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Research Update:

Egypt 'B-/B' Sovereign Ratings Affirmed; Outlook Stable

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Overview

- We anticipate ongoing fiscal consolidation in Egypt over 2017-2020, supported by the three-year IMF program.
- We are therefore affirming our 'B-' long-term and 'B' short-term ratings on Egypt.
- The stable outlook balances the risks arising from Egypt's large external and fiscal deficits, against financing support from the IMF program and gradual reform implementation to address structural imbalances.

Rating Action

On May 12, 2017, S&P Global Ratings affirmed its 'B-/B' long- and short-term foreign and local currency sovereign credit ratings on the Arab Republic of Egypt. The outlook is stable.

Rationale

The ratings on Egypt remain constrained by wide fiscal deficits, high public debt, low income levels, and institutional and social fragility. We anticipate that the IMF's Extended Fund Facility (EFF) program will help Egypt finance its foreign exchange requirements over the coming 12 months and restore macroeconomic stability via gradual reform implementation over 2017-2020. Even so, we believe that the delivery of reforms will be challenged by prevailing macroeconomic impediments including high rates of structural unemployment and poverty.

On Nov. 3, 2016, the Central Bank of Egypt (CBE) formally moved to a floating exchange rate regime. The authorities' move toward a more flexible exchange rate regime was a vital step toward alleviating Egypt's acute foreign currency shortage, eliminating the differential between the official and unofficial exchange rates and improving the country's export competitiveness. At the same time, the CBE raised its policy rate by 300 bps and sterilized part of the large liquidity surplus by introducing deposit auctions with maturities of 118 days. A few days later, the IMF board approved the three-year US$12 billion EFF. The program also featured front-loaded policy measures such as a VAT of 13% and further subsidy reforms for the fiscal year 2016/2017 (ending June 30). These structural reforms aim to achieve and maintain macroeconomic stability and promote growth.

After observing a slowdown in growth in the first half of fiscal 2016/2017, we have lowered our estimate of Egypt's real GDP growth to about 3.8% from 4.3% in 2015/2016. This reflects the authorities' tight fiscal and monetary stance and sluggish domestic demand. We project Egypt's real GDP to continue to grow at a moderate rate of just under 4% on average over 2017-2020, largely driven by investments and net exports. At the same time, we think other factors will continue to weigh on the economy in the near term, particularly the planned fiscal consolidation with the second round of subsidy cuts in 2017/2018, the tight monetary stance, and the slow growth in private demand due to high inflation.

Egypt's economic growth over 2017-2020 will be supported by the recovering security environment, an improvement in external competitiveness following the flotation of the Egyptian pound, stronger capital flows, resilient remittances from Egyptians working abroad, some inward foreign investment, and an improved power supply as new natural gas developments from the Zohr field come on stream in 2018.

Eni's discovery of a super-giant natural gas field offshore in Egypt, the opening of the parallel Suez Canal, and large scale investment in the energy sector could support growth and improve the country's energy and external imbalances from 2018. We consider that the Eni discovery could support economic growth by encouraging investment in the oil and gas sector and alleviating fuel shortages. Production at the Zohr field is expected to start by 2018 and be fully scaled up by 2019.

We anticipate the gradual fiscal consolidation will continue, underpinned both by revenue-enhancing measures such as the 1% increase in the VAT rate to 14% in 2017/2018 and containing public expenditures (such as the wages bill). During the first half of the fiscal year 2016/2017, the Egyptian authorities increased electricity tariffs and reduced subsidies on fuel products by about 32%. We project Egypt's fiscal deficits will decline from double digits currently--averaging 12% of GDP during 2012-2016--to average 8.6% in 2017-2020. The government plans to channel some of the savings from subsidy reforms into constitutionally mandated higher spending on health, education, and scientific research. We expect this fiscal consolidation will put the general government debt as a ratio of GDP on a declining path. We estimate Egypt's general government debt at 92% of GDP in 2016, and we project it to decline to 82% by 2020. We project general government interest expenditure will remain sizeable, averaging 37% of general government revenues over our forecast horizon.

Despite the large fiscal deficit, we do not expect the government to face problems raising debt domestically. A significant share of government domestic debt continues to be held by Egyptian banks and the CBE. We anticipate foreign borrowing will become increasing important for financing Egypt's fiscal deficit. Egypt successfully issued $4 billion in international bonds in January 2017, and is planning to issue another $4 billion Eurobond in 2017/2018. We note that the $12 billion IMF loan and other multilateral lending from the World Bank ($3 billion) and the African Development Bank ($1.5 billion) unlocked additional bilateral lending from the United Arab Emirates and China, and helped replenish the foreign currency reserves to $28.5 billion at end-March 2017 (compared to $17.5 billion in June 2016).

The current account deficit spiked to about 6.0% of GDP in 2015 and 2016, compared to 3.6% in the 2014/2015 fiscal year as import demand remained robust while export receipts dropped sharply. We forecast the current account deficit to gradually narrow to 3.2% of GDP by 2020, helped by the improvement in trade balance on the back of a depreciating local currency. Gas production at the Zohr field coming on stream in 2018 will also help reduce the energy import bill. The manufacturing sector in Egypt remains highly dependent on imported inputs, which limits the effect of the currency depreciation. We expect manufacturers and consumers to use more domestic products, as imported goods become more expensive. We project usable reserves to cover more than three months of imports (that is, 3.5 months of current account payments [CAPs] by June 30, 2017) and reach about 6.0 months of CAPs by 2020. We expect Egypt's overall net external liability position to exceed 300% of CARs by June 30, 2017. We forecast gross financing needs to reach 131% of CARs and usable reserves during the same period.

We assess Egypt's monetary policy flexibility as low, reflecting our appraisal of its central bank's exposure (along with that of the banking system) to the government's domestic debt and a yearly inflation rate exceeding 10%. Annual inflation came in at about 31% in March 2017, exacerbated by the significant devaluation of the Egyptian pound, the subsidy cuts, and the implementation of the new VAT. We anticipate inflation will remain at double-digit levels in the coming months, reflecting pressures stemming from the pass-through of currency depreciation, the planned 1% increase in VAT, and further subsidy cuts.

We expect the CBE to keep its policy rates unchanged or slightly lower because of the decelerating growth of private consumption and the government's high debt burden. While the move to a floating currency increases the central bank's flexibility, the transmission of monetary policy remains challenged by the low penetration of financial services in the economy--for instance, the stock of banks' credit to the domestic private sector is low at an estimated 15% of GDP in 2016. Therefore, price changes are more likely to be dominated by external factors--such as imported inflation from a depreciating pound--rather than changes in central bank key policy rates.

The security and sociopolitical environment in Egypt remains fragile, and about 26% of the population lives in poverty. This high level is fueled by a high 13% rate of unemployment. Public discontent, especially from vulnerable groups as a result of the rising cost of living, is the main risk to the consolidation program and reforms. At the same time, we understand from the authorities that social protection and targeted compensatory measures are an important component of the fiscal consolidation program. Another contentious issue in Egypt is the continued hostility between the Egyptian security forces and the militant group ISIS in Northern Sinai.

Outlook

The stable outlook balances the risks arising from Egypt's large external and fiscal deficits, against financing support from the IMF program and gradual reform implementation to address structural imbalances.

We could raise the ratings if GDP growth picks up beyond our expectations, and if Egypt improves its fiscal and external positions substantially.

We could lower the ratings if current account financing, including from Gulf Cooperation Council countries, became less forthcoming. Deteriorating domestic fiscal funding options, increased political risk, or a weaker institutional environment could also lead us to lower the ratings.

Key Statistics

Table 1

Arab Republic of Egypt Selected Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
ECONOMIC INDICATORS (%)										
Nominal GDP (bil. LC)	1,680	1,870	2,130	2,444	2,708	3,598	4,171	4,806	5,498	6,296
Nominal GDP (bil. $)	280	290	306	333	333	263	220	240	262	289
GDP per capita (000s $)	3.4	3.4	3.5	3.7	3.7	2.9	2.3	2.5	2.7	2.9
Real GDP growth	2.2	2.1	2.2	4.4	4.3	3.8	3.5	3.8	4.0	4.1
Real GDP per capita growth	(0.3)	(0.7)	(0.2)	1.7	2.9	1.5	1.2	1.5	1.7	1.8
Real investment growth	8.0	(9.6)	4.6	8.6	11.2	4.0	4.0	4.0	4.2	4.5
Investment/GDP	16.0	13.9	13.6	14.3	15.0	11.9	11.1	10.1	9.3	8.8
Savings/GDP	12.4	11.7	12.7	10.6	9.1	5.8	5.3	5.1	4.9	5.6
Exports/GDP	16.3	16.9	14.2	13.2	10.4	10.2	12.4	12.1	11.8	11.7
Real exports growth	(2.3)	5.9	(12.6)	(0.6)	(14.5)	1.0	3.0	7.0	7.0	7.0
Unemployment rate	12.4	13.0	13.4	12.9	12.7	12.6	12.3	12.1	11.5	11.0
EXTERNAL INDICATORS (%)										
Current account balance/GDP	(3.6)	(2.2)	(0.9)	(3.6)	(6.0)	(6.1)	(5.8)	(5.1)	(4.4)	(3.2)
Current account balance/CARs	(15.8)	(9.3)	(3.8)	(18.4)	(38.2)	(39.1)	(29.8)	(26.3)	(23.1)	(17.1)
CARs/GDP	23.0	23.6	24.2	19.9	15.6	15.5	19.6	19.3	19.0	18.9
Trade balance/GDP	(12.2)	(10.6)	(11.2)	(11.7)	(11.6)	(10.2)	(11.6)	(10.9)	(10.4)	(9.5)
Net FDI/GDP	1.3	1.2	1.3	1.9	2.0	2.0	2.0	2.1	2.2	2.2
Net portfolio equity inflow/GDP	(1.9)	(0.3)	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Gross external financing needs/CARs plus usable reserves	92.8	100.7	102.7	111.1	118.1	131.2	113.3	111.8	110.4	107.5
Narrow net external debt/CARs	(0.8)	15.7	18.7	25.7	57.8	91.8	103.9	109.0	109.9	102.6
Net external liabilities/CARs	85.5	106.2	107.0	137.7	214.9	308.2	320.0	321.2	319.0	305.1
Short-term external debt by remaining maturity/CARs	15.9	14.9	20.6	19.6	24.5	45.0	47.0	50.1	52.4	52.4
Usable reserves/CAPs (months)	4.3	2.6	2.4	2.5	3.3	3.5	5.2	5.5	5.7	5.9
Usable reserves (mil. $)	15,980	15,624	16,013	19,619	16,468	24,102	26,772	29,377	31,596	34,530
FISCAL INDICATORS (%, General government)										
Balance/GDP	(9.9)	(13.2)	(12.0)	(11.6)	(12.2)	(10.7)	(9.7)	(8.7)	(8.2)	(7.7)
Change in debt/GDP	11.0	17.5	11.7	14.3	17.1	19.4	10.1	9.1	8.5	7.9
Primary balance/GDP	(4.3)	(6.0)	(4.5)	(4.3)	(4.0)	(3.3)	(1.3)	(0.5)	(0.2)	0.1
Revenue/GDP	20.8	21.6	24.4	22.0	20.3	23.0	22.0	21.5	21.5	21.5
Expenditures/GDP	30.6	34.8	36.3	33.7	32.5	33.7	31.7	30.2	29.7	29.2
Interest /revenues	26.8	33.5	30.7	33.3	40.1	32.4	38.1	38.1	37.2	36.1

Table 1

Arab Republic of Egypt Selected Indicators (cont.)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Debt/GDP	73.6	83.6	85.1	88.5	97.0	92.4	89.8	87.1	84.6	81.8
Debt/Revenue	354.2	387.3	349.1	402.0	478.0	401.9	408.4	404.9	393.7	380.4
Net debt/GDP	63.1	73.4	77.0	78.9	84.9	83.3	82.0	80.2	78.7	76.6
Liquid assets/GDP	10.5	10.2	8.2	9.7	12.1	9.1	7.9	6.8	6.0	5.2
MONETARY INDICATORS (%)										
CPI growth	8.1	8.7	8.4	11.8	12.2	30.9	13.0	12.0	11.0	10.0
GDP deflator growth	12.4	9.0	11.5	9.9	6.3	28.0	12.0	11.0	10.0	10.0
Exchange rate, year-end (LC/$)	6.05	7.01	7.15	7.61	8.86	18.50	19.50	20.50	21.50	22.00
Banks' claims on resident non-gov't sector growth	8.2	9.5	7.3	18.4	17.2	15.0	14.0	13.0	12.0	12.0
Banks' claims on resident non-gov't sector/GDP	29.4	28.9	27.2	28.1	29.7	25.7	25.3	24.8	24.3	23.8
Foreign currency share of claims by banks on residents	30.9	28.1	29.4	28.8	33.2	28.7	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	24.0	23.9	24.4	23.4	21.0	20.0	15.0	15.0	15.0	15.0
Real effective exchange rate growth	(1.8)	8.9	(7.2)	6.8	14.7	(16.1)	N/A	N/A	N/A	N/A

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Arab Republic of Egypt Ratings Score Snapshot

Key rating factors	
Institutional assessment	Weakness
Economic assessment	Weakness
External assessment	Weakness
Fiscal assessment: flexibility and performance	Weakness
Fiscal assessment: debt burden	Weakness
Monetary assessment	Weakness

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23,2014
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18,2009
- General Criteria: Use Of CreditWatch And Outlooks - September 14,2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07,2017

Related Research

- Sovereign Ratings History – May 5, 2017
- Credit Trends: 2016 Sovereign Ratings Update: Outlook And CreditWatch Resolutions – April 18, 2017
- Global Sovereign Rating Trends: First-Quarter 2017 – April 10, 2017
- Sovereign Risk Indicators, April 10, 2017. An interactive version is also available at http://www.spratings.com/sri
- Default, Transition, and Recovery: 2016 Annual Sovereign Default Study And Rating Transitions – April 3, 2017
- Eurozone Sovereign Rating Trends 2017, January 10, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion, February 23, 2017
- Sovereign Debt 2017: Eurozone Commercial Borrowing To Stabilize At €871 Billion In 2017, February 23, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

	Rating	
	To	From
Egypt (Arab Republic of)		
Sovereign Credit Rating		
Foreign and Local Currency	B-/Stable/B	B-/Stable/B
Transfer & Convertibility Assessment	B-	B-
Senior Unsecured		
Foreign Currency	B-	B-
Short-Term Debt		
Local Currency	B	B

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support

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