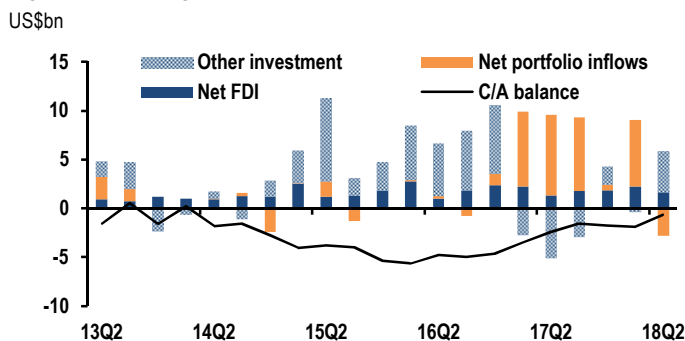


Egypt: A competitive pound improves external balances

- On the back of improved security, a more competitive pound, and rising hydrocarbon production, Egypt's current account deficit came in slightly better than our forecast and eased to 2.4% of GDP in the 2017/18 fiscal year which ended in June, from 6.1% of GDP a year earlier
- We are projecting the current account deficit to improve to 0.3% of GDP in 2018/19 and swing to a surplus of 1.4% of GDP in 2019/20, assuming that the security situation remains stable

Against the background of an improved security environment and much more competitive pound after the sharp devaluation in 2016, Egypt's external imbalances have continued to narrow, with the current account deficit declining to \$6bn (2.4% of GDP) in FY 2017/18, from \$14bn (over 6% of GDP) a year earlier (Figure 1). While the trade deficit was roughly unchanged from a year earlier in absolute terms, exports surged by 19%ooya. Value of imports rose by a modest 7% despite robust real GDP growth estimated at 5.3%ooya, checked by a competitive pound and rising hydrocarbon production led by the Zohr gas field (Figure 2). At the same time, a rising number of tourists almost doubled the services surplus to \$11bn, from \$5.6bn a year earlier due to an improved security situation and a competitive pound (Figure 3). Transfers surged by 21%, driven by remittances from Egyptian expats in the Gulf. We expect the external balance to continue to improve provided the security situation remains stable.

Figure 1: Financing of the current account deficit



Source: CBE, J.P. Morgan

Meanwhile, FDI inflows remained strong at \$7.7bn (3.2% of GDP), driven by investments in the hydrocarbon sector, but portfolio investment eased due to heightened global risk aversion. Sharp EM volatility since the first quarter has led to the reversal of some hot money flows which were attracted after the start of reforms. We believe there remains significant scope for attracting FDI, but expect continued pressure on portfolio investment flows against the background of rising global interest rates. Foreign holdings of Tbills have declined from \$22bn in March to about \$14bn in August. Despite a challenging international backdrop, we believe the IMF program remains broadly on track and so we do not see an impediment to the next IMF disbursement in December. An IMF mission is expected to visit Cairo in mid-October for a program review. We believe the stability of the headline FX reserves continues to support confidence, although deposits which are not included in official reserve assets (including foreign funds coming under the repatriation mechanism) have continued to decline. With this cushion, CBE net international reserves have been resilient against EM volatility standing at \$42bn in August, roughly unchanged from July (6.8 months of imports of goods and services), up from \$33bn in December (Figure 4).

Figure 2: Egypt 12M rolling sum petroleum trade balance

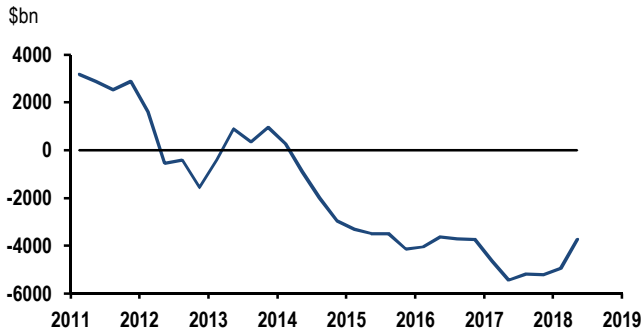


Figure 3: Tourist arrivals and suez canal revenues

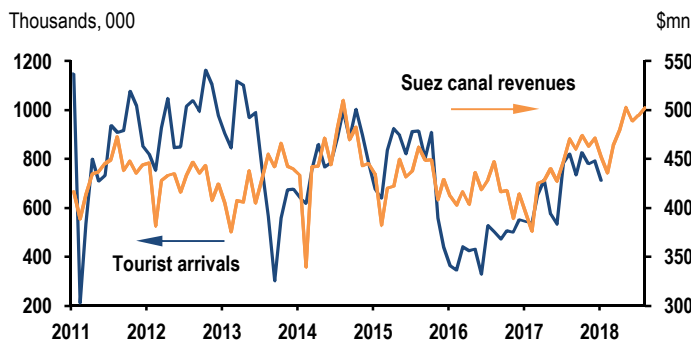
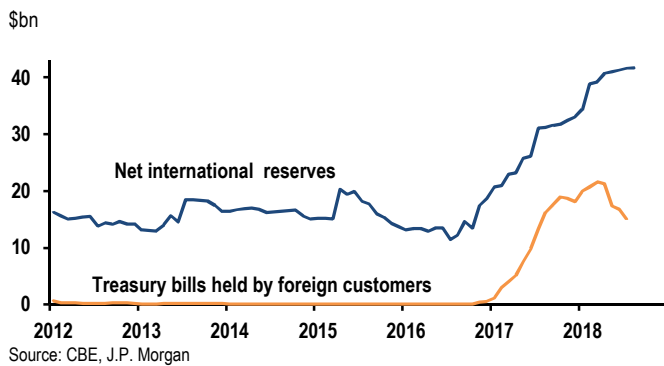


Figure 4: Net international reserves and T-bills held by foreigners



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