Euler Hermes Economic Research

Country Report

Egypt

Market-friendly reforms, one step further

General Information

GDP	**USD 336.3bn (World ranking 31, World Bank 2016)**
Population	95.7mn (World ranking 14, World Bank 2016)
Form of state	Republic
Head of government	Abdel Fattah al-SISI
Next elections	2018, presidential

Strengths

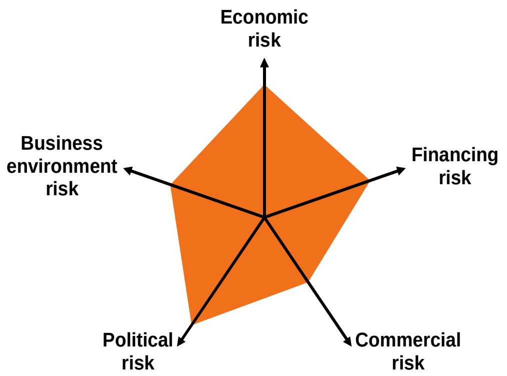
- Large domestic market (83mn) and a strategic position between Middle Eastern and African markets.
- Relatively diversified economy. Sources of foreign exchange generation include oil and gas, tourism, Suez Canal revenues, workers' remittances and a manufacturing base.
- Financial reforms are implemented along with flexible exchange rate, partial unwinding of capital controls, and subsidies cuts.
- External debt repayments are made even more comfortable, as the import cover of foreign reserves recovered to pre-crisis levels.

Weaknesses

- Uncertain political transition. In the short-term, stability appears to have improved, but longer-term issues (see below) persist. Elements within society feel marginalised and represent future stability risks in the absence of meaningful progress in relation to inclusivity.
- Regional uncertainties: relationship with Israel, contagion risk from Syria and Iran's nuclear programme.
- Poverty and lack of job prospects, two underlying reasons behind pressures for regime change, have not been tackled effectively.
- The difficult and protracted political transition has slowed the recovery in economic performance.

Country Rating

C3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United Arab Emira	10%	1	14%	China
Saudi Arabia	8%	2	8%	Germany
Italy	7%	3	5%	United States
Turkey	6%	4	5%	Italy
United States	5%	5	4%	Turkey

By product (% of total)

Exports		Rank		Imports
Petroleum, petroleum products and related materials	17%	1	8%	Petroleum, petroleum products and related materials
Gold, non-monetary (excluding gold ores and concentrates)	11%	2	7%	Road vehicles
Vegetables and fruits	11%	3	6%	Iron and steel

Source: UNCTAD 2016

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Economic Overview

Reforming and rebalancing

Egypt implemented significant reforms in November 2016. These are aimed at switching from a rigid model with a fixed exchange rate, high subsidies, and capital controls to a more market-based one.

The trigger for this change was low liquidity and the need for financing from the International Monetary Fund. As the Egyptian government accepted the IMF'S conditions, the country made a quick comeback to financial markets.

Still, short-term costs are heavy, resulting in high inflation (+30% in 2017). Yet this price shock is helping to rebalance the economy by making imports costlier. This ongoing rebalancing is a pre-condition to making the most of the country's business environment, which is one of the most favourable in the region.

Economic tectonic shifts are ongoing

In early November 2016, the government announced the floating of the exchange rate. This put an end to the self-defeating peg to the USD which had sent foreign exchange reserves spiraling to below three months of import cover. As the EGP depreciated by about -50% the black market premium vanished overnight. In 2017 local currency experienced appreciation pressures. A second substantial measure was the large cuts in subsidies. While these were designed to take effect at a gradual pace, they do push prices up.

Net short-term impact is positive …

These measures helped to free an IMF loan package of USD12bn over three years. Egypt successfully returned to the bond market with a USD 4bn issuance in January 2017. Foreign exchange reserves recovered to above 8 months of import cover, alleviating liquidity pressures. These developments also helped unwind some capital controls with lower barriers to foreign investment.

Such heavy measures could have two impacts. First, by increasing import costs devaluation could lead to sudden reduction in import volumes and close the current account gap. Second, subsidies cuts should help reduce the country's massive fiscal deficit (-12% of GDP in 2016).

…but short-term costs are a risk to the reforms program

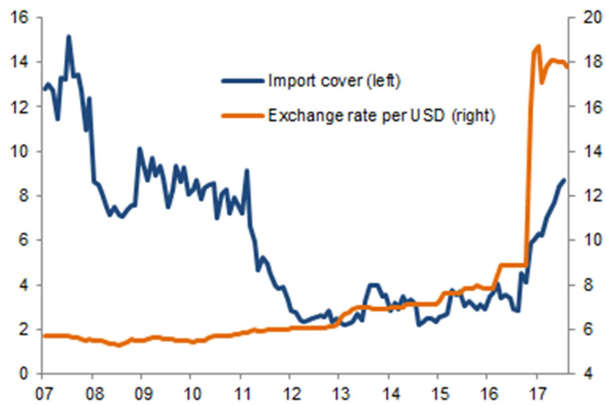
The main risk to reform implementation is social discontent as a result of high inflation and high unemployment (12%). This risk is intertwinned with security concerns which have weighed on political stability in recent years.

Key Economic Forecasts

	2015	2016	2017f	2018f
GDP grow th (% change)	4,37	4,3	4	4,5
Inflation (%)	11	13,7	30	25
Fiscal balance (% of GDP)	-11,44	-12	-11	-10
Public debt (% of GDP)	89	97	98	95
Current account (% of GDP)	-3,7	-5,8	-4	-2
External debt (% of GDP)	15	17	26	35

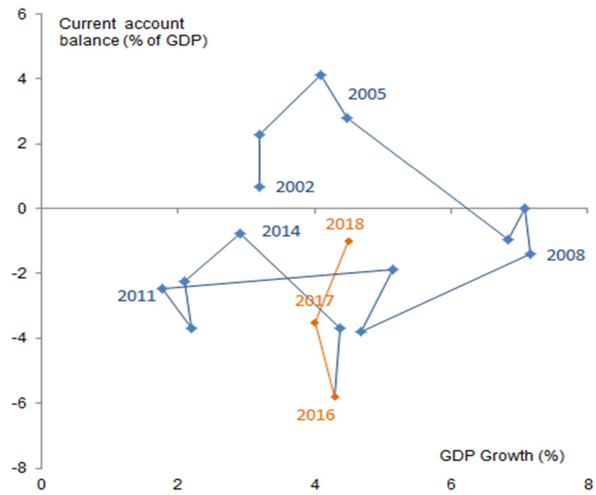
Sources: National Sources, IHS, Euler Hermes

Import cover and exchange rate



Sources: National sources, IHS, Euler Hermes

Growth and current account balance



Sources: National sources, IHS, Euler Hermes

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