Egypt's Economic Reform Program

Egypt initiated bold and front-loaded reform measures, which gained increasing support in the international community. These firm measures succeeded in averting an extremely fragile and precipitous situation, and included a developed homegrown economic reform program aimed at macroeconomic stabilization, which yielded outstanding results. At the forefront of the reform program was the historic liberalization of the foreign exchange regime in November 2016.

Foreign Exchange

The flotation of the EGP boosted external competitiveness through a weaker currency, encouraged and attracted foreign investments back to the country through a more transparent economy and ended the currency black market which was trading at double the price set by the CBE at the time of floatation. In fact, less than a month after floatation the banking sector had attracted more than USD3bn. In addition, after suffering from low and unsustainable foreign currency reserves, Egypt managed to build its reserves to unprecedented levels reaching all-time highs of more than USD 45 bn, covering 9 months of imports. The Egyptian economy also witnessed many positive economic indicators as a result of the reform program which included record high figures of remittances flows, steady increase in GDP levels and persistent decrease in unemployment levels. These were all strong signs of a renewed confidence that international and local investors have in Egypt's economy.

After the flotation of the EGP, the CBE scrapped all FX restrictions that were in place since 2011, these measures included:

- Removal off all caps on deposits and withdrawals of foreign currency for companies and individuals. Individuals and companies may also transfer abroad without maximum limits.
- No restrictions on any individual wishing to buy foreign currency.
- CBE terminated the repatriation mechanism, which was in place to guarantee foreign portfolio flows were secured by the CBE in time of outflow. The removal of the repatriation mechanism came at a time when investor confidence in the EGP market gained and this was reflected in the elevated FX interbank market volumes.
- Before the floatation of the EGP the CBE was following an auction mechanism which prioritized the importation of necessity goods. After the floatation, thanks to the ample of FX liquidity there remains to be no restrictions on importation of any good or service (all items are imported freely).
- The CBE extended the net long position in any foreign currency of a bank operating in Egypt from 1% to 10% of its capital base.

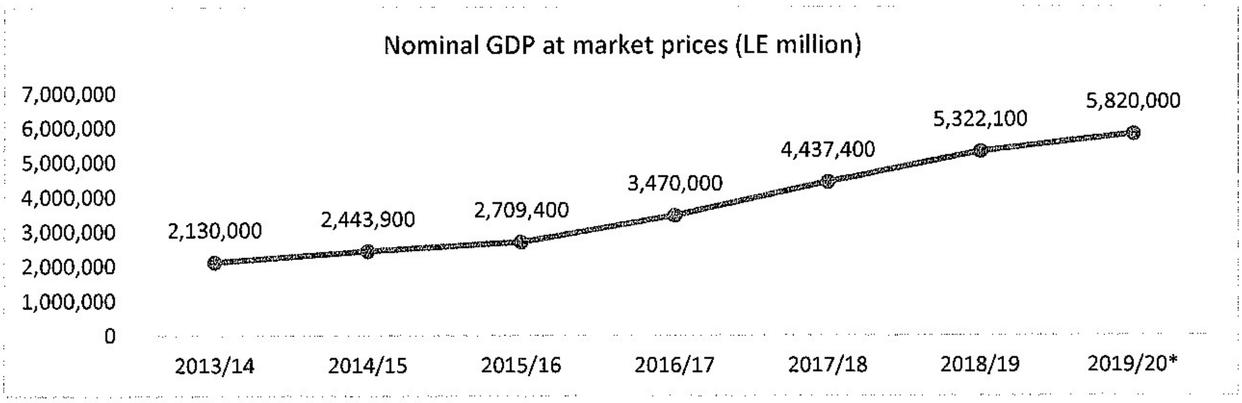
The removal of restrictions was yet another sign that bank liquidity was improving and the FX interbank market was gaining depth and breadth. Five years later the CBE continues to be strongly committed to the flexible exchange rate regime where all exchange rate dynamics remain a product of the forces of supply and demand.

Economic Assessment

The Egyptian economy was cushioned from the global impact of the pandemic by various policies implemented by both the central bank and the government. The Central Bank of Egypt's policies have increased the resilience of the banking sector and provided relief to the most impacted sectors. These included credit boosting initiatives in the form of subsidized lending for the tourism, industrial, construction, agriculture and SME sectors, providing credit guarantees to these sectors and postponing credit dues for individuals and companies. According to the IMF, Egypt has witnessed growth in bank lending to private corporates of 21% (y/y) in October compared to 8% in March 2020. Further reforms have also been taking place across government to shield the economy from the impact of the pandemic. Fiscal stimulus has been in implementation throughout 2020 and has aimed at smoothing the consumption of citizens by providing cash transfers and increasing pensions and social protection program Takaful W Karama. The success of such responses was made possible by policy makers' previous efforts in structural reforms, providing a good primary fiscal surplus which created some fiscal room to sustain a reallocation of spending, emergency packages and more support to vulnerable sectors (tourism, healthcare).

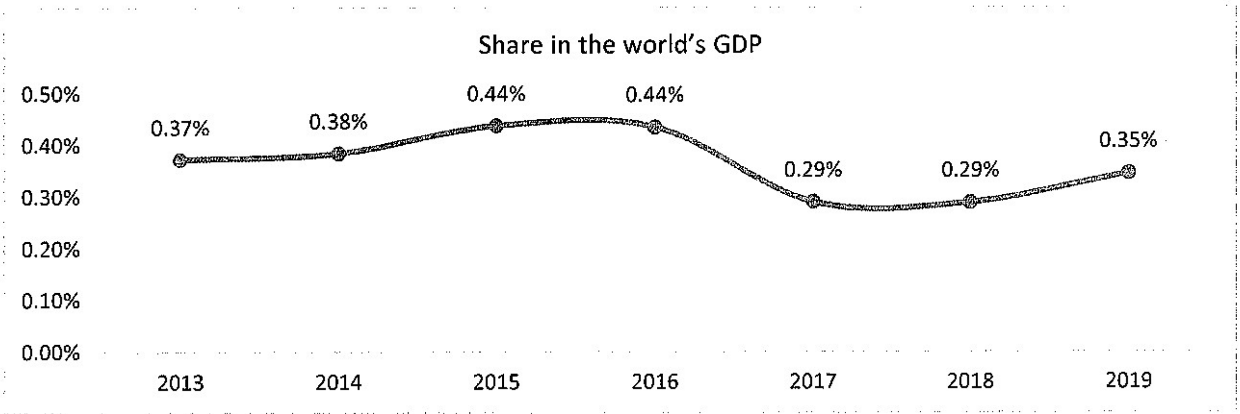
1. Scale of the Economy

i. Nominal GDP



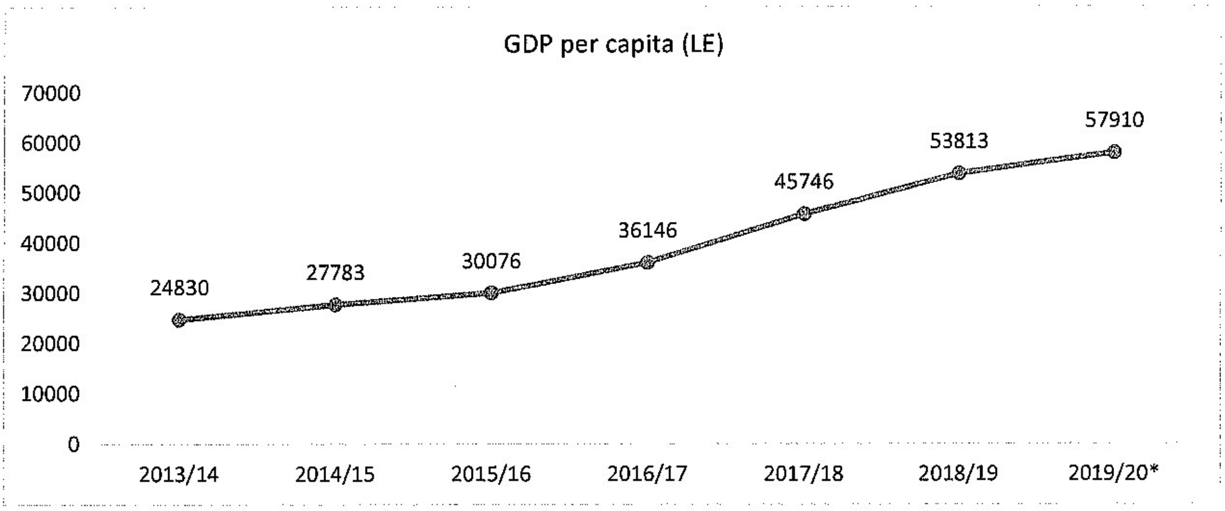
**/Preliminary figures. Source: Ministry of Finance*

ii. Share in the world's GDP



Source: World Bank

iii. GDP per Capita

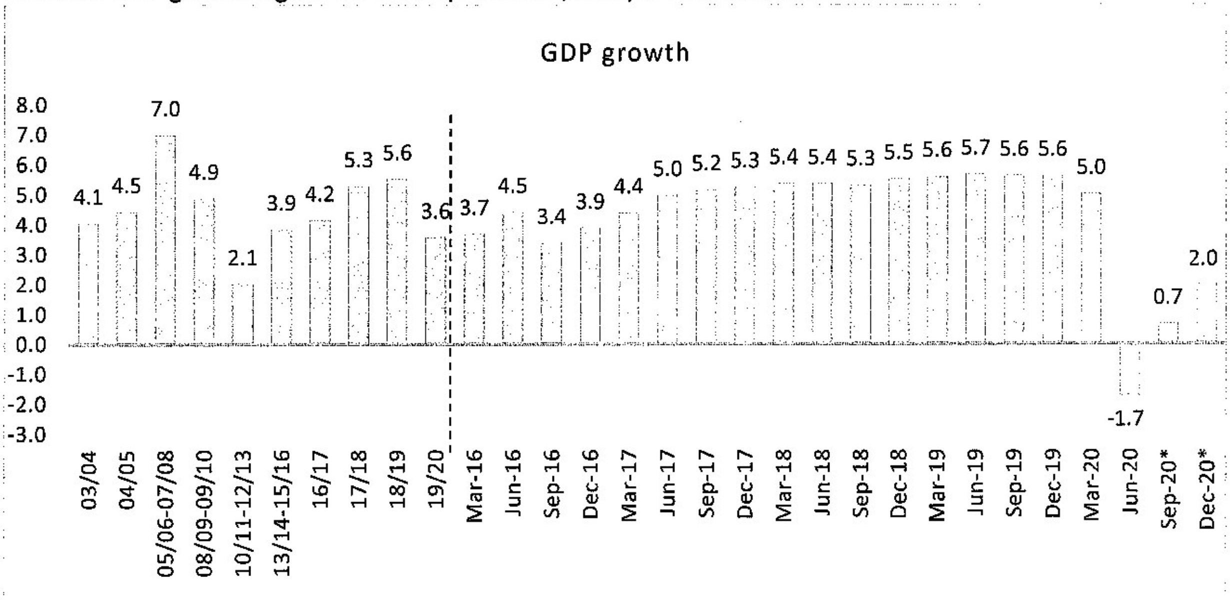


/Preliminary figures. Source: Ministry of Finance

2. Growth of the Economy

i. Real GDP Growth

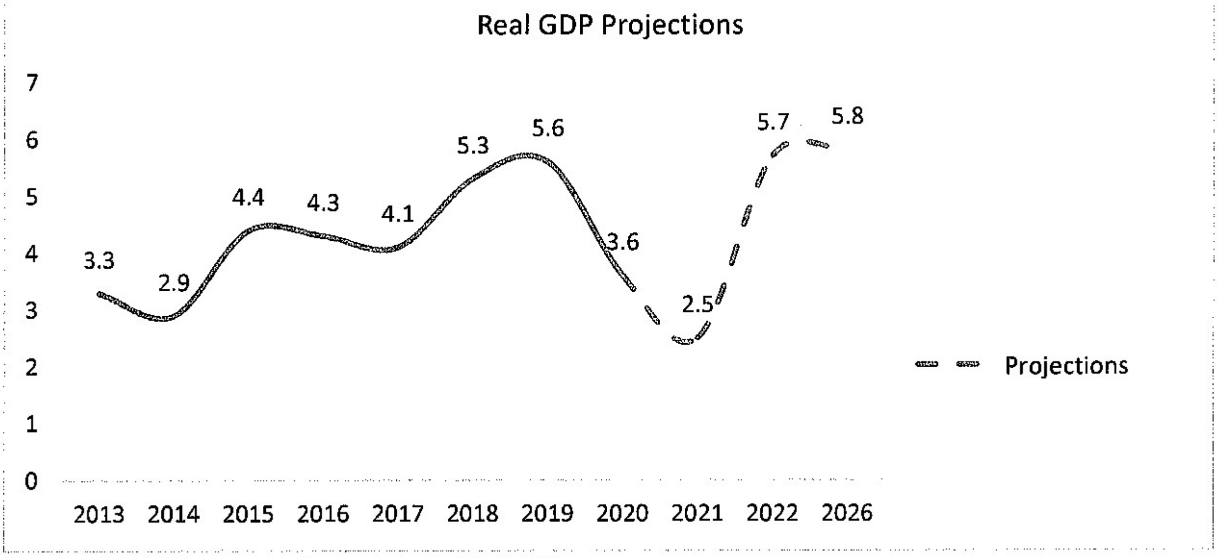
GDP growth exceeded expectations in FY2019/20 as it grew by 3.6% instead of the expected 2% according to the IMF's Stand-By arrangement on Egypt. This was mainly due to strong growth in consumption levels and policies that supported the most vulnerable sectors. Egypt was one of the only emerging markets to achieve positive growth during the pandemic. The quarterly figures also have also witnessed a significant increase, as the government announced its preliminary headline GDP growth figure for 2020 q4 at 2.0%, compared to 0.7% in 2020 Q3.



/Preliminary figures. Source: Ministry of Planning and Economic Development

ii. GDP growth Outlook

According to the IMF latest world economic outlook, a strong recovery is expected, with GDP recovering to its pre-covid levels of 5.5% in the coming years.



Source: World Economic Outlook April 2021, IMF

iii. Savings and Investment Quotes

1. "Egypt is on a journey to revive and transform its infrastructure creating and enabling environment for free flow pf trade, investments, broaden access to electricity and ICT, and at the same time accelerate towards the energy transition" – **H.E Dr. Rania Al-Mashat**
2. "Egypt has made major progress, starting with the adoption of a comprehensive and modern legislative framework for investment and business activities. As part of institutional reforms, GAFI was recently put under the direct authority of the Council of Ministers to provide a more streamlined allocation of responsibilities and policy-making processes. The establishment of a centralized one-stop-shop and the operationalization of a nation-wide Investment Map were other major breakthroughs in the services offered to investors. Both are expected to substantially improve investors' access to land and business opportunities. The government of Egypt has also revised its SEZ policy, and several state-owned enterprises have taken steps to incorporate corporate governance standards." – **OECD**
3. "The country has undertaken a number of structural reforms since the flotation of the Egyptian Pound (EGP) in November 2016, and after a strong track record of successfully completing a three-year, $12 billion International Monetary Fund (IMF)-backed economic reform program, Egypt was one of the fastest growing emerging markets prior to the COVID-19 outbreak. Increased investor confidence and the reactivation of Egypt's interbank foreign exchange (FX) market have attracted foreign portfolio investment and grown foreign reserves." – **Bureau of Economic and Business Affairs, US Department of State.**
4. "The dynamic growth of the Egyptian economy (around 7% before the crisis), its strategic geographical position, low labor costs, skilled workforce, unique tourist potential, substantial energy reserves, large domestic market and the success of the reforms undertaken by the authorities (including many privatizations) contributed to drive up FDIs." – **Santander Bank**
5. "Egypt and Saudi Arabia are the most popular growth destinations for Middle East CEOs" – **PwC Middle East**
6. "The authorities are making positive strides toward a green recovery. Multi-sectoral adaptation and mitigation plans have been developed to reduce Egypt's vulnerability to climate change effects, including sea level rise and extreme weather conditions. The fuel pricing reform, investment in solar and wind parks, and projects to

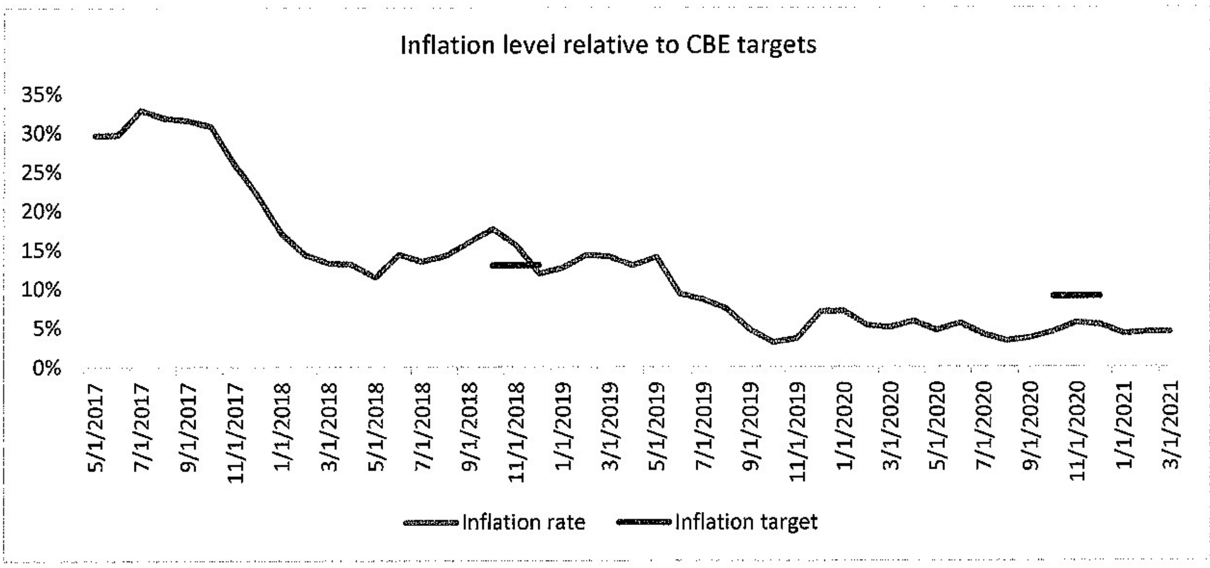
convert gasoline powered vehicles to natural gas and shift public transport to electricity are expected to promote a green recovery and create jobs over the medium term." – **IMF**

3. Inflation Rates

i. Inflation level relative to any targets

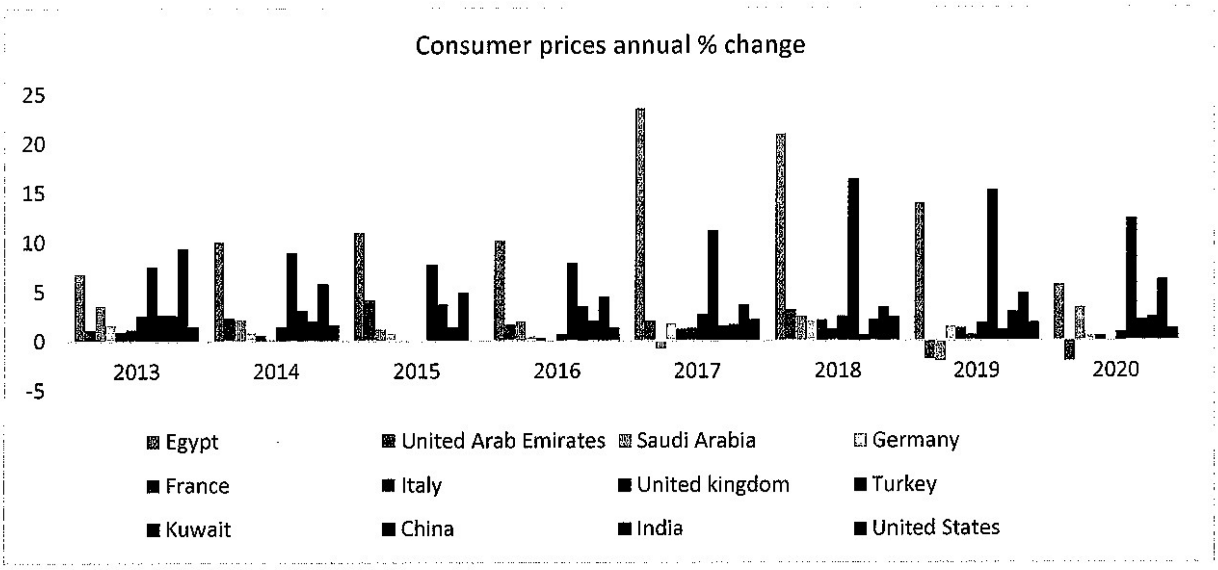
So far Egypt has set three inflation targets:

1. The inflation target of 13% (±3 percentage points) for 2018 Q4, that was announced in May 2017, has been achieved.
2. The inflation target for 2020 Q4 has been announced at 9 percent (±3 percentage points), down by 4 percentage points from the 2018 Q4 target. During 2020 Q4, annual headline urban inflation registered an average of 5.2 percent, coming below the lower target band of 6 percent previously announced in 2018.
3. Finally and as the CBE continues to support macroeconomic stability, the CBE's next inflation target has been set at 7 percent (±2 percentage points) on average during 2022 Q4 down from 9 percent (±3 percentage points) on average during 2020 Q4.



Source: Central Bank of Egypt

ii. Consumer price index (% change) level compared to trading partners



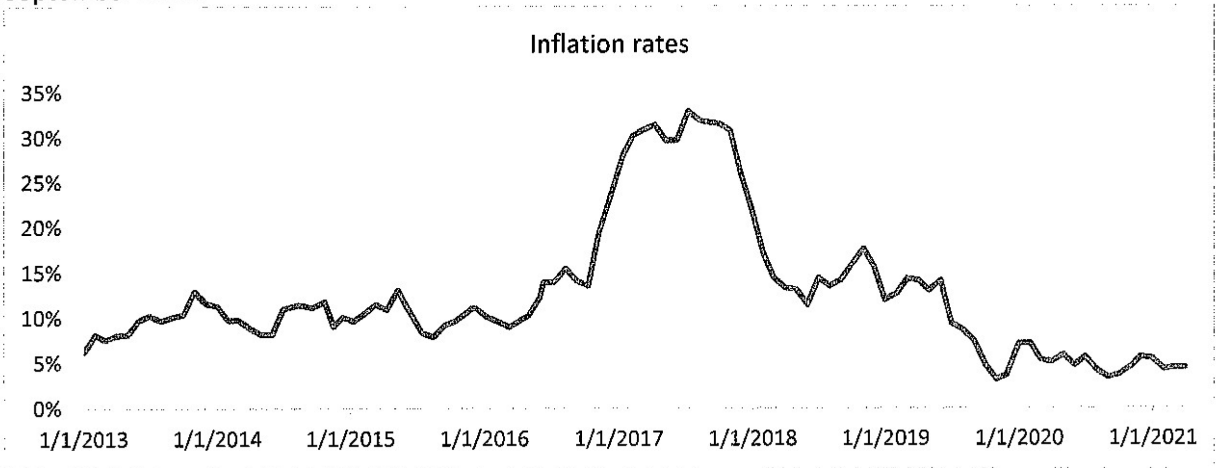
Source: World Economic Outlook April 2021, IMF

iii. Inflation rate trends

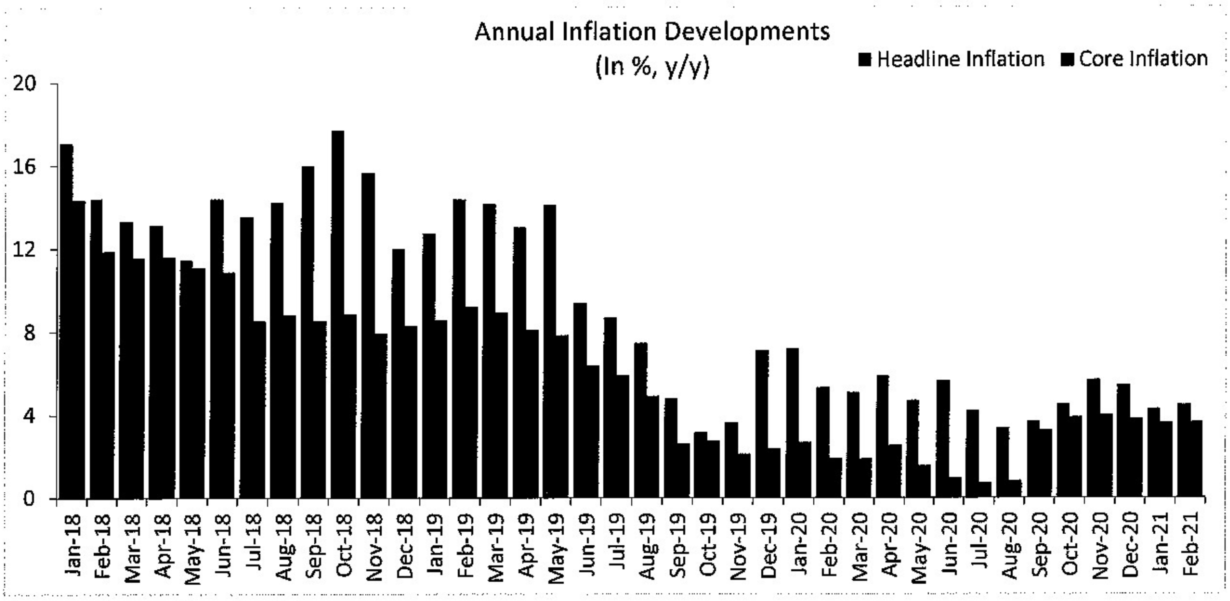
Inflation has been declining in 2020 as headline inflation fell from 7.1% in January to 5.4% in December (y/y). This was due to an overall decline in food prices as a result of the government's efforts to technologize the agriculture supply chain and to streamline logistical bottlenecks in agriculture supply.

Annual headline urban inflation marginally increased to 4.5 percent in February 2021 from 4.3 percent in January 2021. This comes after it declined from 5.4 percent in December 2020. Headline inflation continued to record single digits since June 2019, and has remained below 6 percent since February 2020.

In the meantime, annual core inflation stabilized at 3.6 percent for the second consecutive month in February 2021. Annual core inflation continued to record single digits since July 2018, and has remained between 3-4 percent since September 2020.



Source: Central Bank of Egypt

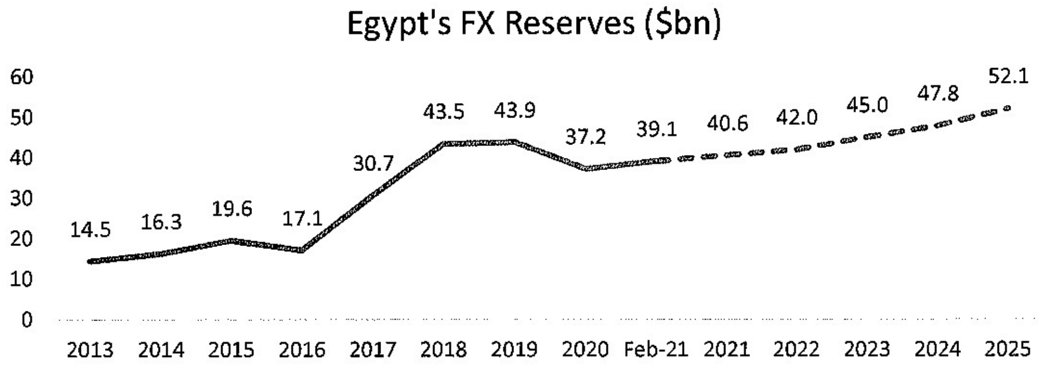


Source: Central Bank of Egypt

External Sector Assessment:

1. Foreign Exchange Reserves

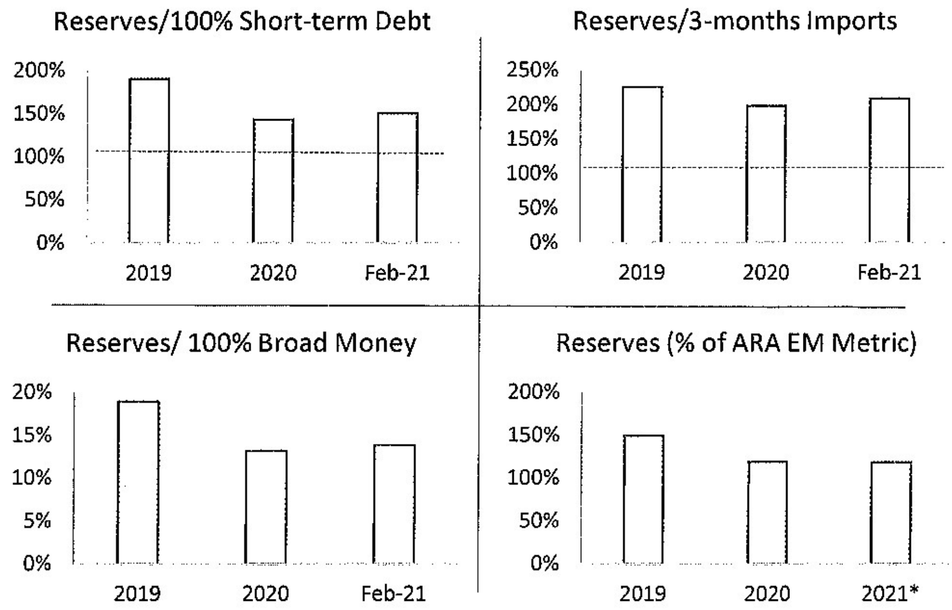
i. **Reserves Development**



*Based on IMF Forecasts Jun 2021- Jun 2025

- Since the floatation, Egypt has successfully built a strong FX reserves buffer reaching a record high of $44bn in June 2019.
- This was interrupted by the outbreak of the Coronavirus which resulted in a decrease in the FX reserves to $37bn in June 2020.
- Egypt has successfully managed the crisis and bringing the FX reserves to pre-pandemic levels, recording $39bn as of Feb 2021. **This is a clear evidence of the resilience of FX reserves during the crisis which was subject to a quicker rebound compared to other countries thanks to the strong economic reforms** that were carried pre the pandemic under the ambitious home-grown reform program that aimed to correct large external and domestic imbalance and promote inclusive growth and job creation.
- **Egypt's FX Reserves are currently standing at a healthy level and are expected to further improve. In fact, as per our internal forecasts as well as the latest IMF forecasts, Reserves are expected to continue this increasing trend (reaching $52bn in June 2025) allowing for more buffers in case of any global shocks.**

ii. Reserves Adequacy



All years in all graphs are fiscal years

*2021 ARA figure is based on IMF Forecasts

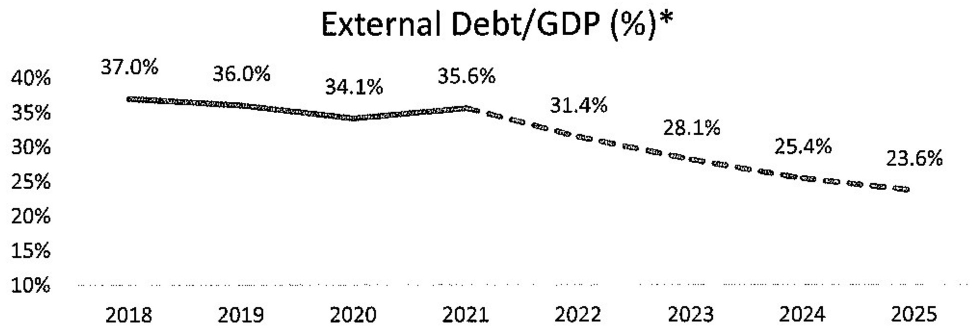
- The gradual accumulation of FX Reserves served as a buffer to smooth out the effects of the coronavirus while maintaining **adequacy in all Reserves adequacy metrics.**
- **Even at the lowest level in June 2020 in the last 3 years, FX reserves remained adequate covering:**
  - 143% of short-term external debt (adequacy range: >100%)
  - Metric of 3-month imports coverage of goods and services was 198% (adequacy range: >100%)
  - 13% of broad money coverage (adequacy range: 5%-20%)
  - and 120% of the IMF ARA metric which is within the Fund's suggested adequacy range and is broadly comparable to reserve levels in most emerging economies (adequacy range: 100%-150%)

- **Adequacy metrics improved in Feb-21 compared to Jun-20. This is in line with the IMF and the Egyptian authorities' forecasts that with Egypt resuming its structural reform plan, the FX reserves are expected to maintain their current strong position and improve more in the future.**

Egypt's FX Reserves are at healthy levels and adequate pre and post the Covid-19 crisis.

2. External Debt

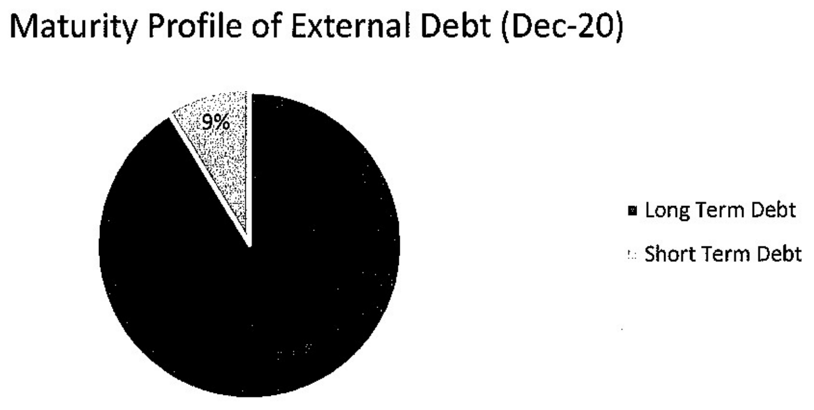
i. External Debt Sustainability and Composition



*Based on IMF Forecasts Jun 2021- Jun 2025

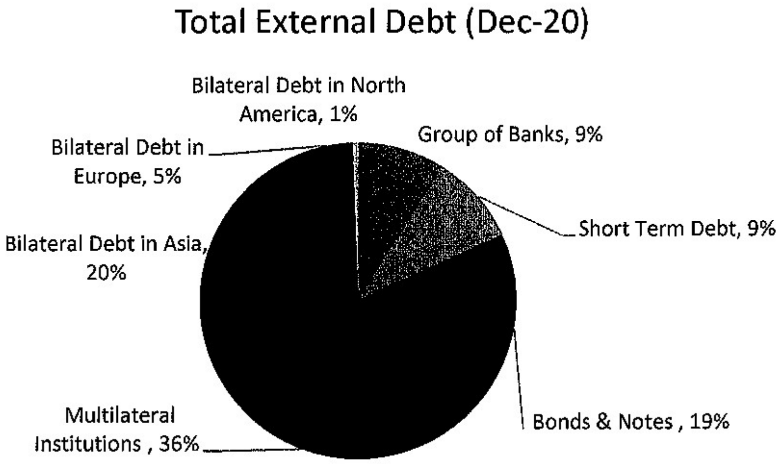
- **The External Debt as a % GDP is on a sustainable declining path** based on our internal models and the IMF's Debt Sustainability Framework under several stress scenarios. It is expected to peak at about 36 percent of GDP in 2021 due to pandemic effect; however, it is projected to decline thereafter.
- An imminent proof of external debt sustainability is the recent IMF provision of exceptional access to Egypt and the granting of Rapid Financing Instrument (RFI) and Stand-by-Arrangement (SBA) as it meets the following criteria:
  - Egypt's debt is **sustainable and its capacity to repay the Fund is adequate.**
  - The Egyptian authorities' **favorable track record and commitment to strong policies support a solid rebound after the crisis**

- It is also worth noting that Egypt has never defaulted on any of its commitments and thus established credibility and confidence within the international markets.



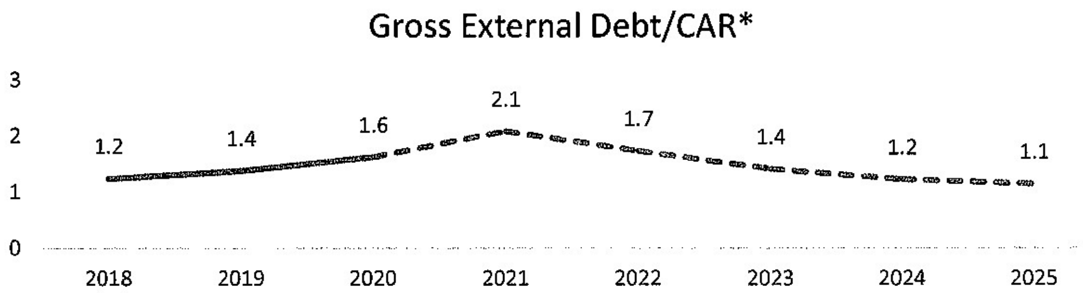
- As shown in the above pie chart, the maturity profile of Egypt's external debt is quite balanced where the **share of short-term debt is only 9% which reduces rollover risk.**

- In addition, **long-term commitments are mostly concessional, therefore bear low interest rates.** It's also worth noting that authorities have begun to further extend maturities in order to increaser the average maturity of overall external debt.



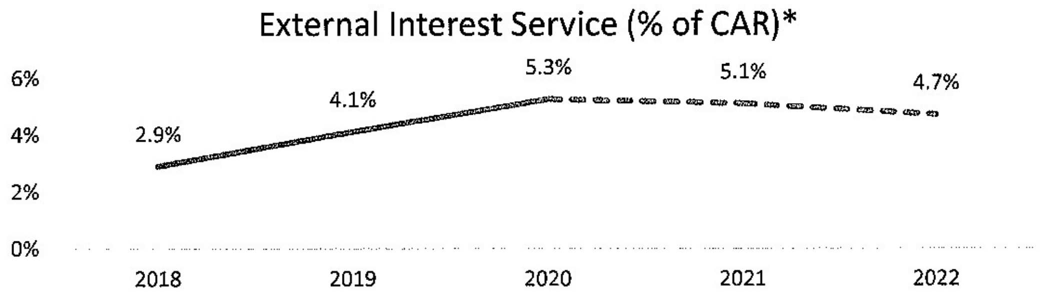
- The above chart indicates that Egypt has a relatively diversified base of creditors where it varies from multinational institutions (36%) to bilateral debt (26%) and bonds & notes (19%). **This shows that that Egypt's external debt structure is well diversified which provides greater protection and less vulnerability against shocks.**

ii. External Debt Metrics:



*Based on IMF Forecasts Jun 2021- Jun 2025

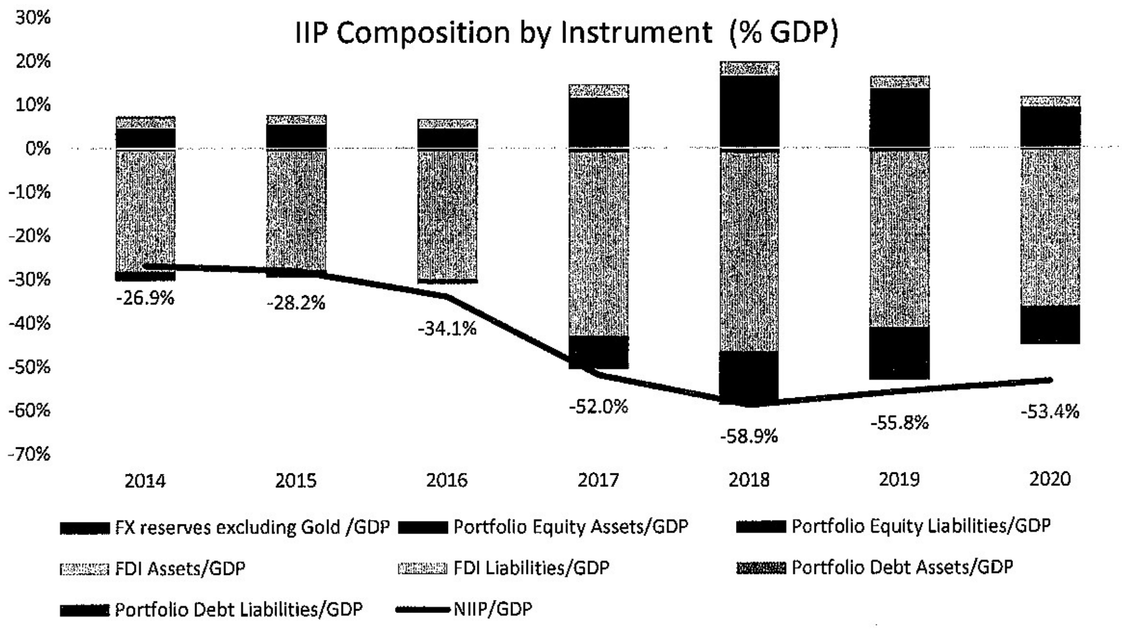
- External debt over current account receipts (CAR) ratio **is on a declining path**, it is expected to peak at around 2.1 due to the repercussions of the Covid-19 crisis and recover thereafter.
- **This shows that Egypt's external debt level is sustainable based on our internal models and the IMF's Debt Sustainability Framework under several stress scenarios.**



*Based on Fitch's Forecasts Jun 2021- Jun 2022

- Due to the Covid-19 crisis and the disruptions caused in the global markets, Egypt's interest payments increased and its current account receipts (CAR) decreased in FY-20 resulting in a ratio of 5.3%. However, with the gradual resumption of activity worldwide and the stabilization that Egypt is witnessing, **this ratio is expected to decrease. Fitch forecasts that this ratio will decrease in the coming years to reach 5.1% in 2021 and 4.7% in 2022.**

iii. External Position: Net International Investment Position



- Egypt's Net International Investment Position (NIIP) stood at about -53 % of GDP in FY-20 showing an improvement compared to -56% in FY-19. **The current ratio of NIIP to GDP (-53%) is considered sustainable,** especially with the current difficult economic situation of the Covid-19 pandemic, due to the fact that FDI liabilities constitute the largest share of the NIIP and the current account balance is projected to improve in the medium term.

iv. Access to External Financing

- Egypt has succeeded in filling the External funding needs gap resulting from the pandemic effect by the **IMF's RFI & the SBA agreements**, in addition to securing **concessional financing assurances** from the World Bank, the African Development Bank, the Arab Monetary Fund.
- **In addition, Egypt has shown its ability to mobilize funds from abroad through its strong access to international markets.** The IMF's External Sector Assessment in Jan 2021 stated that **"Egypt had favorable market access prior to the pandemic and quickly re-established market access** with a $5 billion Eurobond issuance in May following the RFI and public statements regarding SBA discussions, and a $750 million green bond in September. **The country also has a strong track record of maintaining investor confidence during times of temporary stress".** The May issuance was more than four times oversubscribed, reflecting investors' confidence in Egypt's medium-term economic prospects. This has been further evidenced by Egypt's recent successful Feb 2021 international issuance of $3.75 billion.

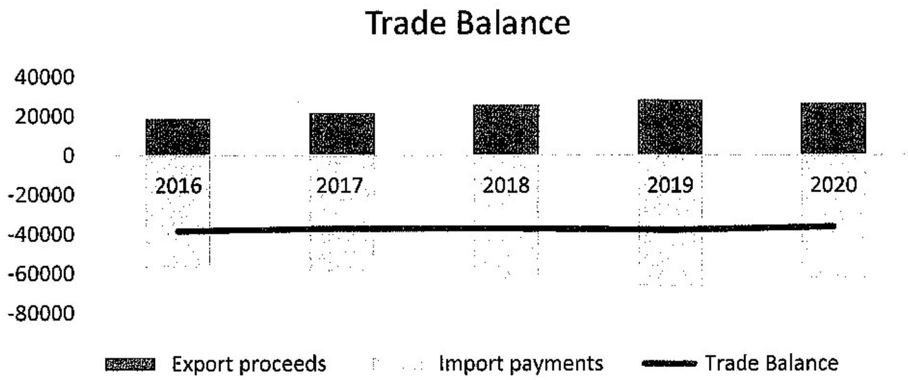
  - **Egypt's External debt and interest payments are on a declining path.**
  - **Egypt's ease of access to international markets for external financing.**

4. Current Account

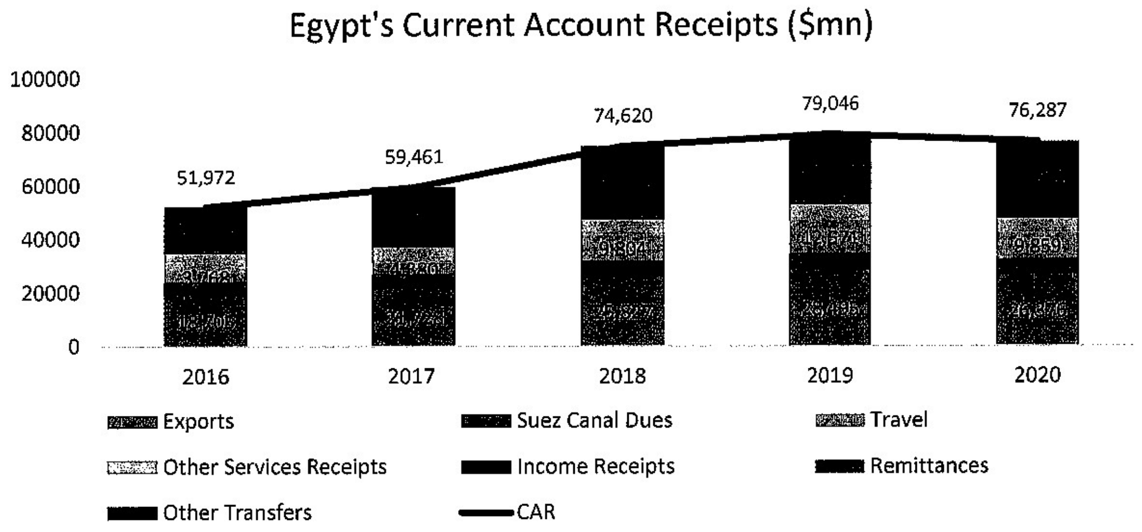
i. Trends

% of Total Exports	2018	2019	2020
Fuel, Mineral Oils & Products	35%	42%	33%
Raw Materials	9%	8%	10%
Semi-finished goods	17%	13%	20%
Finished goods	40%	37%	37%
Other	0%	0%	0%

- As illustrated in the above table, **Egypt's exports base is well diversified** which provides **protection against external shocks. There is a much higher percentage of exporting finished goods (37%) versus raw materials (10%) which shows the increase in value added exports.**
- The trend is expected to persistently continue to improve and increase the ratio of finished export goods as more structural reforms are applied in order to move more into value added products.

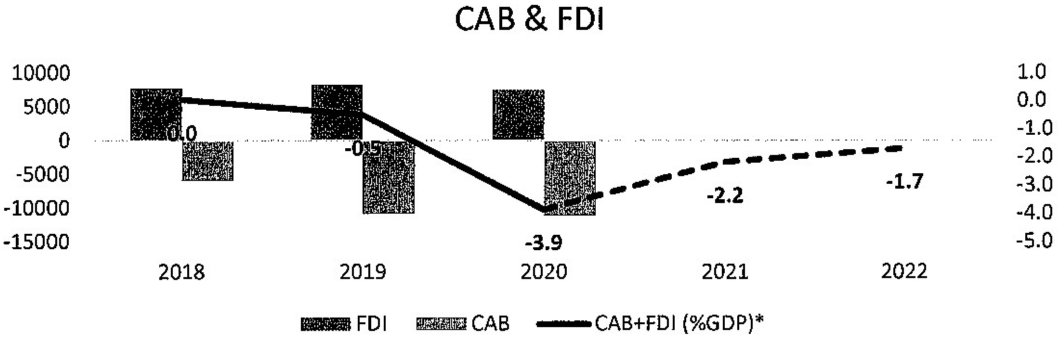


- **Egypt's trade balance remained stable since FY-16 to FY-20.** This affirms the resilience provided by the diversified exports base which enabled the trade balance to be stable during the Covid-19 crisis. Egypt is undergoing many structural reforms that are directed to boost its external competitiveness and would further improve the trade balance.



- As illustrated in the above chart, **Egypt's Current Account Receipts (CAR) have been on an increasing trend since FY-16 to FY-19** mainly due to increasing exports and remittances receipts.
- This gradual improvement in CAR was slightly interrupted in FY-20 due to the Covid-19 crisis. **Travel (tourism) item declined during the pandemic** as a result of the **unprecedented travel restrictions** which affected all the countries worldwide. **They are expected to rapidly rebound in FY-21 and FY-22 with the vaccinations taking place.**
- However, **most CAR items were resilient during the crisis such as exports, Suez Canal and remittances receipts.** In fact, **remittances increased in FY-20** compared to previous fiscal years.
- **The relatively small decline in Current Account receipts (CAR) is only temporary on the back of unprecedented global events and is expected to rapidly pickup.**

ii. Financing the Current Account Deficit



- As we can see from the above chart, FDI flows remained relatively resilient during the Covid-19 crisis.
- Egypt's current account balance deficit increased in FY-20 recording $-11.2bn compared to -10.9bn in the previous year on the back of the pandemic effect, which is still considered a relatively small increase in the CA deficit given the unprecedented Covid-19 crisis. This is an **expected temporary increase** in the deficit mainly due to **the travel restrictions brought about by the pandemic affecting tourism receipts.**
- Tourism sector is expected to rapidly rebound in 2020/21 and 2020/22 meaning that the CAB+FDI (%GDP) ratio is expected to increase in the coming years. **In fact, according to Fitch's forecasts, this ratio will increase from -3.9% in 2020 to -2.2% and -1.7% in 2021 and 2022 respectively.**
- In addition, Egypt is undergoing many structural reforms that are directed to boost its external competitiveness and would thus improve the CAB.

  - **Exports composition and the overall trade balance remained resilient and are expected to further improve in the coming years.**
  - **FDI flows were stable from FY-18 till FY-20.**
  - **It is true that CAB weakened in FY-20 on the back of the pandemic effect and the travel restrictions which affected Tourism receipts; however, CA is expected to rapidly rebound with the rebound in the tourism sector and as a result of pick up in the momentum of the structural reforms carried by the Egyptian government.**