ECONOMIC PULSE
OF EGYPT

ECONOMY & PUBLIC POLICY
MONTHLY INSIGHTS

November

2023

SUMMARY

This month has proven to be a dynamic period for Egypt's economic landscape, featuring a combination of positive and challenging developments across various sectors.

In the realm of monetary policy, both globally and domestically, significant decisions have shaped the economic narrative. The American Federal Reserve's choice to maintain interest rates for the second consecutive meeting is mirrored by Egypt's Central Bank, which opted to keep key policy rates unchanged. This alignment reflects the efficacy of fiscal tightening policies in mitigating inflation without triggering adverse economic outcomes.

A noteworthy positive trend has emerged in Egypt's inflation landscape. Non-food inflation, or core inflation, has softened for the third consecutive month, contributing to a drop in the annual urban consumer price inflation rate to **35.8%** in October. This positive trajectory is attributed, in part, to the government's proactive initiative to cut prices of key food items, marking a concerted effort to address inflationary pressures.

Investor-friendly initiatives have taken center stage with the launch of the **"Golden License"** online portal by the General Authority for Investments and Free Zones (GAFI). This streamlined platform offers a more efficient process for investors to acquire or lease land and operate enterprises, eliminating the need for additional government approvals. Such measures underscore a commitment to fostering a conducive environment for business activities.

Expanding on economic strategies, the government's plan to extend the real estate-for-FX scheme to the private sector is a significant move. Allowing Egyptian expats and foreigners to purchase properties in foreign currency, following the removal of the cap on foreign property ownership in July, aims to generate $191 billion by 2026. This forward-looking approach to real estate transactions aligns with broader economic goals.

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SUMMARY

However, challenges persist, particularly in the currency market. The unprecedented depreciation of the US dollar in the parallel market, exceeding **EGP 50/1 USD** for small amounts and approximately EGP 55/1 USD for larger amounts, introduces a level of volatility that may impact various economic sectors. This underscores the importance of monitoring and managing currency fluctuations effectively.

Additionally, **credit rating downgrades**, including Fitch Ratings' decision to lower Egypt's credit score to B-, pose challenges. This move, in line with actions by Moody's and S&P, highlights concerns about the pace of reforms and delays in the International Monetary Fund program review. The divergence in assessments from different credit rating agencies underscores the complexity of Egypt's economic situation.

Amidst these intricacies, Egypt is navigating geopolitical tensions in the region and global economic challenges. While Citigroup Bank expresses optimism towards Egypt's bonds, the credit rating downgrades place the country deeper into junk territory. Although, in a surprising development, Egypt started to obtain access to financing to rebuild its foreign reserves. Foreign inflows resumed in the form of bilateral and multilateral funding. Gulf countries deposits and investments were pumped again in to the Egyptian economy after 11 months of abstaining due to stricter and broader funding conditionality.

In this publication, IPA delves into the intricate landscape of these unfolding developments. We provide comprehensive insights into the profound economic implications they carry for Egypt, while also shedding light on the strategic policy measures that Egypt has adeptly implemented to navigate this complex situation.

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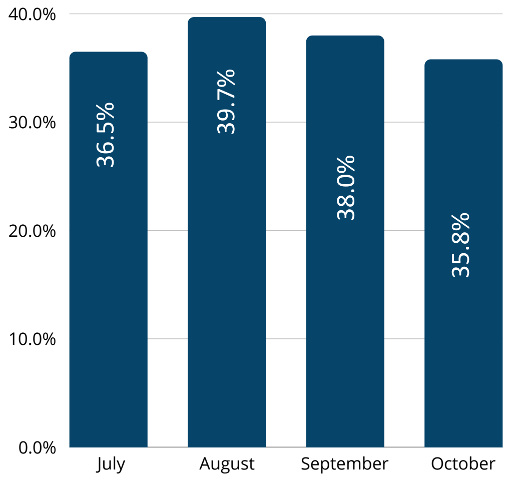
ECONOMIC PERFORMANCE

Egypt's economic growth faced a significant downturn, experiencing a sharp decline from the previous year's robust 6.6% to **3.8%**. This substantial setback is primarily attributed to **disruptions in global supply chains and an exacerbated external debt crisis.** Despite the government's initial optimistic projection of 5.7% growth, the economic outlook was revised downward in response to these formidable challenges.

Egypt's annual urban inflation in October experienced a welcome easing, marking the first decline in six months. The rate decelerated **to 35.8% year-on-year from September's 38.0%**, primarily attributed to a slowdown in food and beverage price inflation, This improvement follows the government's agreement with private food producers to reduce prices on key items by 15-25% from mid-October.



The Central Bank of Egypt (CBE) recently convened for its policy meeting, **maintaining key interest rates** amid persistent inflation. With the overnight deposit rate held at 19.25% and the overnight lending rate at 20.25%, the decision aligns with the anticipation of analysts who note the diminishing effectiveness of interest rates in controlling inflation.

Deposit rate

19.25%

Lending rate

20.25%

IMF is considering increasing Egypt's **existing USD 3 billion loan program** due to the challenges posed by the conflict in Gaza, highlighting potential economic difficulties ahead.

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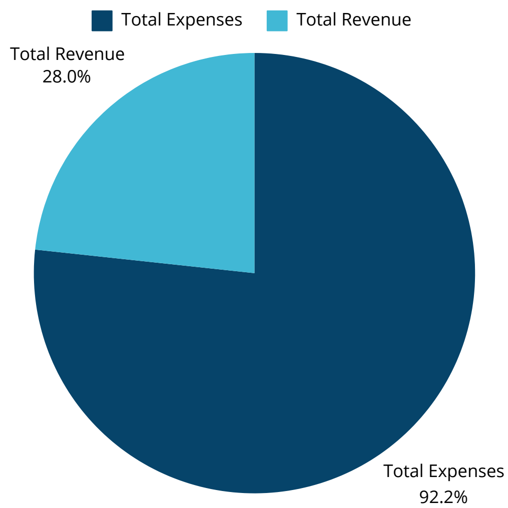
THIRD QUARTER HIGHLIGHTS

Fiscal Performance

The total budget deficit for the first two months of FY2023/2024 reached **3.2%** of GDP, exceeding EGP 383 billion **($12.4 billion)**. Total expenses in July and August rose significantly by **92.2%**, reaching EGP 590.7 billion. However, total revenue showed a robust annual growth of **28%**, amounting to EGP 206.88 billion during the same period.



Total budget deficit for the first two months of FY2023/2024: 3.2% of GDP

Budget Deficit Estimate

The government revised its **budget deficit estimate to 6.9%** of GDP for FY2023/2024, citing the impact of global economic crises. The country is actively seeking additional funding to address a **projected $17 billion financing gap by 2026, with $6-8 billion** needed in FY2023/2024.

Foreign Exchange Reserves

Foreign exchange reserves continue to rise, **reaching USD 35.1 billion** in October, up from USD 34.97 billion in September. **Despite this, the Egyptian Pound (EGP) remains relatively stagnant near EGP 50 in the parallel market. This stability may be influenced by the government's efforts to manage currency dynamics amidst global economic uncertainties**.

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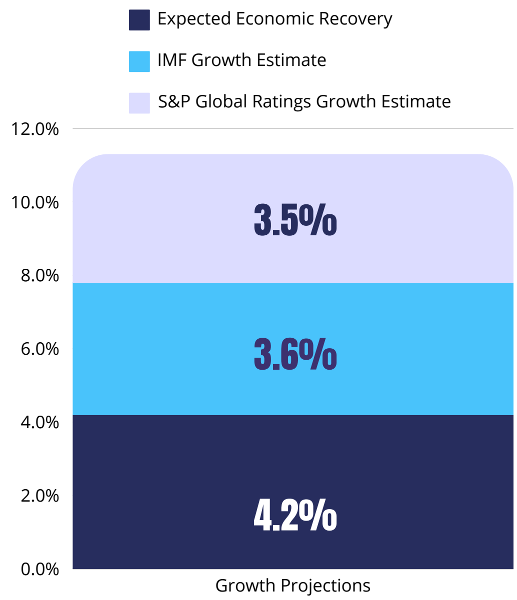
THIRD QUARTER HIGHLIGHTS

Growth Projections

Despite expectations of a slight economic recovery to **4.2%** in the current fiscal year, both **S&P Global Ratings** and the **IMF** adopt more conservative estimates, anticipating slower growth at **3.5%** and **3.6%**, respectively.

This divergence underscores the challenges and uncertainties facing Egypt's economic landscape.



The real annual growth rate for Egypt's economy stood at an impressive 3.8%.

The GDP reached a substantial LE10.2 trillion, underscoring the overall health of the economy.

While the data indicated a 7% unemployment rate, comprising 30.9 million workers in both formal and informal sectors.

Foreign Direct Investments (FDI) and Suez Canal activities experienced a commendable 12.8% increase, totaling $10 billion during the last fiscal year.

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Trade Balance

Trade Deficit

FY 2022\2023

$31.2 bn

Trade deficit improved by 28.2 percent, reaching only US$ 31.2 billion.

Total Imports

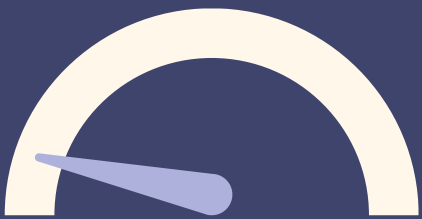
FY 2022\2023

$70.78 bn

Dropped by 19% compared to the las FY's figures at 87.30 bn

Total Exports

FY 2022\2023



$39.62 bn

Dropped by 9.7% compared to the previous fisical year

$25.8 Billion

Non- Oil Exports
FY 2022\2023

CBE, Oct2023

Non-oil merchandise exports slightly declined by US$ 121.7 million, reaching US$ 25.8 billion.

POLICY UPDATES

In response to Egypt's ongoing foreign exchange (FX) crunch, sellers must now **settle value-added tax (VAT) dues in foreign currency** for transactions invoiced or paid in foreign currencies.

Egypt's General Authority for Investments and Free Zones (GAFI) has launched the first phase of the "Golden License" **online portal,** offering a streamlined process for investors without additional government approvals.

Egypt is strategically positioning itself as a leader in Middle East green hydrogen production, catalyzing a substantial market expansion. This initiative signals a significant shift in the nation's energy landscape, with anticipated GDP growth of **$10 to $18 billion** by 2040 and the creation of 100,000 jobs.

Egypt's car-for-FX initiative, that aimed at bolstering foreign currency reserves, sees a remarkable **100,000 registrations in its inaugural week**. The program allows Egyptians abroad to import tax-free cars, necessitating a deposit equivalent to saved duties in a five-year FX certificate of deposit. See the impressive numbers in the graph below.

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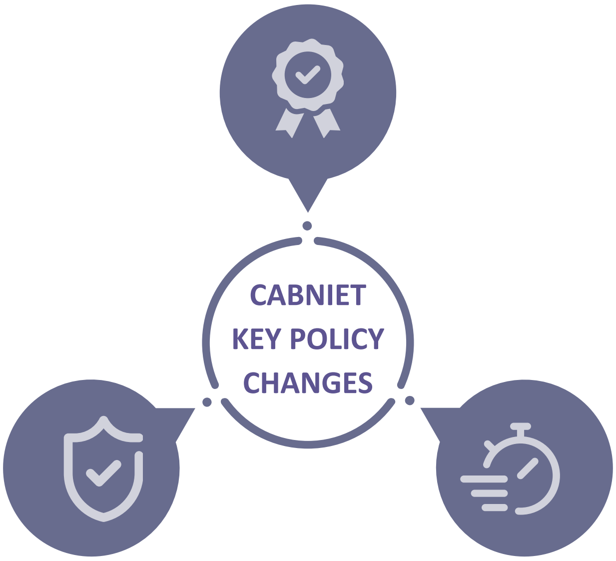
PUBLIC POLICY ACTIONS



Building Settlement Legislation

- Draft law introduced for easier settlement for building owners on state-owned land.
- Building owners given a 6-month window to file applications for legalization.

Double Taxation Agreement

- Agreement proposed to prevent double taxation on income and capital between Egypt and Croatia.

Land Ownership Extension in Sinai

- One-year extension proposed for current rules and conditions of land ownership and licensing under the usufruct system in Sinai.

The House of Representatives has approved several policy changes

01 Amendments to the 2020 SMEs law, providing exemptions for financing from the SMEs Development Agency.

02 Implementation of a ban on double taxation for profits generated from air transport between Egypt and Brazil.

03 Egypt's accession to the Basel Convention, which regulates the trade and disposal of hazardous waste.

04 Agreement on EUR 259 million financing from the Asian Infrastructure Investment Bank for the redevelopment of the Abu Qir railway in Alexandria.

05 Finalization of an agreement with TMH International, a Russian company, for the importation of 1.3k train carriages.

PRIVATIZATION

- In a significant update on Egypt's privatization strategy, **the government aims to generate $191 billion by 2026 by extending the real estate-for-FX scheme to the private sector.** This move opens up opportunities for Egyptian expatriates and foreigners to acquire properties in foreign currency, following the removal of the cap on foreign property ownership in July.

- Additionally, the **Central Bank of Egypt (CBE) and the Kuwait Investment Authority** (KIA) have entered into a pivotal agreement to divest almost half of their respective **49.37%** stakes in the Arab African International Bank (AAIB). As part of the privatization plan, a **20%** stake sale by each entity is planned through a private placement to a strategic investor, along with a sale on the Egyptian Exchange (EGX).

- The anticipated conclusion of this transaction is set for 2024 and is in alignment with the government's broader strategy to privatize state-owned companies. Citigroup and JPMorgan have reportedly been appointed as advisors for KIA and CBE, respectively, highlighting the involvement of international financial expertise in the privatization process. To ensure transparency and effective execution, a joint committee comprising representatives from AAIB, KIA, and CBE will oversee the sale.

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In 2015, Influence Public Affairs (IPA) emerged as a significant subsidiary of Influence Communications Group —a leading marketing communications consultancy in Egypt since 2007, serving a diverse portfolio of over 90 local and regional clients.
As a premier public policy and public affairs firm, we are fully committed to creating a positive impact on society.

Leveraging our extensive expertise and unwavering dedication to excellence, we actively shape government policies and foster effective stakeholder communication. Our team of seasoned professionals possesses a profound understanding of Egypt's political landscape, regulatory frameworks, and socioeconomic dynamics.

IPA Influence Public Affairs

IPA transcends the conventional role of a public affairs firm, assuming the mantle of a distinguished think tank and research institute. Our unwavering commitment to Egypt and the Middle East's economic and public policy landscape is a testament to our dedication to providing invaluable insights and strategic guidance, IPA's expertise shines as a beacon of knowledge, guiding you through the ever-evolving business environment, ensuring your endeavors are rooted in wisdom and poised for success.

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EDITORIAL

WOULD THE FX SHORTAGE CRISIS IN THE COUNTRY END SOON?

Egypt's economy has faced significant challenges due to the Ukraine war and the global pandemic, resulting in a severe shortage of foreign currency. This editorial delves into recent economic policies, emphasizing key trends and the prospects for resolving the ongoing FX shortage crisis.

MONETARY REFORMS

Over the last 11 months, Egypt has experienced a gradual increase in international reserves, with the Central Bank of Egypt **(CBE) reporting a rise from $34.97 billion in September to $35.1 billion** in October 2023. This upward trend suggests progress in rebuilding foreign currency reserves, a critical step in alleviating the FX shortage crisis.

FOREIGN DIRECT INVESTMENT INFLOWS

Recent agreements with regional partners underscore positive developments in Egypt's economic landscape. **Agreements with Saudi Arabia and Qatar, each valued at $1.5 billion, signify a substantial injection of funds. Additionally, the UAE's commitment to pump additional investments across various sectors further contributes to Egypt's economic revival.**

RESUMPTION OF GCC FUNDS

The resumption of funds from **GCC countries** after a year of abstention is a noteworthy milestone. **Kuwait's extension of a $4 billion deposit, Qatar's sovereign wealth fund depositing $1 billion, and potential new dollar deposits from the UAE and Saudi Arabia are significant financial boosts. Notably, almost $30 billion of Egypt's FX reserves are comprised of deposits from Arab countries, emphasizing the critical role of regional collaboration.**

EDITORIAL

DEBT-DRIVEN SOLUTION

While external borrowing has provided vital support, Egypt grapples with a substantial foreign debt of $165.3 billion. With debt service payments totaling $71.6 billion over the next three years, including $29.23 billion in 2024, the debt-driven approach raises questions about its long-term sustainability. Despite increasing reserves, this strategy has yet to stabilize macroeconomic indicators and the foreign exchange system.

IMBALANCES IN THE MACROECONOMY

Despite recent positive developments, Egypt's economic strategy faces challenges in attracting foreign investments. The country targets an annual collection of **$191 billion** in US dollar revenues by 2026, yet recent inflows fall short. The apparent increase in investment inflows lacks a solid foundation in stabilized macroeconomic indicators, which is crucial for sustained investor confidence.

EXPORT-DRIVEN RECOVERY

A crucial shift from a debt-driven to an export-driven recovery is imperative for Egypt's economic sustainability. As of now, Egypt's external debt growth rates outpace foreign direct investment growth. The focus should be on stabilizing macroeconomic indicators to attract long-term foreign capital, fostering economic growth and employment.

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Path Forward

- Since the expansion in external borrowing has not supported the achievement of the targeted macroeconomic stability, **the path to economic recovery needs to shift from being debt-driven to being export-driven**. So far, Egypt's external debt growth rates have been much higher than FDI growth.

- **The rehabilitation of the macroeconomic environment is imperative** in order to re-attract foreign capital in the form of investments. Eventually, this stability would encourage the attraction of foreign capital in the form of investments, trigger growth, and increase employment while bridging the financing gap and addressing the medium- and long-term balance of payments deficits.

- **Increasing exports** will aid the Egyptian government's plans to bring in its set target of $191 bn in annual revenues by 2026, up from the current figure of $70 bn. In line with the ambitious goal announced in 2022, to increase annual exports gradually to $100 bn in five years.

- Egypt is seemingly making progress in increasing the role of the private sector in growth in parallel with reducing the size of the state's footprint in the economy. The coming phase has to witness **further leveling of the playing field between public and private institutions, by strengthening governance, competition, and transparency in the business climate to support export-driven and private sector-led growth**.

ROAD AHEAD

- With the Federal Reserve maintaining a status quo on interest rates in consecutive meetings, the specter of potential rate hikes looms over global economies.

- The bar has been set high for such actions, given the cautious approach adopted by the Fed. However, the lingering risk of further intervention persists, as indicated by the Fed Chair's acknowledgment that the journey to achieve sustainable inflation levels is far from over.

- Despite the adverse effects of currency devaluation, Egypt's economic landscape anticipates a moderation in the overall inflation rate in 2024, averaging at 27.4% year-on-year. This moderation is attributed to a favorable base effect, countering the inflationary pressures linked to the devaluation.

Privatization

- The success of Egypt's privatization program emerges as a pivotal factor for economic growth in the coming years. As the nation braces for potential external shocks, including the ongoing conflict in Gaza, adaptive strategies and vigilant monitoring become imperative. The interplay of these factors underscores the need for a proactive stance, especially considering their potential impact on key economic indicators.