NEW ZEALAND
FOREIGN AFFAIRS & TRADE
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Egypt: It’s about the Long-Game

MARKET INTELLIGENCE REPORT

Summary

- Egypt has made some gains in generating foreign exchange from good tourism numbers but efforts to attract foreign direct investment are not yet delivering the hoped for deals. High inflation is projected to continue into 2024; there could be further devaluation of the Egyptian pound in the coming weeks; and three major agencies have recently downgraded their financial ratings. Access to foreign exchange remains restricted, hampering import/export flows.

- The IMF has delayed its first review of its USD 3 billion loan arrangement (December 2022) in a bid to give Egypt more time to show progress against the loan conditions. The review could be delayed until September, negatively impacting the timing of additional funding from the IMF and other international institutions.

- The current and FY 23/24 forecast growth rate is 4%. Whilst good, it is not high enough to service national debt (92% of GDP) and population growth (2.5million per annum).

- Egypt was hit hard by the twin blows of the C-19 pandemic and Russia's illegal invasion of Ukraine. But the longevity of the economic crisis comes down to structural issues. The business environment does notprovide a level playing field between the private sector and the state-owned/run sectors of the economy, impacting investor confidence.

- The government is starting to open the economy to the private sector through the sale of several state-owned enterprises. It has introduced packages of incentives for investment in Egypt, focusing on Egypt's competitive labour market, large internal consumer market (110 million) and strategic location as a hub to Europe, the Gulf and Africa.

- Long-term investments are under way in the energy sector (oil & gas, and renewables) and in the manufacturing sector through Egypt's industrial zones (e.g. Suez Canal Economic Zone).

Report

Prepared by the New Zealand Embassy in Cairo.

The opportunities

Egypt as a manufacturing base and export hub to Europe, the Gulf and Africa

Short-term, Egypt presents some difficulty in navigating a complex regulatory environment, the impacts of high inflation and the FX shortage. However, long-term, Egypt offers some core advantages. The labour force is large and growing, as is its domestic market, and the country's location as a close neighbour of Europe, the Gulf and Africa makes it a strategic place to hub exports. The devalued exchange rate presents a competitive advantage. Nestlé's in-market director recently commented "the potential for growth once Egypt is out of the current crisis is unprecedented."

Recent investment announcements from Swedish, Norwegian, Chinese, and Korean companies support a long-term view of Egypt's potential, including significant new investments in renewable energies, as well as investments in the more traditional sectors of manufacturing, minerals, logistics and food production.*

* For example, in March 2023, Egypt signed a USD 5 billion agreement with Norway's Scatec to establish a plant in the Suez Canal area for producing green ammonia. The Red Sea Wind Energy Consortium announced in April it is building a second 500-megawatt wind farm, with private investments of $680 million. An Australian consortium is reportedly planning a phosphoric acid plant as a joint venture on the Red Sea coast, with an investment of USD 875 million. According to China's National Development and Reform Commission, Chinese companies have USD 1.2 billion of investment in the Suez Economic and Trade Cooperation Zone and under a series of agreements signed in Beijing last month, Suez Canal Economic Zone chair Walid Gamal El-Din says that could get to USD 3 billion.

The Challenges - Significant but short-term?

Three major credit rating agencies have downgraded Egypt in recent months. On 21 April, Standard & Poor Global rated Egypt at B for local and foreign currency in both the short and long term, indicating some risk. On 5 May, Egypt was downgraded by Fitch Ratings for the first time in a decade. Egypt's sovereign credit rating was cut one level to B from B+, with a negative outlook. On 9 May, Moody's Investors Service placed Egypt's B3 long-term foreign-currency and local-currency issuer ratings on review for downgrade. The reasons given include the rising risks for the government's debt affordability, deterioration in government revenue (due to devaluation) and the slow progress of state asset sales.

Inflation remains high

Despite regular interest rate increases by the Central Bank of Egypt, inflation remains at record levels. Egypt's Central Agency for Public Mobilization and Statistics (CAPMAS) announced that Egypt's annual headline inflation rate reached 31.5% in April, although annual urban inflation dropped marginally compared to March. This far exceeds the IMF target set in January this year of 16% inflation by March. Longer-term, Hassan Abdullah, Central Bank Governor, has set targets to curb inflation to between 5% and 9% by the fourth quarter of 2026. Inflation continues to be driven by a rise in global food and commodity prices, the impact of currency devaluation, and the effect of the FX shortage. With an increasing cost of living, and food inflation at 61% (March 2023), Egyptian consumers face depleted savings, with reduced spending on meat, fruits and dairy, and foods that were once considered staples now discretionary.

The exchange rate - steady but is a further devaluation coming?

Since January 2023, the value of the Egyptian Pound (EGP) has remained steady at 30EGP to 1USD, albeit it at half the value it was in March 2022. The divide between the official and black market rates remains marked (on 14 May, at 30.95 EGP to 1 USD and 38 EGP respectively). Tight government control over use of foreign currency for imports has kept the pound artificially stable. A 1 May report by the Bank of America warned that market expectations of the value of the pound could be as low as 50 EGP to 1 USD if the exceptionally high gas export prices seen over the past quarter drop. Credit Suisse is forecasting the pound to fall to 45-50 EGP to 1 USD by the end of August, with a rebound to 33-34 EGP to 1USD by the end of the year.

Cash flow challenges

Up to 47% of Egypt's imports are used as inputs for production. Measures aimed at limiting some imports in 2022 ultimately exacerbated the cash flow delays and hindered local production, resulting in a drop in confidence in the Egyptian market. Access to foreign currency remains difficult for importers.

The squeeze on foreign currency could get worse in the coming months as cash flows take time to recover. To get through, some importers are offsetting imports with exports to generate and preserve direct access to foreign currency, rather than relying on traditional cash flows.

Debt levels high

Egypt's combined external and internal debt is set to reach USD 397 billion accounting for 92.9 % of GDP in 2023. Although devaluation of the EGP will drive up the cost of servicing external debt, it constitutes only around 25% of Egypt's national debt.

Institutional reforms and Incentives for investment

Privatization was one of the critical measures of the agreement reached with the IMF under its four year programme. In February, Egyptian Prime Minister Madbouly announced plans to sell stakes in at least 32 state owned companies by the end of March 2024, with a target revenue of USD 2 billion before the end of June this year, and USD 6 billion by mid-2024. Of the 32 SOEs slated for sale, two deals have been closed to date.* The Government has not yet indicated how it will meet its target of $2 billion by the end of June.

On the surface, the challenge lies in the diminishing value of the SOEs amidst devaluation, inflation and declining business confidence. But outgoing World Bank representative to Egypt, Marina Wes, has said the critical issue is "the lack of a level playing field" - it is the major issue derailing FDI. To get through the crisis, the Bank maintains that Egypt needs to undertake structural reforms to enable a private sector and generate jobs if it is to fulfil its potential. Investors are, in Wes's, view taking a "wait and see approach" and remittances are not as buoyant as they used to be because the fiscal and monetary policies are not providing the required support structure.

Yezid Sayigh, senior fellow at the Malcolm H Kerr Carnegie Middle East Centre, said "the real issue for Gulf investment funds is that military companies depend entirely on state funding in the form of an assured flow of government procurement contracts, subsidies and the ability to transfer losses to the treasury, hence, there is little attraction for outside investors unless they are assured of the continuation of these privileges." (the real value of the company being far less once privileges are lost).

* UAE's National Paints Holding Company took over 81% of state-owned paint maker Pachin for around USD 25 million; and unnamed buyers, reportedly local investors, acquired a 10% stake of Telecom Egypt for USD 127.5 million. Two Emirati companies are reportedly in discussions to acquire between 20% -25% of the state-owned Wataniya Petroleum and Safi Waters

Incentives, Institutional and Regulatory Reforms

On 16 May Egypt's Supreme Council for Investments approved 22 decisions to facilitate investments, including reducing the cost of establishing companies, facilitating the purchase of lands and the import of production requirements, reducing the financial and tax burdens on investors, and expanding eligibility for the "golden license" scheme by which companies can invest in Egypt, dealing only with one Government agency for all licenses and procedures under accelerated timeframes. It is also making progress with the allocation of industrial lands through a central committee, allowing for immediate allocation for major or foreign investors, and fixed prices for industrial zones.

It is too soon to know if the government will deliver significant institutional reforms; bring increased coherency and predictability to the regulatory environment; and review its fiscal policy. Willingness to sell shares in several major SOEs is only the first step of a reform process that could take several years.

Key information

- GDP: USD 404.1Billion (2022); per capita USD 3,698.
- Growth rate 4% (World Bank forecast for 2023/4 = remain steady at 4%)
- Budget deficit FY 2023/4: anticipated to be 7% of GDP (USD 30.5 billion).
- Population: 110 million (estimated); +2.5 million per annum. Population < 40 years: 77%
- Goods **exports**: USD 44.5 billion per annum.
    - Goods export partners by destination are Turkey, Italy, India, USA, Saudi Arabia, Spain and Malta. Oil and other mineral products account for 32% of Egypt's goods exports, followed by chemical products, textiles, and agricultural products each accounting for 10-12%.
- Goods **imports**: USD 98 billion per annum.
    - The top source countries for goods imports are China, Saudi Arabia, USA, Germany, Turkey and Russia, India and Italy. Mineral and chemical products account for 25%, followed closely by agricultural products and food (24%), machinery and electrical equipment (15%) and base metals (13%).
- **Services earnings:**
    - Egypt's labour diaspora continues to send high levels of remittances. The past fiscal year saw income of USD 32 billion; incomes are lower this fiscal year to date, with expectations it will be USD 24 billion.
    - Suez Canal revenues account for approximately USD 7 billion
    - The tourism sector accounts for approximately USD 12 billion, with plans to increase visitor numbers from the current 15 million per annum to 30 million per annum over the next four years.
    - Egypt's largest source of FDI is Europe, followed by UAE, UK and USA.
    - Egypt receives a high amount of direct international development assistance from bilateral partners.

New Zealand/ Egypt bilateral trade

Year End March 2023: New Zealand exported $270.57 million of total goods and services to Egypt and imported $21.5 million. For trade in total goods and services, Egypt ranked 33 of 240 for highest export value, 79 of 242 for highest import value, and 49 of 245 for highest total trade value. (NZ Stats Dashboard)

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