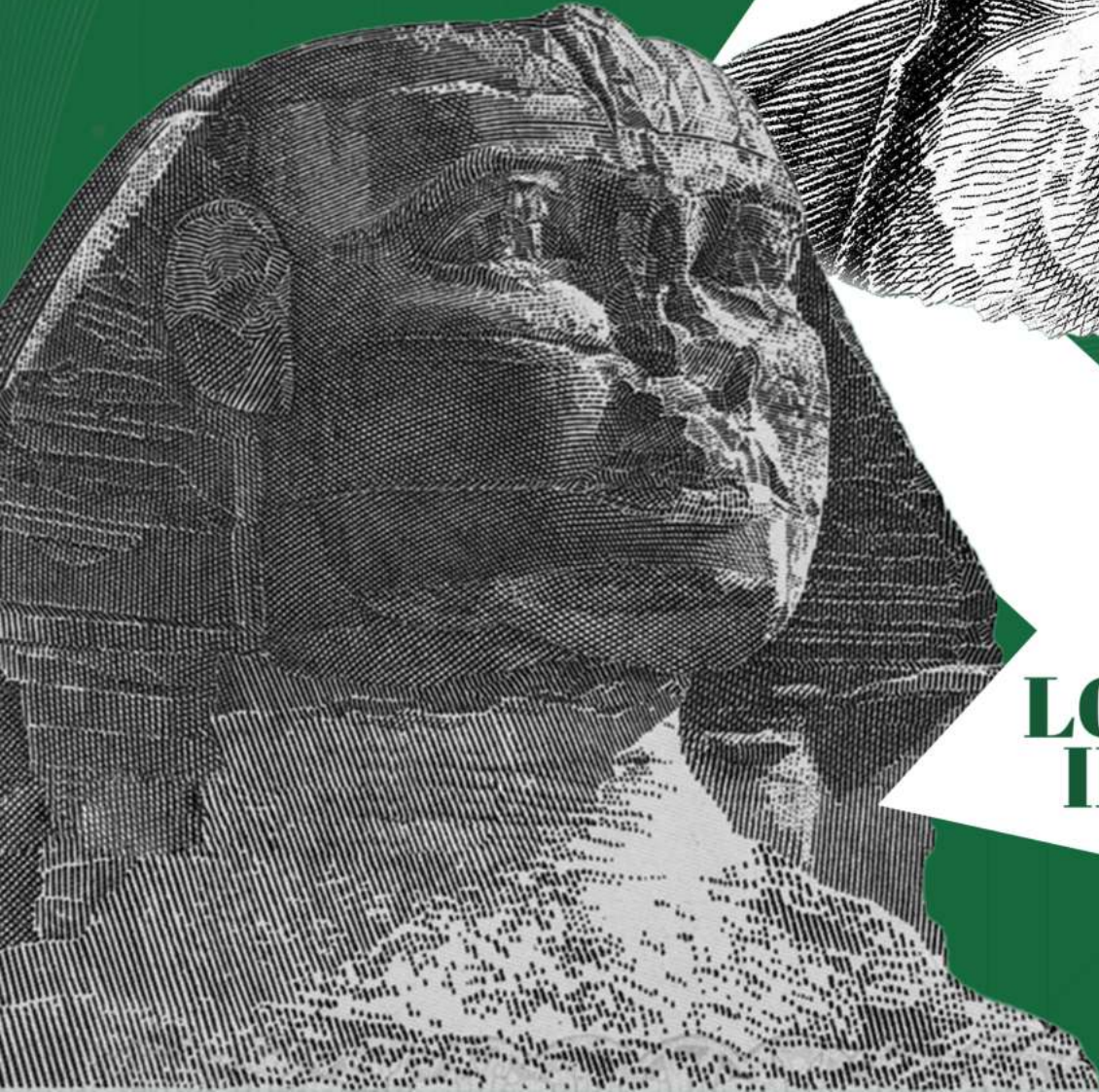


EGYPT IS FACING A FOREIGN- EXCHANGE CRUNCH



The EGP has already fallen nearly 22% since March, when the central bank devalued the currency in response to rising external pressures fueled by the war in Ukraine. Devaluing the pound was set to boost the competitiveness of exports and better position Egypt for a new loan from the IMF, yet it seems like it hasn't been enough to offset high commodity prices and the flight of foreign direct investments.

22%



USD to EGP Exchange Rate in 2022 (Jan - Sep)

Egypt is currently facing a foreign-exchange crunch akin to that faced back in 2016. The EGP fell past 19 EGP/USD, bringing it roughly 3% away from 2016's all-time low. Also, speculations have grown in recent weeks that the EGP will need to slide more against the dollar to manage the growing external imbalances and attract foreign capital back to the country.



“ Why Are Expectations Getting Stronger about a Second Wave of Depreciation? ”

A- Growing Financing Gap:

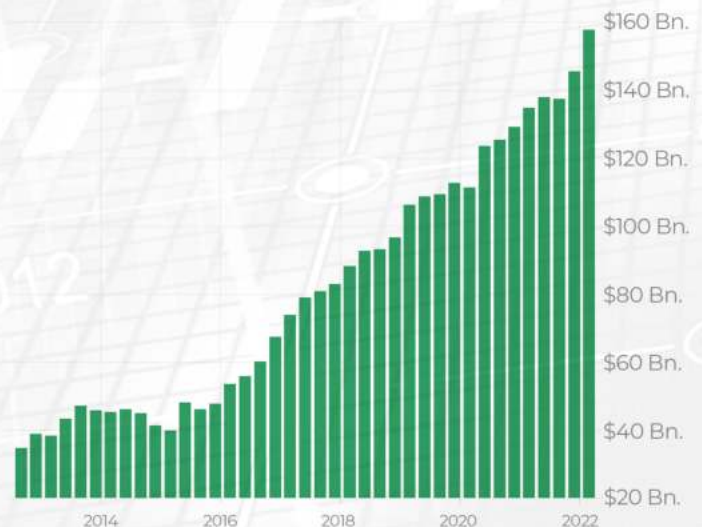
According to Fakhri Al-Feqi, head of the parliamentary planning and budget committee, **Egypt's financing gap amounts to about \$25bn**, of which \$15bn are installments and debts due during the current year, and the rest is from the deficit in the balance of payments, which is largely due to the weakness of domestic savings, which represent only 13% of GDP.

Egypt's Financing Gap = \$25bn



B- Rising Debts:

A report released by the World Bank at the beginning of July indicated that **Egypt's foreign debt had reached unprecedented levels of nearly \$158 billion** as of the end of March. Egypt has committed to repaying \$33 billion in foreign debt in a one-year period, from March 2022 to March 2023, according to the report (which accounts for almost all of the country's foreign currency reserves, estimated now at \$33.3 billion).



Egypt's Foreign Debt (2014-2022)

Source: Trading Economics

C- Foreign Outflows:

The country has seen about \$20 billion in foreign outflows after investors in local debt exited. When the Fed raised interest rates, hot money speculators shifted their dollar, or hard currency, investments from Egypt to US treasury bonds in search of higher returns. Currently, the Fed offers higher interest rates than the central banks of most of the world's large economies.

D- New IMF Loan:

Egypt is currently seeking a new loan from the IMF that could be under the Extended Fund Facility (EFF) for 4 years. According to Moody's latest report, this could lead to a gradual devaluation of the EGP.

It's Not all Gloomy on the Economy Front:

01. Positive GDP Growth:

According to Maait, Minister of Finance, Egypt attained a real GDP growth of

6.2% in FY 2021/22

which is expected to moderate to 5.5% in FY 2022/23 and to 5% in FY 2023/24 owing to the Russian-Ukrainian conflict. Maait said that this rate is expected to jump to 7% in FY 2025/26 and FY 2026/27.

02. More Investments from the Gulf:

Saudi Arabia, the UAE and Qatar have pledged to invest as much as

\$22 Billion

in Egypt this year, providing a vital source of foreign currency. Gulf investors are showing interest in the series of planned privatizations of state-owned companies. Moody's expects the government's privatization strategy — which aims to bring in USD 40 bn in fresh investments over the next 4 years — will help bolster Egypt's FX reserve buffer in the future.

03. Promising Projections:

The GDP is projected to record above **EGP 9.0 trillion in FY 2022/23** and to continue to grow to hit **EGP 16.3 trillion in FY 2026/27** according to Maait. Also, he noted that the government adopts a plan to decrease the debt to GDP ratio to **71.9% in FY 2026/27**, down from the current 87.2%.

04. Surplus Achievement:

The initial surplus in FY 2021/22 jumped

to EGP 100 billion

compared to EGP 93.3 billion in FY 2020/21, making Egypt among the few countries all over the world that achieved a primary surplus of 1.3% of GDP, while most of the emerging market reported a primary deficit of 4.7% in the same period.

05. Egypt's External Debt is still within Safe Levels:

According to Fakhri Al-Feqi, Egypt's external debt represents about **30-35% of the GDP**, as the size of Egypt's external debt is about \$158bn. As long as it is less than 50% of the gross domestic product, it remains at safe levels.





So, what is the Fair Value of EGP? By How Much Does it Need to Weaken? “Experts & Analysts Perspectives

The combination of widening deficit and falling foreign exchange reserves had hit investor sentiment in Egypt, leading to a bearish USD/EGP forecast.

Bloomberg Economics

Bloomberg Economics:

The currency needs to fall about **23%** to help the economy adjust and reduce Egypt's funding gap.



Deutsche Bank AG and Goldman Sachs Group Inc.:

The currency is about **10%** overvalued based on its real effective exchange rate.



Citigroup Inc.:

The currency is about **5%** overvalued.



Capital Economics:

It expected the Egyptian pound to fall **10%** against the dollar to record 21 per dollar by the end of 2022, and a further **16%** fall to 25 by the end of 2024.



Naeem Holding:

It expected the Egyptian pound to record **20** per dollar by the end of this year and **20.25** in 2023.



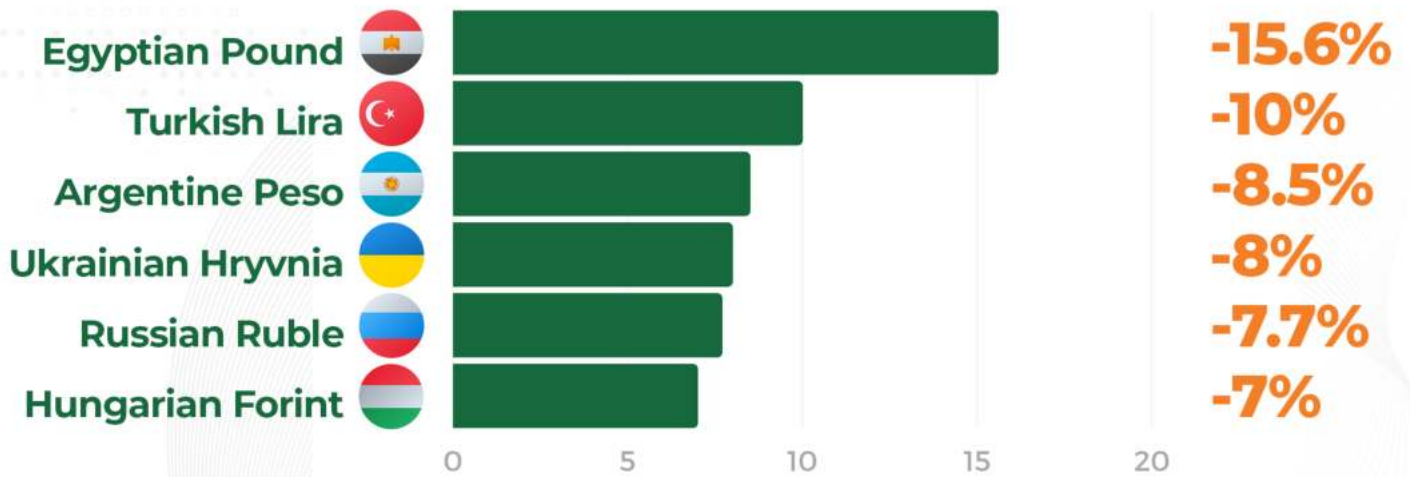
The Egyptian Minister of Finance:

The loan will bolster trust in the Egyptian government and the US dollar will remain in the range of **LE20**.



Is Egypt the Only Country in MENA Region Suffering from Currency Devaluation?

It is true that Egypt's economy has been hit severely by the war, but it is also important to examine the global context. Egypt is certainly not alone. The IMF revised its previous estimates of the growth rate of the global economy for the years 2022 and 2023, as well as reduced its forecasts for growth rates in about 143 countries in the April 2022.



World Currencies Fall against US dollar during first 4 months of 2022.
Source: Bloomberg

The April 2022 issue of the World Bank's "Commodity Market Outlook" indicates that the increase in energy prices over the past 2 years can be considered the largest since the 1973 oil crisis and that the recent increases in the prices of food commodities and fertilizers are the largest since 2008. The World Bank noted that the Russian-Ukrainian crisis had prompted a change in trade, production, and consumption patterns and prices are expected to remain at those high levels until 2024.

Yet, according to Bloomberg and subsequent to the Ukrainian crisis, the EGP was the most devalued currency against the US\$ among the "Emerging Markets".



IMF Loan, Is it the Biggest Driver Behind Devaluation? And is it Inevitable?

Speculation that IMF would demand more flexibility in the pound as part of the conditions attached to a new package helped push the currency toward a record low. Egypt and the IMF have been in negotiations since March, where Egypt has pledged to the IMF to attain the overall budget deficit at 6% of GDP and to raise the initial surplus by 1.6% in FY 2022, according to Maait.

An inflexible exchange rate policy could further delay agreement on a new IMF program. Adopting a flexible exchange rate policy is likely one of the IMF's key demands before it agrees to extend another multi-bn USD loan to Egypt. The series of policy tools deployed so far — allowing a limited fall in the currency, restricting imports, and attracting Gulf investment — have done little to ease the external pressures. A fresh program could provide additional funding and give extra assurances to investors.

\$17.9 Bn. Egypt's outstanding purchases and loans to the International Monetary Fund (as of June 30, 2022)



According to Hany Geneina, an economist and lecturer at the American University in Cairo, there are many benefits to resorting to the IMF:

- 01** **The value of Interest on these Debts:** The interest on the IMF loan is close to the interest rate on US treasury certificates. According to Geniena, the interest rate for the loan is likely between 3-4% at present. This figure stands in stark contrast to the 15% interest rates on government debt instruments, of which hot money comprises a significant portion.
- 02** **IMF loans don't Depend on Credit Rating:** A loan from the fund can be considered a "certificate of trust" for the Egyptian economy that could improve Egypt's credit rating and encourage foreign investors to invest in debt instruments.
- 03** **Quick Solution to Financing Gap:** The IMF loan might quickly contribute to closing a large part of the financing gap in the Egyptian economy, rather than having to wait for a significant period to put out bonds or sell state assets directly to investors or through the stock market.

What's Next..?

With less than a decade between Egypt's last devaluation and this one, the question is;

How Can We Avoid Repeating This Again?

Egypt has been facing a foreign exchange supply shock for many years, and the external shock due to Covid-19 & Russia-Ukraine War has now hit all the sources of foreign exchange in Egypt: tourism, remittances, Foreign Direct Investment, exports, and international capital flows. For example, flows to emerging markets have taken a big hit globally, and the flight of hot money out of Egypt is reported to have been around \$20bn. As a result, international reserves has reached \$33.1 billion in July compared to 40.9 billion in February.

Egypt had no choice but to borrow again in order to plug the growing FX hole. These new borrowings add up to an already fast-growing public debt, which starts raising red flags relating to its sustainability. Since 2012, public debt has grown faster than the economy, and it now stands at over 85% of GDP. It is mainly internal, but the external portion has grown fast, and is already making Egypt more vulnerable to any external shocks.

The Dollar Strength:

The dollar accounts for about 59% of global foreign reserves, and 40% of global cross-border financial transactions are done in US dollars. It also constitutes 90% of all foreign-exchange transactions. The strength of the dollar is backed by strong global demand and by the strong US economy.

The dollar has far gained 10% in 2022 (a 20-year high) against a basket of currencies that includes the euro, the pound sterling, the Japanese yen, the Canadian dollar, the Swiss franc and the Swedish krona.

EGP is overvalued and further depreciation is necessary to reduce BOP imbalances. Devaluation will allow prices on imported goods to rise, depressing demand for such goods and likely reducing Egypt's trade deficit, which has strained the country's reserves. The new IMF program will be just a short-term quick solution to support Egypt's faltering external balances, but it's unlikely to push for faster progress. Increasingly, reliance on reactive short-term solutions will eventually become more expensive and less available.

The only long-term solution, which has been recognized since the 1990s but never attained so far, is to restructure economy and transform it into a productive and industrial one while boosting its exports. The country's private sector need to produce more tradable goods: for its local market (to reduce imports), or for export markets.

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