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The Egyptian economy witnessed positive developments during the year 2017, thus sending strong messages of hope that the country is on the right path. Improved performance in Egypt's key sectors, tighter fiscal management and increased capital inflows drove an economic recovery during this year. In fact, economic growth augmented in Egypt, specifically in the third quarter of the year as the IMF-driven reforms implemented in late 2016 started to gain momentum. Consequently, during the end of December, the IMF unlocked \$2B of additional funding, which will be complemented by \$1.2B recently committed by the World Bank to help support the economy and boost job creation.

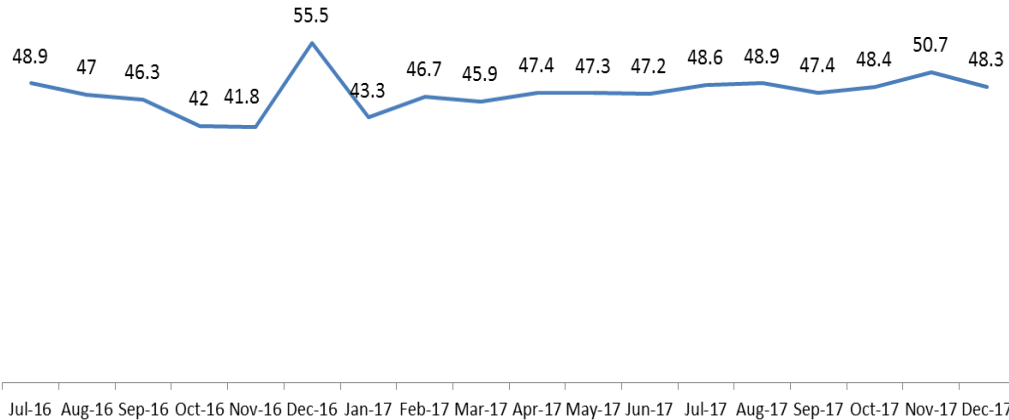
Growth

Economic activity in Egypt continued to recover with real GDP growth posting a growth of 4.2% in fiscal year 2016/2017. By H2 of the financial year 2016/2017, average growth stood at 4.6%, the fastest growth pace recorded for Egypt since 2010. Key sectors posted an improvement owing it to the tighter fiscal management and increased capital inflows into the country, which drove an economic rebound in 2017, with growth expected to accelerate further in 2018.

In fact, on the 20th of December, the IMF completed the second review of Egypt's Extended Facility Fund (EFF) which further unlocked the \$2.03B tranche of Egypt's \$12B IMF funding. The IMF also increased its forecast for the country's economic growth in the fiscal year 2017/2018 and 2018/2019, from 4.5% and 5.3% in the first review, to a projected 4.8% and 5.5%. From a sectorial perspective, services, and namely: real estate, trade, and construction sectors drove the growth. The contribution of real estate and construction improved vis-à-vis Q1 2017 and this may be attributed to the mega projects the authorities launched in the real estate sector, such as the New Administrative Capital and social housing project. Banks also offered financial facilitation for real estate projects through several initiatives, including the Mortgage Finance Fund and the Central Bank of Egypt (CBE) initiative of targeting funds to home buyers from various socioeconomic classes. The annual growth of the tourism and hospitality sectors also strengthened even though tourism's contribution to GDP growth fell, as other sectors improved.

PMI¹

Emirates NBD Egypt Purchasing Managers' Index™ (PMI points)



Source: *Emirates NBD and IHS Markit*

In the first half of FY 2017/2018, the PMI indicated an average of 48.72, reflecting an improvement for Egypt’s non-oil private sector compared to the previous semester, but it remained in the pessimistic territory below the 50 mark. Nonetheless, looking at previous PMI values lower than so, the recent PMI is associated with high growth rates. The average PMI for H2 2016/2017 stood at 46.3, with a GDP growth of 4.6%. Therefore, we estimate the growth rate to be around 5% in H1 of 2017/2018.

In November 2017, Egypt’s private non-oil sector marked the first expansion in 2 years hitting a PMI of 50.7 points compared to 41.8 points in the same period last year. The improvement was nurtured by foreign demand on Egyptian goods reaching record-highs. The expansion marked the first fruit of the multi-faceted economic reform program adopted by the Egyptian authorities since Nov.2016.

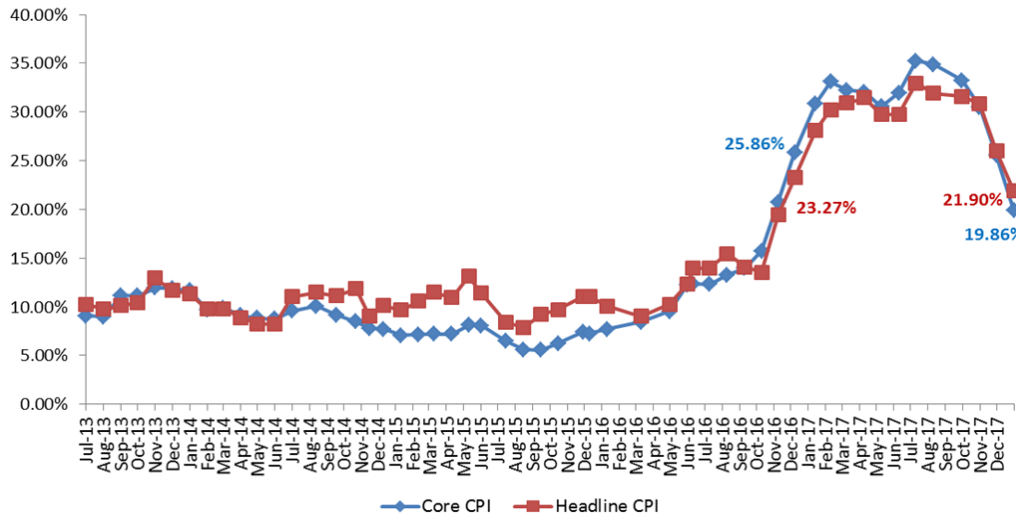
Nonetheless, in December 2017, Egypt’s PMI modestly deteriorated, slipping from 50.7 points in Nov. 2017 and from 55.5 points in December 2016 to 48.3 points in Dec. 2017. The retreat back into pessimistic territory was fueled by reduced foreign and domestic inflows of new business, less new export orders and fewer total new businesses, all of which constitute Egypt’s economic health indicator. However, on a positive note, future growth prospects in H2 2017 remained strong and business confidence was supported by the contraction in job shedding to a 28-month low. According to the Emirates NBD Bank, PMI sponsor, the overall optimism vis-a-vis the business conditions by December is underpinned by a higher capital spending and a forecasted improvement in economic stability.

¹Definition (as per Egypt’s Ministry of Finance): The Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI is based on components and indicators such as: new orders, inventory levels, output, stock purchases and the employment environment. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts and purchasing managers. PMI is produced by Emirates NBD Bank.

Inflation (Consumer Price Index)

The baseline inflation outlook remains consistent with achieving the CBE's inflation target of 13% ($\pm 3\%$) in Q4 of 2018 and single digits thereafter.

Annual Inflation (y-o-y % change)



Source: Central Agency for Public Mobilization and Statistics (CAPMAS), and CBE calculations

High inflation, which constituted the main risk factor to Egypt’s macroeconomic stability since November 2016, was placed on a downward trajectory during the last months. Inflation soared following the floating of the Egyptian pound in November 2016 and peaked at a 30-year high of 35.26% year-on-year (y-o-y) in July 2017. In details, the country’s annual urban consumer price inflation contracted to 21.9% in Dec., from 26% in Nov. 2017 as per the country’s official statistics agency CAPMAS. As for annual core inflation, it slid from 30.53% in October 2017 to 19.86% in December, which represented the lowest inflation rate reached throughout the year. Meanwhile, the month-on-month inflation rate came in at -0.2% in December, its lowest rate since November 2015, and monthly core inflation climbed from 0.70% in October 2017 to 1.31% in November, mainly driven by regulated items, namely higher taxes on tobacco and by the seasonality in clothing prices. In December, Annual food and beverage prices alone rose by 25.2%, compared to 32.3% the previous month. Overall though, lower inflation is not necessarily considered an economic recovery, as the consumers’ purchasing power is yet to fully recover from the floatation costs. Nonetheless, inflation is expected to remain slightly elevated through H2 of 2017/2018, hovering around the 20% mark, before receding down to an expected 10-12% by end 2018. In parallel, the government continues the subsidy restructuring process with a second round for fuel subsidy cuts by June 2018.

Unemployment

The pickup in economic activity by December 2017 coincided with an improvement in unemployment which continued to narrow, from its historical high of 13.4% recorded in Q3 2016 to 11.98% in Q2 2017 for the first time since the 2011’s uprising, owing it to improved productivity and slipping real wages. Egypt is targeting an unemployment rate of 11.5% by end 2017/2018 compared to the 12.2% last year.

Tourism

According to Egypt's Chairman of Tourism Promotion Board, the number of tourists in Egypt rose by 54.7% to stand at 7.5M by Nov. 2017 compared to Nov. last year, on the back of the recovering economy and political stability. Boosting the tourism activity in Egypt is crucial as it boosts revenues from tourism, which together secure foreign currency inflows as well as job creation in the economy. The latest data available shows that total number of tourists in November 2017 stood at 778,000, up by an annual 55.91% (from 499,000) last year, of which, Arab tourists rose by 24% to reach 140,000 tourists.

Hospitality

Alongside the improvement in tourism, Ernst & Young's 4- and 5-star benchmark survey show that Cairo's hospitality market registered a rise in average occupancy by 13 percentage points in October. Cairo's hotel occupancy rate stood at 67.3% by October 2017, up by 4.3 percentage points compared to the same period last year. This was accompanied by increases in the average daily room rate and room yield (revenue per room) which respectively rose to \$85 and \$57 by Oct.2017, from \$47 and \$29 by October 2016.

On the other hand, the contribution of the industrial sector was weaker in early 2017; yet, this was partially offset by the investor-friendly environment and industrial licensing laws set in August 2017, alongside the improvement in oil extractions during Q2 2017. In details, foreign investment was supported by offering investors incentives like tax breaks and rebates. Meanwhile, the production of natural gas is expected to rise by approximately 30%, as per the Egyptian Minister of Finance Al Garhy. This is equivalent to an estimated 42B to 43B cubic meters during FY2017 and to 55B cubic meters in FY2018 on the back of energy production starting at the country's new Zohr natural gas reserve. Other sectors such as trade, Suez Canal and general government also improved by December 2017 compared to Q1, all of which suggest a positive growth momentum.

Real Estate

Amid Egypt's economic recovery during H1 2017/2018, the country's real estate continued to prosper. The sector posted a remarkable growth during 2017, valued at EGP 66.61B (approximately \$37.63B) according to *Property Finder*, the country's leading online real estate portal. In details, the agency's data showed that the number of registered properties rose by an annual 128.8% to reach 119,240 properties in 2017. Meanwhile, the value of properties listed on *Property Finder's* website also grew from EGP 60.18B in 2016 to EGP 193.6B in 2017. In fact, the demand for properties for sale/rent in Egypt gained 179.17% y-o-y in Q1 2017. Meanwhile, the number of properties supplied increased by 54.26% y-o-y over the same period. *Property Finder* expects to finalize 27,767 real estate deals with its partners by end 2018.

The improvement in the sector is mainly attributed to mega-projects the Egyptian government launched following the flotation of the currency in 2016. These include the *New Administrative Capital* whose aim is to offer social housing projects and employment opportunities for the youth in the country. The authorities also initiated a number of other diverse residential and touristic projects. Another eminent project is *The Golden Triangle Economic Zone*, proposed to draw major investments in the mining, agriculture, and industrial sectors. The keenness of the government to develop and revive the sector was coupled with banks' offerings of financial facilitations that encouraged real estate initiatives. These credit facilities mainly included the *Mortgage Finance Fund* and the *Central Bank of Egypt (CBE) initiative* of targeting funds to home buyers to enable them to buy residential units.

With these projects falling into completion as planned, and with real estate developers enhancing the delivery of smaller units for more flexible prices in the residential market, more expats will be able to purchase houses at reasonable prices. Therefore, we expect Egypt's real estate to grow by approximately 6% in 2018, as more supply is bound to attract investment and change in trends, diversity, and smart and affordable solutions and sales.

External Sector

Egypt continued to benefit from the liberalized exchange rate system, as the floating exchange rate regime continued to lure in foreign investors' appetite for Egyptian assets. As such, the Balance of Payments (BOP) registered a surplus of \$5.1B in Q1 of 2017/2018, compared to a surplus of \$1.9B in Q1 2016/2017 according to the central bank of Egypt. The improvement is attributed to Egypt's current account deficit narrowing by an annual 65.7% to \$1.6B compared to \$4.8B in the same period last year. Meanwhile, the capital and financial accounts recorded a net inflow of \$6.2B in Jul/Sept.2017 compared to \$7.2B in Jul/Sept 2016.

Current Account

Developments in the components of the current account reflected a yearly 5% reduction in the Trade deficit which reached \$8.9B in Q1 2017/2018, compared to \$9.4bn in the same period last year. This revealed the contribution of the devaluation which improved the competitiveness of the Egyptian economy, thus boosting exports and contributing to the slowdown in imports. Accordingly, merchandise exports rose by 11% y-o-y to \$5.8B compared to \$5.3B in the same period last year. Oil exports recorded an annual uptick of 16.8% to US\$ 1.8B (from \$1.5B last year), and Non-oil exports rose by 8.6% y-o-y to \$4.1B (from \$3.7B). Meanwhile, merchandise imports recorded an incremental rise of 0.7% y-o-y to \$14.8B, as oil imports rose by \$40.4M to \$2.8B, while non-oil imports increased by \$63.3M to \$12B.

Moreover, the Minister of Planning Hala Al-Saeed estimated exports will increase to \$22.5B by the end of the current FY 2017/18, compared to \$20.5B recorded by end 2016/2017. The Egyptian planning minister also predicted exports to exceed \$30B by the end of 2019/20.

As for the services balance, it doubled to reach \$2.8B in Q1 of 2017/2018 compared to \$1.4B last year. This came on the back of the upticks in both, the Suez Canal receipts which rose by 7.7% y-o-y to \$1.4B over the same period, and in Travel receipts which stood at \$2.7B this year as travel payments retreated by 41.3% y-o-y to stand at \$649.3M in Q1 2017/2018. Also, it is important to note that workers' remittances increased by \$1.6B supported by the liberalization of the exchange rate. These boosted the Net unrequited current transfers account by 37.3% to reach \$6B in Q1 2017/2018.

Overall, December 2017 carried a breakthrough to the Egyptian economy as energy production began at the country's new Zohr natural gas reserve estimated at 850B cubic meters. The field has a production capacity of 350 million cubic meters, which is expected to give a fair boost to the economy and render Egypt self-sufficient again on that aspect. The increased production levels may help Egypt reclaim its position as net energy exporter in 2018 as it aims to halt imports by 2019, thereby slashing the imports bill and easing the burden on the government budget.

Capital Account

Meanwhile, the floating exchange rate regime continued to strengthen foreign investor appetite for Egyptian assets, supporting the financial account. As such, the capital and financial account recorded a net inflow of \$6.2B in July/September 2017/2018, compared to \$7.2B in the corresponding period last year.

In details, Egypt's total FDI inflows amounted to \$1.6B, knowing that net inflow from oil sector investments alone rose by an annual 84.2%. In its turn, Portfolio investment rose to \$7.5B in Q1 2017/2018, compared to a net outflow of \$840.9M during the same period last year, as foreigners' investments in Egyptian TBs increased to \$7.4B (net purchases) instead of last year's \$55M. Throughout Q2, Net FDIs as well as Net portfolio inflows continued to recover, following the strong rebound in Q1 which was supported by Eurobond issuances in January and May 2017.

Other assets and liabilities in the capital account registered a net outflow of \$3.6B (against a net inflow of \$4.8B). Immediately after the devaluation of the EGP, foreign currency resources rose, increasing banks' net foreign assets by \$2.1B; while banks' foreign liabilities recorded a marginal uptick of \$0.5B.

Fiscal Sector

On the fiscal front, Egypt managed to reduce its fiscal deficit to 10.9% of GDP in fiscal year 2016/2017 compared to 12.5% in 2015/2016 through the introduction of several reforms including slashing bread and energy subsidies and introducing a 13% VAT rate. The IMF projects that the share of energy subsidies in GDP will drop from 4.1% in the fiscal year 2016/2017 to 3.1% in the fiscal year 2017/2018. The budget deficit stood at 9.5% of GDP in Q4 of fiscal year 2016-2017 while it constituted 11.5% of GDP in Q4 of the previous fiscal year. According to IMF projections, budget deficit will shrink to 9.2% of GDP in 2017/2018 and 7.4% in 2018/2019.

Revenues are recovering but not as they should following the introduction of the VAT with total revenues increasing from 18.1% of GDP in 2015/2016 to 19% in 2016/2017. The IMF projects revenues and grants to constitute 18.8% of GDP in the fiscal year 2017/2018 and to go down even more in 2018/2019 to 18.7% as GDP growth will outpace that of revenues.

On the expenditures front, the elimination of subsidies and the high economic growth are bearing fruit with expenditures (including the net acquisition of financial assets) declining from 30.2% of GDP in 2015/2016 to 29.7% in 2016/2017. The downward path is expected to continue with expenditures reaching 28.00% of GDP in 2017/2018 and 26.1% in 2018/2019.

However, Egypt will need to implement more reforms on the tax and customs' side in order to break the deficit-debt cycle. The government is expected to realize a marginal primary surplus of 0.2% of GDP this fiscal year, and an important surplus of 2.1% of GDP next year. But with high interest rates and a large debt, more effort will be needed to control the evolution of public debt. Government's debt represented 103.3% at end 2016/2017 compared to 96.7% of GDP by the end of 2015/2016 and 86.6% of GDP by the end of June 2015. However it is expected to be put on a downward slope starting the current year shrinking to 91.1% of GDP. In this context, domestic debt is expected to decline to 74.6% by the end of the current fiscal year. As for foreign debt, it has increased by 10 percentage points to reach 18.1% of GDP during 2016/2017 but will decline to 16.7% by end of current year. Egypt is planning on issuing Eurobonds worth \$3 to \$4 billion dollars in the first quarter of 2018.

In order to mitigate the impact of the reforms on the poor, the authorities adopted several social protection programs. The authorities have more than doubled the value of cash transfer allowances offered through food smart cards – from 21 to 50 Egyptian pounds per person – and raised transfers for infant milk and children’s medicines. They also expanded the social solidarity pensions to include medical coverage, as well as expanded the coverage of the Takaful and Karama programs to 2 million households and increased the amounts provided. The government raised pension benefits, especially for the lower pension categories. The government started in June 2017 a new program “Forsa”. Partnering with private sector, Forsa links the children of the Takaful and Karama recipient families and job seekers with employment opportunities which offer them steady income. The government paid a one-time allowance to public employees to compensate for high inflation and provided free school meals and new gas connections in poor districts while increasing the exemption threshold for taxes on domestic salaries.

Monetary Sector

After the float, foreign exchange shortages and the parallel market were eliminated. The depreciation of the exchange rate reflected the prevailing foreign exchange shortages. The exchange rate is now determined by market forces of supply and demand. Egypt was able to rebuild its international reserves as confidence was restored and capital flowed in. The central bank foreign reserves reached USD 37 billion by end December 2017 compared to less than USD 18 billion before the float. Looking forward, the market determined exchange rate is critical in ensuring external competitiveness of the Egyptian economy, supporting exports and ultimately promoting stronger and job-rich growth.

Meanwhile, the Central Bank of Egypt’s (CBE) restrictive monetary policy allowed for inflation, a major macroeconomic vulnerability, to ease in 2017. In order to keep inflation in check, the CBE will have to keep policy rates high; in its latest monetary policy report published in September 2017, the CBE stated that policy rates have increased by 700 basis points since November 2016, with the overnight deposit rate standing at 18.75% and the overnight lending rate at 19.75%. Accordingly, the weighted average interest rates on deposits in Egyptian Pounds (EGP) ranging from 1-3 months, 3-6 months and 6 months to a year all increased from 8.8%, 9.4%, and 9.8% in November 2016 to 13%, 14.4% and 13.2% in November 2017, respectively. Interest rates on corporate loans with a duration less than or equal to a year also rose from 16.0% in November 2016 to 19.7% in November 2017.

Almost a year after Egypt secured a \$12 billion IMF loan floated its currency² and reduced energy subsidies, the IMF assured that the country’s reform program “is yielding encouraging results”. So far, Egypt has drawn \$6.08 billion out of the \$12 billion IMF loan approved in 2016. The CBE introduced a 1% entry fee on all foreign currency portfolio investments that enter via the repatriation mechanism and kept the 0.5% exit fee. Egypt’s foreign currency reserves hit pre-crisis levels and reached \$37.02B in December 2017, up from \$36.72B in November 2017.

² End December 2017 1 USD = 18.0052 EGP compared to 1 USD = 17.81954 end December 2016

Stock market

The EGX 30 recorded the highest increase for 2017, with a yearly surge of 21.85%, and total traded stocks rising from 57.4B stocks in 2016 to 61.59B in 2017. The Egyptian reforms have helped revive the stock market, attracting more than 1,000 foreign investors, including individuals, retails, and investment funds in 2017. In details, foreign buying on the EGX stood at EGP 7.4B in 2017 (\$418.54M), and EGP 13B (\$735.28M) after the flotation of the Egyptian pound on 3 November 2016.

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