Egypt: Awaiting trickle-down

Florence Eid-Oakden, Ph.D, Chief Economist
Charlene Rahall, Senior Analyst

- **Egypt's economic growth outlook remains favourable, but sustained reform implementation will be critical if the benefits are to trickle down to the average citizen.**
- **Challenges include lower than average FDI, a private sector under pressure, high government debt and delayed privatisation.**
- **Security challenges also remain, as poverty rates have soared, and unemployment remains high although it has started to decrease.**

Table 1 – Egypt Macroeconomic Indicators[1]

	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

Protests squashed for now

Despite significant economic progress initiated through Egypt's IMF programme, recent protests (quickly squashed by President Abdel Fattah el-Sisi) have underscored that the fruits of reform have yet to be delivered to the average citizen. We highlight areas of ongoing concern.

- Protests against Sisi were put down with over 3,000 Egyptians, including children, arrested. This crackdown was one of the largest waves of arrests in the country in recent history. But it put Sisi back in control, at least for now.
- Sisi, however, no longer seems invincible. The arrests, combined with the government's limited attempts at addressing protesters' economic grievances, suggest an anxious government rushing to plug holes.
  - Examples include the announcement reinstating subsidies for staples like rice for the 1.8 million Egyptians who had been pulled out of the programme for having incomes considered too high to qualify.
  - Minister of Finance Amr El-Garhy also assured citizens that there would be no increase in tax rates in the income tax law that is currently being drafted; it will also not include any amendments on tax exemptions.
  - The government has also sought to lower domestic fuel prices, even though cutting such subsidies was part of the wider IMF economic reform programme.
  - While such measures might ease political tensions, they risk fiscal slippage. The state's 2019/20 budget aims to raise GDP by nearly 6% and lower the deficit to 7.2%, down from the 8.4% targeted in FY 2018/19.
- Despite the relatively small size of the demonstrations, the fact they even took place was a loud alarm bell for the regime.
- We do not adhere to the idea that Islamists were behind the protests. But we were not surprised that the protests occurred, in the sense that they are a common reaction to austerity from the IMF programme, and highlight that the fruits of reform have yet to be delivered to the average citizen.
- We have no reason to believe that Egypt's 5.9% economic growth forecast for the fiscal year 2019/2020 is not achievable, which would make it the fastest in the MENA region.[2]
  - However, Egypt needs sustainable growth rates of as high as 8% to create jobs for the 2.5 million people entering a workforce every year that already has high youth unemployment.[3]
  - Strong growth in recent years has resulted in a steady decline in overall unemployment from the peak of 12.9% in 2014/15. It stood at 7.5% in Q4 of the fiscal year 2019/20.
  - However, the youth unemployment rate remains high at 32.6%, according to the International Labour Organization, and such joblessness is intertwined with security concerns which have weighed on political stability in recent years.
  - World Bank estimates indicate that over 30% of the 99 million population lived below the national poverty line in 2018/19, with the highest poverty rates in rural Upper Egypt.
- Even more troubling for Sisi are rumours that sectors of the regime may have incited the protests. While impossible to corroborate, this highlights the possibility that Sisi might be struggling to control even his closest allies, despite several rounds of purges and reshuffles.

We see monetary policy easing and lower inflation as supportive of business confidence and local consumption demand, which will in turn boost private sector activity and encourage much needed FDI.

- In response to inflation sinking to its lowest levels in at least a year, the Central Bank of Egypt (CBE) cut key policy rates by 100 bps on 26 September following a 150-bps reduction on 22 August.
  - The overnight deposit and lending rates were lowered to 13.25% and 14.25%, respectively. The discount rate was also cut by 100 bps to 13.75%.
  - The cuts were supported by relatively lower monthly inflation figures, and by favourable base effects.

[1] Arabia Monitor; IMF.
[2] IMF.
[3] World Bank estimate.

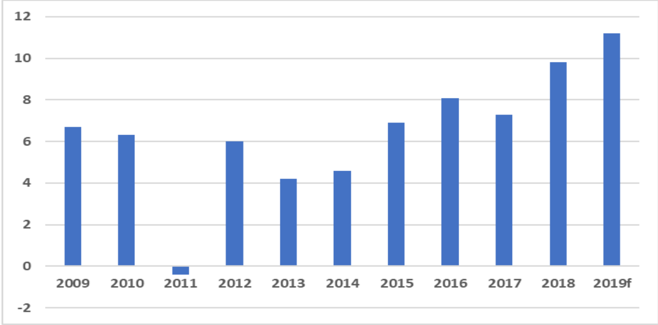
- This will encourage capital spending by businesses that have been holding back on such investments, supporting consumer spending and government finances through a reduced interest bill.
- Core inflation dropped to a seven-year low of 2.6% in September from 4.9% in August and a significant drop from the 35.5% peak in July 2017.
- The Monetary Policy Committee reiterated after its August and September meetings that its moves were consistent with achieving the inflation target of 9% (±3 percentage points) in Q4 2020, and price stability over the medium term.
- In October, the IMF lowered its forecast for headline inflation in Egypt to 9.6% for 2019/20 from 10.7% estimated in July.

➢ Egypt's non-oil PMI edged up in September, but still remains in contractionary territory: posting 49.5 (vs 49.4 in August). The reading was supported by a rise in export orders, although output and new orders declined.
- 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, as consumption has been growing at less than 1% in the last two fiscal years versus a high of 4% in 2016/17.
- These have in part been a result of the ongoing IMF reforms. But lower interest rates now should improve private sector cash flow through its impact on the lending rate.

➢ FDI -- always a volatile indicator that needs to be interpreted over time -- has not been as initially forthcoming as the government might have wished.
- Data released by the Central Bank of Egypt for the first nine months of the 2018/19 fiscal year points to a total inflow of USD 10.2B during the period, only a 1% YoY increase from the same period a year earlier. This was skewed towards the oil and gas industry as significant gas discoveries of offshore reserves attracted investments.
- 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.
- 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.

Figure 1 – Egypt FDI[4]



➢ Gross Egyptian 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.

Slow privatisation

Stakes in five or six large state-owned enterprises will now be offered by end-June 2020 in public listings. They were initially planned for the end of this year but delayed by the government due to global market volatility and fears the shares would not be properly valued.

➢ In 2016, Egypt had announced the launch of the government's IPO programme.
- As part of the economic reform programme, the government wants to offer 15%-30% of stakes of some state-owned companies in the fields of petroleum, chemicals, services and real estate on the stock exchange to increase funding to Egyptian companies and maximise the benefit from state assets.
- Egypt had planned to list about 4.5% of Eastern Company (a tobacco exporter) in October of 2019.

➢ The last time state-owned companies were listed on the exchange was in 2005 when shares of Telecom Egypt, the state's landline monopoly, and oil companies Sidi Kerir Petrochemicals and AMOC were floated.
- Market capitalisation as a percentage of GDP rose from 29% in 2000, reaching a peak of 107% in 2007, in large part due to the privatisation.
- Half of the 299 million shares of Telecom Egypt sold by the government went to Egyptian and international institutional investors, 45% went to retail investors in Egypt and 5% to the company.

[4] Arabia Monitor; Central Bank of Egypt.

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Arabia Monitor
Aston House| Cornwall Avenue| London L3 1LF
Tel +44 203 239 4518
info@arabiamonitor.com
www.arabiamonitor.com