from Russia to Egyptian Red Sea resorts. Hotels have received a boost from the devaluation of the Egyptian pound. It led to the highest July average daily rate (ADR) value on record in Sharm El Sheikh in 2018, according to analysts STR. The ADR rose 42.7% year-on-year to EGP1,106.67 while revenue per available room (RevPAR) rose in the year to July 2018 by 45.4% to EGP691.78. Hotel occupancy rate rose 1.8% to 62.5%. Cairo hotels probably achieved 7% occupancy growth in 2018, versus the previous year, Colliers International said in December. It expected that Cairo will witness 34% increase in Average Daily Rate (ADR) in 2018. It foresees growth of 29% and 36% y-o-y in RevPAR in the final quarter of 2018 in Sharm El-Sheikh and Hurghada hotels respectively, benefiting from positive security awareness, and the return of chartered flights from the traditional resource markets. Colliers said new hotel developments in Cairo including the Fairmont Pyramids and Hilton Garden Inn were a response to demand for five-star stays. Hotel supply in Cairo grew by 6% with the entry of 1,182 rooms between Q3 2017 and Q3 2018. Alexandria supply grew by 7% with the entry of 190 new rooms to the market, it said.

In August 2015 Egypt opened a major expansion of the Suez Canal, which deepens the main channel and provides ships with a 35km waterway parallel to it. Suez Canal revenues rose 10.3% to a record high of $4.8bn in the 10 months to October 2018 thanks to $506.1m in October alone, according to official data. The chairperson of the Suez Canal Authority and the Suez Canal Economic Zone, Mohab Mamish expects revenues from the passage of the ships to reach $13.2bn annually by 2023, especially after the inauguration of the New Suez Canal April. Meanwhile GDP per capita looks certain to continue to lag the region.

GDP per capita, current prices



Source: IMF, World Economic Outlook database, October 2018

Tensions rise with Italy over student murder

Tensions rose in December 2018 between Egypt and Italy over the investigation into the murder of the student Giulio Regeni. Italian investigators have added members of Egypt's security services to its list of suspects. An Egyptian government news agency said it did not acknowledge the record of suspects saying any charges should be based on evidence and not suspicion. Regeni's mutilated body was found on a desert road near Cairo nine days after he disappeared in January 2016. Prosecutor Giuseppe Pignatone, has said he believes Regeni was killed because of his research, which focused on trade unions in Egypt.

In November 2018 security forces killed 19 militants in a shootout, including the gunmen suspected of killing seven Christians in an earlier attack on pilgrims traveling to a remote monastery. A local

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Islamic State (IS) affiliate, which spearheads militants fighting security forces in the Sinai Peninsula, claimed responsibility for the attack in a statement. The attack and its response are a reminder that attacks by IS and allies are still a risk. IS has repeatedly vowed to go after Egypt's Christians as punishment for their support of president Sisi. Two gunmen opened fire outside a Coptic church south of Cairo in late December 2017, killing at least nine people in the latest attack on the country's Christian minority. It was the latest in a series of attacks in 2017 on the Christian community.

Egypt has launched a major offensive against Islamic militants in the Sinai Peninsula, seeking to end a conflict that has killed hundreds of civilians and soldiers in recent years. In July 2018 the security services confirmed that Abu Jaafar al-Maqdesi, a local leader of IS's branch in Egypt's Sinai Peninsula, had been killed. Human Rights Watch warned in April 2018 that the campaign had left 420,000 civilians on the brink of humanitarian crisis. Children in some areas have been unable to go to school and markets have been left empty as vendors are unable to bring in food supplies. A bomb ripped through the Rawdeh mosque in Bir al-Abed, north Sinai in late November 2017. The mosque belongs to a Sufi order — a mystical branch of Islam whose followers are regarded by hardline Islamists as apostates because they revere saints and shrines. As people fled, gunman started shooting at the survivors.

Egypt remains on a heightened level of alert for terrorist attacks in the wake of the crash of an Egyptian airliner into the Mediterranean Sea on route from Paris to Cairo in May 2016 with the loss of 66 passengers and crew. In July 2018 investigators into the December 2016 crash of EgyptAir flight MS804 was likely to have been caused by a cockpit fire. Egyptian air accident investigators have revealed that traces of explosives were detected on the remains of victims. This suggested that a bomb caused the crash, although it does not solve the mystery of where a device might have been smuggled on board — or who was responsible. Investigators have said a black box retrieved from the crash site confirmed that smoke alarms had sounded onboard, while soot on the wreckage indicated a fire.

Austria is to use the final days of its presidency of the European Union in December 2018 to hold talks with Egypt to revive the bloc's campaign for north African countries to take in more migrants. Abdel Fattah al-Sisi, Egyptian president, is due to meet Sebastian Kurz, Austria's chancellor, in Vienna. However Egypt is reported to be worried that those rescued could end up staying for years and cause security problems and is likely to put a large price tag on cooperation. Egypt and the EU have already signed two agreements worth almost $155m in a bid to create jobs and tackle illegal migration. The first agreement will fund an EU programme for inclusive growth, with a focus on creating job opportunities, through investment in small and medium businesses. The second deal, worth some $6.9m, is targeted at reducing illegal immigration, as well as smuggling and human trafficking. Egypt already hosts more than 221,675 refugees and asylum seekers, with 3,118 newly registered in 2018 alone according to the UNHCR. Unofficial estimates however indicate that the actual number exceeds 300,000.

Sisi has ruled out seeking a third term as president. He said in November 2018 that he did not intend to change the constitution and its provision of a two-term presidential limit. "It doesn't suit me as a president to stay one more day against the will of the Egyptians," he told CNBC. "We will not interfere with (the constitution). I am with preserving two four-year terms." Speculation that he might push for a change in the constitution had risen in August. In August 2018 the Egyptian authorities arrested Masoum Marzouk, a retired diplomat who earlier in the month called for a popular referendum to be held on the regime. Unauthorised protests and public gatherings have been banned in Egypt since Sisi overthrew an elected Islamist predecessor in a popularly-backed coup in 2013. In October 2018 Egypt's parliament voted to extend a state of emergency in the country for three months, prolonging the authorities' ability to use special powers into 2019. The state of emergency grants the authorities sweeping powers, allowing them to make arrests and crack down on what they call enemies of the state.

After securing a second term as president in June, Sisi has appointed a new government. The cabinet, headed by Prime Minister Mustafa Madbouly who was appointed after Sisi's poll win, includes new ministers of defence, interior, trade, finance and agriculture. The result of the election had never been in doubt as his only opponent was Mousa Mostafa Mousa who said during the campaign that he was not there to challenge his rival. Sisi won 97.08% of valid votes but on a 41.5% turnout, a slight increase in the number of votes in his favour despite a dip in turnout from the previous election in 2014.

Reforms are needed to boost Egypt's low investment rate, raise productivity and create jobs for the country's rising population. Failure to deliver on reforms as the authorities are repressing political dissent will raise the threat of a renewed bout of unrest. In September 2018 an Egyptian court sentenced 75 prominent members and affiliates of the Muslim Brotherhood to death, as part of a mass trial that included 739 people charged after the violent dispersal of a protest camp in support of former Egyptian president Mohamed Morsi in 2013.

Fall in inflation opens door to more rate cuts

The central bank decided in November 2018 to keep the overnight deposit rate on hold at 16.75%. The decision has been widely predicted by analysts. It marks the fifth month in a row that rates have remained on hold after being hiked by a cumulative 200 basis points (2 percentage points). Explaining its interest rate decision, the bank said current interest rates remained in line with achieving single digit inflation. It added that it closely monitored all economic developments and would not hesitate to adjust its stance to achieve its mandate of price stability over the medium term. The decision came ahead of figures showing the first drop in annual inflation in four months in November 2018. The headline rate fell to 15.7% from 17.7% in October but below a peak of 33.0% in July 2017. The fall was driven by weaker food inflation and a sharp fall in clothes price inflation offsetting minor falls in other groups. Food prices, which account for 40% of the inflation basket, fell to 18.7% from 20.2%, thanks to a slowdown in fruits and vegetables inflation to 48% from 52.7% and a slowdown in inflation for regulated items (20.7% vs 23.9 %). Core inflation eased to 7.9% from 8.9%. Despite the latest fallback, inflation is still above the outer limit of the central bank's target range of 13% plus/minus 3% for the end of the year. The IMF said in October 2018 that the central bank's "prudent" monetary policy had helped bring down annual inflation from 33% in July 2017 but did not give any advice on future policy action as it has done in the past. In its October 2018 world economic outlook, the IMF said that inflation was expected to decline to around 10% by 2020 and to single digits in 2021. The weaker currency has made imports more expensive. The IMF expects the inflation rate to slow gently to 10.1% by 2020

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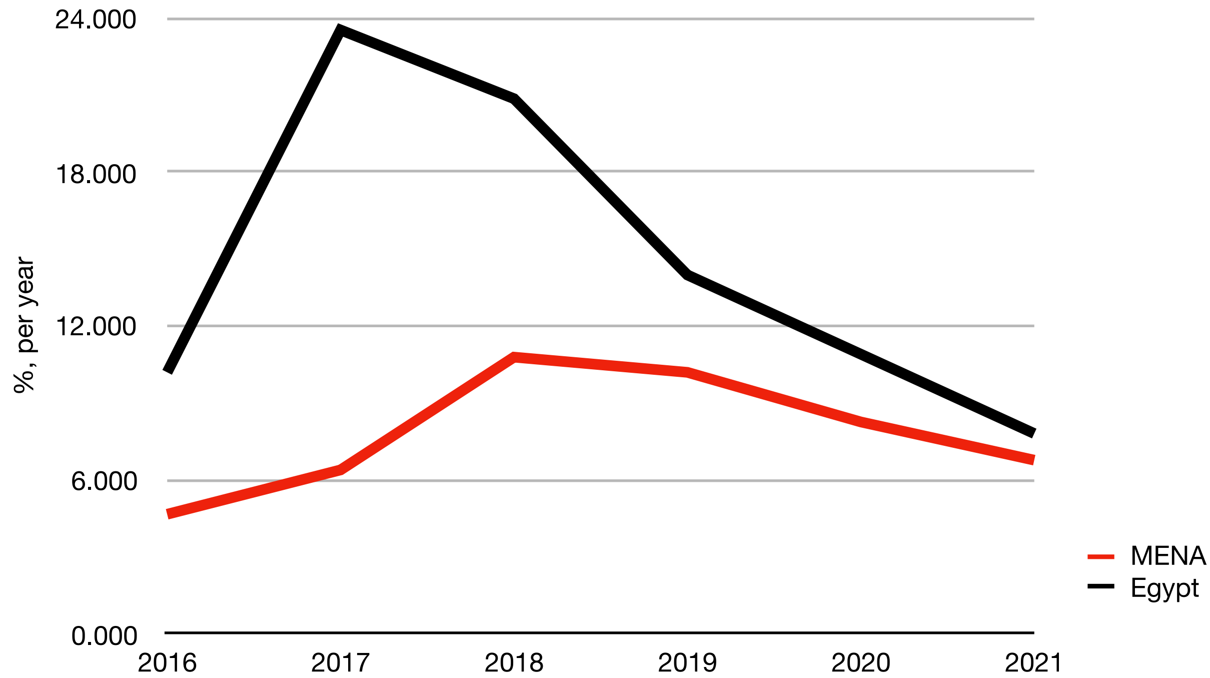
CPI inflation



Source: IMF, World Economic Outlook database, October 2018

Currency stable despite reform doubts

The pound was virtually unchanged during December 2018, starting the month at EGP17.892 and closing it at EGP17.896 to the US dollar (chart 4). It has only fallen by 1% against a strong dollar during 2018, leading to speculation that the authorities may have lent on state-owned banks to sell foreign exchange assets in exchange for pounds to boost the currency's value. The central bank has not been part of this as official reserves have been broadly steady at $44bn over the past six months. That puts them back at their level at the time of the 2011 uprising. Given that the IMF would object to any use of government funds to support the pound analysts such as Capital Economics believe it will depreciate to EGP10 by the end of 2020. However updated forecasts for Noozz show that the pound is likely to appreciate gently after hitting a trough in 2016. The forecasts point to the pound appreciating to EGP13.77 by 2021 (Chart 5). The parallel market between official and street exchange rates has virtually disappeared, and there are reports of foreign bond investors using the open market to buy pounds. Fitch Ratings said high rates and the reform programme had attracted a surge of foreign participation in the local debt market — non-residents held $19bn of domestic government debt at end-2017. The moves are seen as a sign that investors are confident in the exchange rate and in getting their money out of the country if necessary. In July 2018 the IMF said exchange rate flexibility was critical to safeguard competitiveness and help cushion against external shocks. In November 2017 the Central Bank of Egypt removed caps on deposits and withdrawals of foreign currency for importers of non-essential goods. Businesses could face problems if the interbank market is reluctant to provide liquidity amid concerns of further devaluations. The central bank devalued the pound in November 2016 and the currency subsequently fell by 50% against the US

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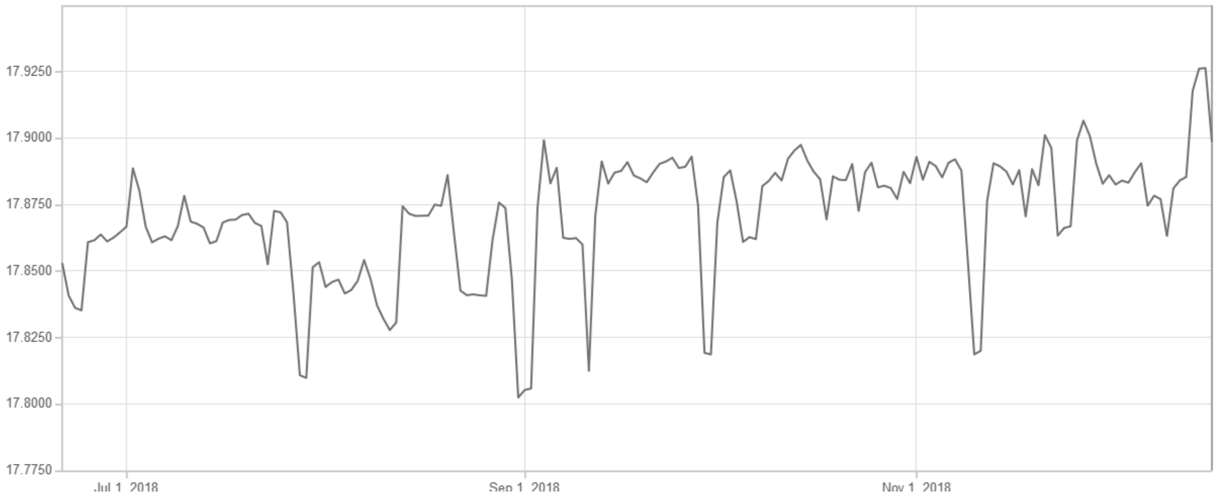
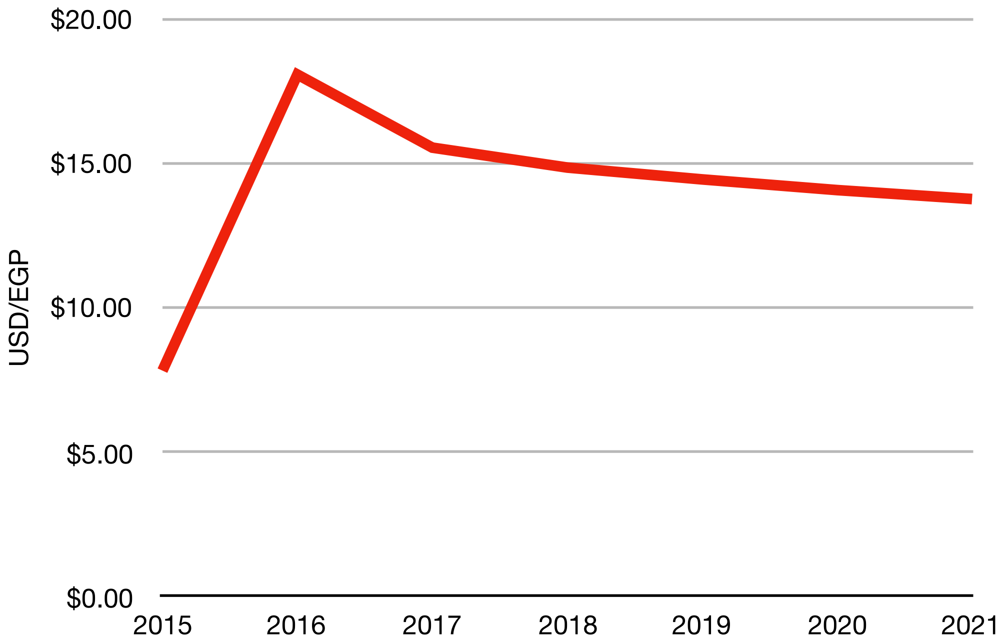
dollar. Egypt had faced growing pressure to devalue the pound since it started rationing dollars to keep the currency artificially strong at the EGP7.7301 fix. Devaluation to EGP8.8 had appeared inevitable because of the shortage of foreign exchange and the weakness of the export sector.

USD/EGP



Source: https://markets.businessinsider.com/currencies/usd-egp

Exchange rate forecast



Source: IMF, World Economic Outlook database, October 2018

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Egypt achieves fresh deficit cut

Egypt's budget deficit decreased to 1.9% during the first quarter of the fiscal year 2018/19 that ended in September 2018, compared with 2% in the previous fiscal year. Egypt has achieved its first primary budget surplus in 15 years for the fiscal year that ended in June 2018. The surplus, which excludes debt interest payments, came in at EGP4.0bn or 0.2% of GDP. The government is aiming for a 2% primary surplus (or $5.5bn) in the current fiscal year, which began in July. However, the overall budget deficit was 9.8% of GDP in 2017-18, about 10% lower than the previous financial year. The Egyptian government has no plans to seek a renewal of the $12bn financing agreement from the International Monetary Fund when the Extended Fund Facility expires in 2019. Finance Minister Mohamed Maait pointed to "some sort of cooperation" with the Fund. The IMF released the next tranche of $2bn in financing in November 2018 after holding meetings with the Egyptian authorities taking total payments to $10bn. Mission chief Subir Lall said the economy had continued to perform well, despite less favourable global conditions, supported by the authorities' strong implementation of the reform programme. He said Egypt's fiscal policy in 2018/19 and beyond would continue to aim at keeping general government debt on a clearly declining path and achieving a primary surplus of 2% of GDP. Egypt is targeting a budget deficit of 8.4% of GDP for the 2018-19 fiscal year that ends in June, compared with 9.8% in the previous year. Maait said the government would receive $55.3bn in tax revenues in the year to June 2019, of which $45.6bn would be spent on debt interest and instalments. The government approved its 2018/19 fiscal year budget in March 2018, targeting a budget deficit of 8.4% of GDP. The new budget includes investments worth EGP100bn, up from EGP70bn in the current fiscal year that ends in June 2018. In November 2018 Standard & Poor's maintained Egypt's outlook at stable and affirmed its BB rating, saying its outlook reflected the potential of raising the rating next year, if larger-than-anticipated structural reforms that support investment, growth, and decrease inflation continued. It said the general government fiscal deficit would decline to 6.8% of GDP by fiscal year 2021 from 9.7% in the 2018 fiscal year that ended in June. It said the fiscal position had benefited from front-loaded fiscal reforms under the IMF programme, such as introducing value-added tax (VAT), subsidy reforms, and government wage reforms. However S&P warned it could cuts its ratings if Egypt's plan to gradually reduce government debt to GDP were derailed by fiscal slippages, higher borrowing costs, more pronounced currency depreciation than expected, or if foreign exchange reserve levels were to fall significantly. Moody's said in September the fiscal deficit would reach 10.1% of GDP in fiscal year 2018, from 10.5% in the previous year, falling to 9.0% in fiscal 2019 and 6.8% of GDP by fiscal 2021. In October 2018 the IMF projected net lending, a different measure of the deficit, of 8.3% of GDP in 2018, narrowing to 4.7% of GDP by 2021, wider than the 3.4% it had forecast in April (chart 6). The IMF programme believes an improvement of the primary balance by a cumulative 5.5% of GDP is attainable. It projects general government debt to decline from 92.5% of GDP in 2018 to 81.5% by 2021. Energy subsidy reform, wage restraint, and the new VAT have all contributed to reducing the fiscal deficit and helped free up space for social spending to support the poor. In October 2018 the World Bank forecast the deficit shrinking to 8.5% and 7.5% in the 2019 and 2020 fiscal years. The government target for gross debt for fiscal year 2018/2019 is 97% of GDP, and 88% the following year.

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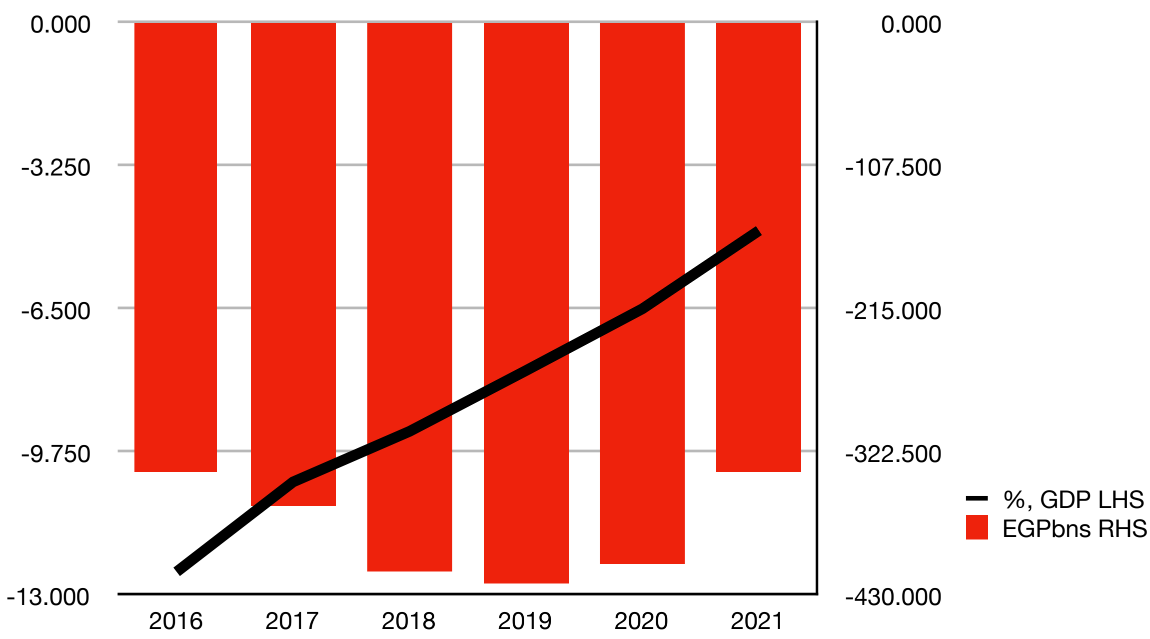
Government budget balance



Source: IMF, World Economic Outlook database, October 2018

Egypt looks at yen and yuan issuance

Egypt will go to the international capital markets in early 2019 to issue debt but could look to diversify into yen and yuan-denominated debt, finance minister Mohamed Maait said in December 2018. He told Bloomberg News the government was also expecting to issue its first green bonds, linked to environmental projects, in the 2018-19 financial year ending in June. However he said it was unlikely to launch its first Islamic bond, or sukuk, until the following year. Egypt has launched an international promotion campaign for its global bonds in European and Asian countries such as South Korea, Italy, France, China and Japan. Egypt has plans to issue $6bn-$7bn of Eurobonds in the fiscal year that ends in June 2019. In September it raised $2.46bn from the sale of eight-year and 12-year Eurobonds at 4.8% and 5.6% respectively. The sale followed its cancellation of an auction of three- and seven-year treasury bonds for EGP3.5bn in September 2018, saying that the interest rates required were "not within the logical limits". The central bank scrapped its special foreign exchange repatriation mechanism in December 2018. It ends the use of a mechanism guaranteeing that foreign investors wanting to sell out of Egyptian securities could pull out their money in dollars. It said that it had overcome its shortages of foreign currency and the move will be seen as a sign it believes that investor confidence has been restored to the extent that the dollar guarantee is no longer needed. Egypt's current account deficit for the 2017-18 financial year that ended in June narrowed by 58.6% to $6bn. The trade deficit stood at $37.3bn, compared with $35.4bn for the 2016-17 financial year. Central bank figures showed portfolio investment slowed to a net inflow of $12.1bn, down from $16bn, mostly due to lower foreign investment in treasury bills. Remittances from Egyptians working abroad rose sharply, to $26.4bn from $21.8bn year earlier. Net foreign direct investment (FDI) for the 2017-18 financial year was $7.7bn, of which $4.5bn was in the oil sector, the bank said. FDI was down from

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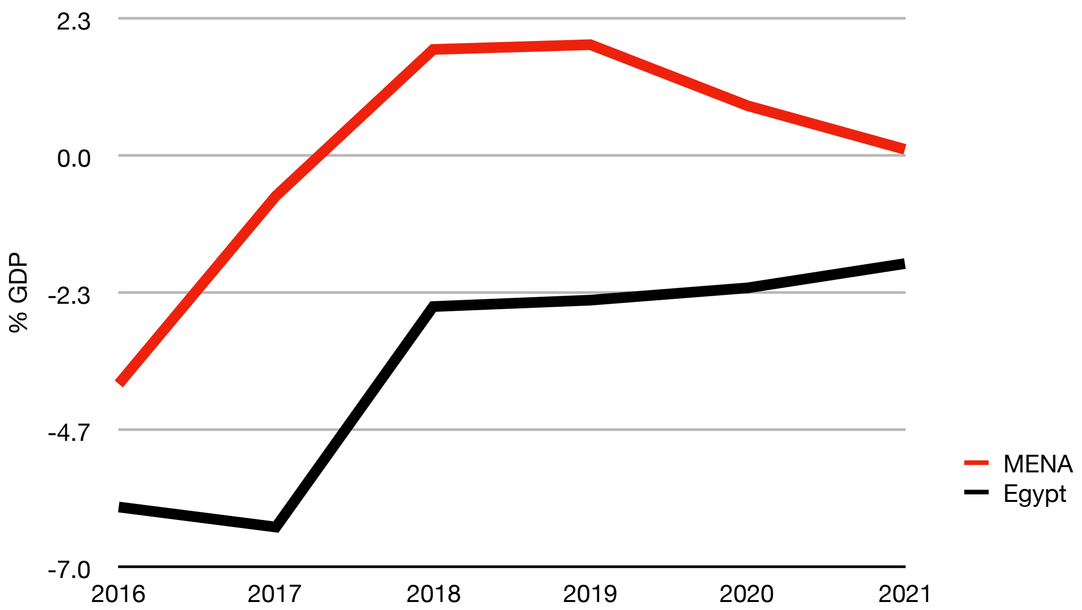
$7.9bn in 2016-17. The country is benefiting from the tranches of money from the IMF's $12bn bailout fund. Fitch revised Egypt's outlook to positive and maintained its rating at B grade, saying that it expected the current account deficit to narrow further in 2018-19. The current account will benefit from Egypt becoming a net gas exporter. The IMF said in its January 2018 Article IV assessment that Egypt's reforms of the business environment and a further recovery in tourism would help narrow the current account deficit to about 4.5% of GDP in 2017/18 and to about 3.5% of GDP by 2021/22. Capital Economics said in February 2018 the higher gas revenues could eliminate it. The IMF's executive board completed the fourth review of the EFF programme in October 2018, allowing the authorities to draw about $2bn, bringing total disbursements to $10bn. The payment will continue to bolster the country's national finances. In addition to the $12bn from the IMF and the $3bn from the World Bank, it is borrowing $1.5bn from the African Development Bank (AfDB) to support the general budget. The IMF loan has stemmed the shortage of reserves created by declines in foreign investment and tourism receipts. The current account is expected to narrow further but to remain in deficit.

Current account balance



Source: IMF, World Economic Outlook database, October 2018

Unemployment rate rises back to 10%

The jobless rate rose in the third quarter of the 2018 calendar year, taking it back above 10%. It marked the end of seven successive falls in the jobless total although still close to its lowest rate for four years. Official figures showed that unemployment rose to 10.0% in the three months to September up down from 9.9% in the three months to June 2018 and 11.9% a year earlier. The Central Agency for Public Mobilization and Statistics (CAPMAS) expects the rate to keep declining to 8.5% in the fiscal year 2021/22. CAPMAS said the number of jobless increased by 45,000 to reach 2.92m on a year-on-year basis. One reason was a rise in the size of labour force rose on a year-on-year basis by

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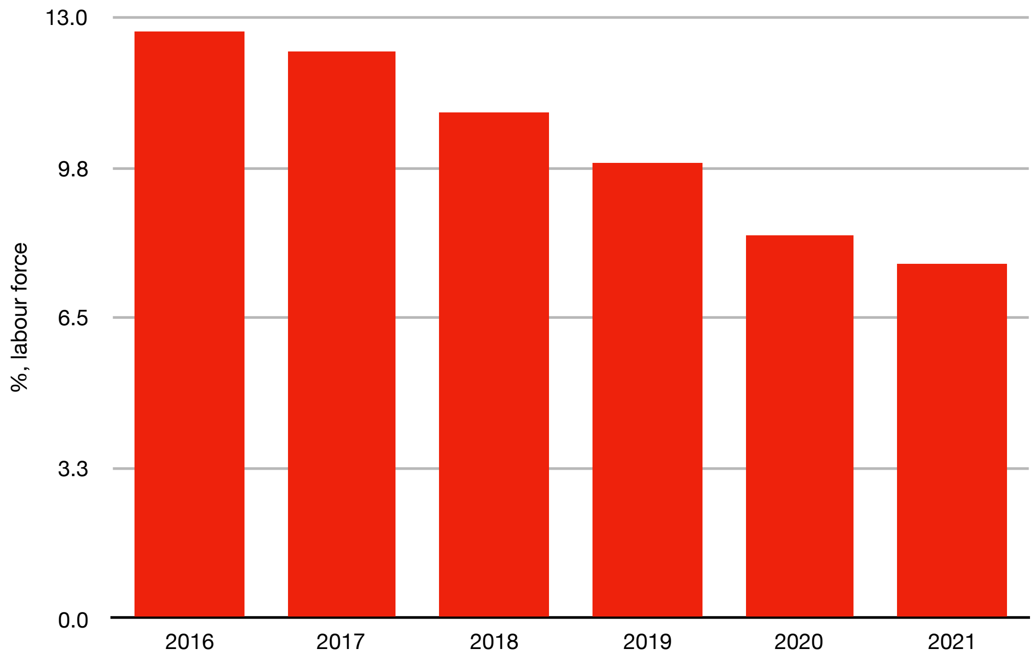
179,000 to 29.22m. More than nine out of 10 (92.9%) of the unemployed workforce are university graduates or school certificate holders. By 2028, the working age population in Egypt will have increased by 20% to a labour force of 80m Egyptians who will all be needing jobs, according to the IMF. "A more inclusive private sector-led growth model is essential to absorb the significant increase in the labour force expected over the next five years," David Lipton, First Deputy Managing Director of the IMF, said in July 2018. The unemployment rate averaged 10.7% between 1993 and 2015, hitting an all-time high of 13.4% in the third quarter of 2013, since when a rebound in economic growth has led to a rise in employment. The IMF now expects the headline rate to decline from 12.7% in 2016 to 7.8% in 2021 (Chart 8). President Sisi has pledged to reduce joblessness to 10% over the next five years — a target that will require much higher levels of economic growth than are currently forecast. The poverty rate was 26.3% in the 2012/13 fiscal year, the latest available figures, but the World Bank estimates the poverty rate based on $3.20 a day to decline to 15.3% by 2019 from 15.6% in 2017. The government has taken action to create jobs and reduce unemployment but further rises in the jobless rate could add to social unrest.

Unemployment rate



Source: IMF, World Economic Outlook database, October 2018

Medium term outlook is cautiously upbeat

There is a renewed sense of optimism that the tough medicine imposed by the IMF is having a positive impact. Egypt has perhaps begun to reap the benefits of what was an ambitious but politically controversial economic reform programme. The successful fourth review of the Extended Fund Facility (EFF) is a positive sign. While the government's indication that it will not renew its IMF funding is not a surprise, it is a show of confidence that the economy has achieved a sustainable footing for future growth. The overwhelming victory by President Sisi in the election combined with the IMF's

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steadfast support will reassure investors, albeit on a low turnout. Egypt's economy should experience a cyclical upturn in growth over the next two to three years. However investors and analysts are still watching to see the detail of Sisi's agenda for his second term. The pound has stabilised, and the twin external and fiscal deficits are falling. The medium-term growth prospects look positive provided the authorities can tackle the short-term challenges and implement growth-friendly policies and reforms. The reform plan aims to create well-paying jobs to meet the rapidly growing population by paving the way for increased private sector-led investment, productivity growth, and enhanced competition. Sisi's huge majority gives him a mandate to take ambitious action. The ability of the government to more than $13bn in foreign-currency denominated bonds since it liberalised the currency in 2016 is a further sign of investor confidence despite the cancellation of a local currency auction. The strength of economic growth may indicate that the economy is turning a corner, especially if non-oil business activity can regain its growth trend. The IMF points to the liberalisation of the exchange rate, energy subsidy reform, wage restraint, and the new VAT levy having all contributed to reducing the fiscal deficit. The government's success in achieving a primary surplus in the 2017/18 fiscal year of 0.2% of GDP is a sign that Egypt is meeting its objective of putting government debt on a firmly downward trajectory over the medium term. Debt as a share of GDP is likely to have declined in 2017/18 for the first time in a decade. A flexible exchange rate regime, a strong monetary policy framework, and a commitment to a continued fiscal adjustment should help rebuild policy buffers. The government believes that investors are growing confident that the economy has entered a new phase. The authorities will hope that the liberalisation of the exchange rate regime and the 55% depreciation of the pound will restore confidence in the economy and eliminate foreign exchange shortages. It should also improve Egypt's external competitiveness for exports and tourism, attract foreign investment and expatriate remittances, and enable the central bank to rebuild its international reserves. Structural reforms are also critical for the success of the programme. The forecast for growth to hit 5.8% by 2020 indicates that the economy will emerge fully from its current trough. ENI, the Italian group, has begun production at a gas field in the Nile delta while supplies from the giant Zohr gas field in the Egyptian sector of the Mediterranean Sea have come on stream. If production were to hit 2.7bn cf/d in 2019, that would add 2% to the level of GDP.

But both economic and political risks remain

Despite the upbeat tenor among analysts and policymakers, the overall outlook, however, is still uncertain and Egypt faces a number of downside risks including foreign currency shortages, still high inflation, tight monetary policy, and fragile market confidence. While the economy faces the prospect of a modest recovery, that must be achieved in the face of a number of political and economic challenges. Over the last few years, growth has averaged just 2.5%, budget deficits are high, and the external position has been weakening, while inflation has been high as well. Three successive rises in inflation will make the bank cautious about cutting rates again too soon. The feeling of caution will have been reinforced by the strong hint by the IMF that the bank should maintain a restrictive monetary policy. There is great uncertainty over the future path for interest rates with the range of forecasts ranging from a cut of 1 percentage point to as much as 3.5 percentage points in 2018. A further steep rise in oil prices and/or a sharp rise in global interest rates will exert fresh pressure on the public finances which would mean the government would have to ramp up fiscal austerity. The authorities need to maintain steadfast implementation of policies to cement macroeconomic stability and advance structural reforms to unlock Egypt's growth potential. Any

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slippage or delays in the implementation of economic and administrative reforms would jeopardise the restoration of the budget and external balances. Opposition by vested interests would weaken the programme's hard-won credibility, and thus hurt the prospects for investment and growth. Pressures to increase spending on wages, or expand social programmes beyond what is budgeted, could undermine fiscal goals. On the other hand, the implementation of the reform programme will mean public spending will also undergo a noticeable cut. The main potential impacts if these risks materialise are that domestic funding for government deficits will get tighter, the external position will weaken further, and that fiscal and economic reforms agreed upon under the IMF programme are delayed or reversed. This could lead to a drop in investor confidence depending on the form and speed of reversals and the implications for government finances and external liquidity. The investment rate is one of the lowest in the emerging world. One test will be whether the finance ministry goes ahead with plans for a further $3bn-$4bn Eurobond issue in the 2018/19 fiscal year. The IMF has noted that macroeconomic stability is still fragile and the reform agenda difficult, but that the authorities have demonstrated a strong resolve to contain the risks. Renewed social and political instability or a material deterioration in the domestic security situation are other major risks. Higher prices have weighed on consumer spending and any long-term upturn in inflation could fuel social unrest especially as firms have been quick to pass on the higher costs. This could both hurt the overall financial stability and impact social need, especially on those who have low income. Social conditions remain difficult with unemployment still at 10% and the absence of a notable acceleration in employment. Egypt needs to create jobs for its rapidly expanding labour force. According to the UN, over the next 10-15 years Egypt's working-age population will grow by an average of about 2% per annum. Failure to deliver on reforms and create a sufficient number of better-paid jobs for the country's burgeoning population would significantly raise the threat of a renewed bout of social unrest. Hikes to domestic energy prices that are part of the economic reform programme will add to inflation, which is still in double-digits despite 700bps of interest rate hikes over the last two years. While lower interest rates will bring relief for businesses' borrowing costs there is a risk that premature easing of monetary policy could adversely affect inflation expectations. There are already signs that costs are being passed on down the supply chain, which is in turn impacting growth.

Renewed intensification of political turmoil and instability is a worry. Regional and domestic security risks threaten the recovery of foreign investments and tourism. The downing of the Russian jet over Sinai has raised fears that IS terrorists are operating with impunity within the country and that the country's airport security is easily compromised. This was compounded by slaughter of more than 300 worshippers at a mosque in November 2017 that was claimed by IS. The wave of attacks against Coptic Christians may herald further carnage to come and is also an indication that IS will seek to exploit religious divisions within Egypt. These fears are likely to affect tourism over both the short- and medium-term unless the government can convince foreign authorities that they have tightened security and eliminated IS cells. It will also dampen household confidence and may affect consumer spending. Tourism makes up 15% of Egypt's GDP and supports around 1.3m jobs. The loss of export earnings from tourism will hit the country's current account deficit and put the shrinking official reserves under further pressure. Deterioration in the political situation in the Middle East and continued tensions between Russia and the West over Syria could lead to a slowdown in global trade that would affect Suez Canal revenues. On the domestic front the low turnout in the national elections combined by signs of increasing authoritarian behaviour by the government have stirred concerns of a repeat of the 2011 Arab Spring revolution. Perceptions that the parliament is simply

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rubber-stamping Sisi's decrees could foment dissent among citizens that are already dealing with 10% unemployment. The continued crack down on political opponents and talk of an end to the two-term presidency augurs poorly for the political outlook. There are still risks arising from the recent air disasters. If the May 2016 plane crash does, as seems extremely likely, turn out to be a terrorist incident that will highlight the ongoing security risk posed to Egypt and to travellers. Even if terrorism were ruled out, the general climate of fear would still deter tourists.