SOVEREIGN AND SUPRANATIONAL

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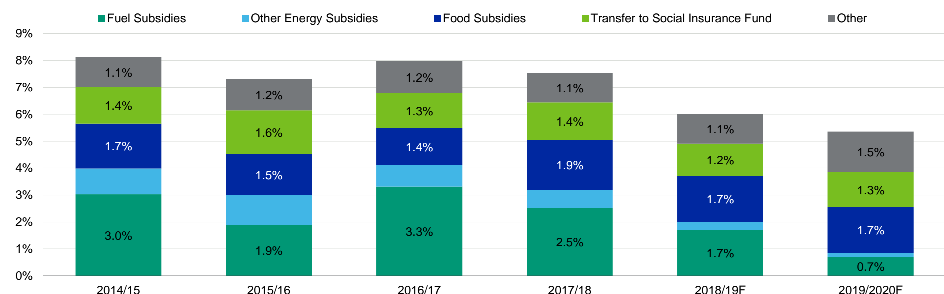
Government of Egypt

Egypt's fiscal 2020 budget points to continued fiscal consolidation, a credit positive

On 31 March, the Government of Egypt (B3 positive) approved a budget for fiscal 2020 (which ends June 2020) and sent it to parliament for review and approval. The budget targets a reduction in the overall deficit to 7.2% of GDP from the 8.4% targeted for fiscal 2019, and a primary surplus of 2% of GDP, based on a GDP growth rate of 6%. In light of our marginally lower growth forecast at 5.8% for fiscal 2020, we forecast that the fiscal deficit will be 7.5%, and the primary surplus will be 1.7% of GDP. We view continued fiscal consolidation as credit positive and conducive to reducing Egypt's general government debt/GDP ratio to 82.3% in fiscal 2020 from an expected 86.3% in fiscal 2019 and an actual 92.6% fiscal 2018.

In addition to improved revenue collection, the budgeted deficit reduction of about one percentage point of GDP stems mostly from a reduction in expenditures, and in particular involves the share of subsidies, grants and social benefits, which we project will decline to 5.4% of GDP in fiscal 2020 from an expected 6% in fiscal 2019 (see Exhibit 1). Within this category, petroleum spending cutbacks to an estimated 0.7% of GDP from 1.7% in fiscal 2019 following the completion of fuel subsidy reform by June this year, and the continued reduction in electricity subsidies will create some fiscal space to expand spending for targeted income transfers and social welfare payments, including an increase in pension transfers to 1.3% of GDP from 1.2% in fiscal 2019. These projections are broadly in line with the parameters of Egypt's Extended Fund Facility with the International Monetary Fund (IMF).

Exhibit 1
Egypt's fiscal consolidation is occurring mainly in subsidies, grant and social benefits budget allocations
Percent of GDP



Sources: Egypt Ministry of Finance, International Monetary Fund and Moody's Investment Service

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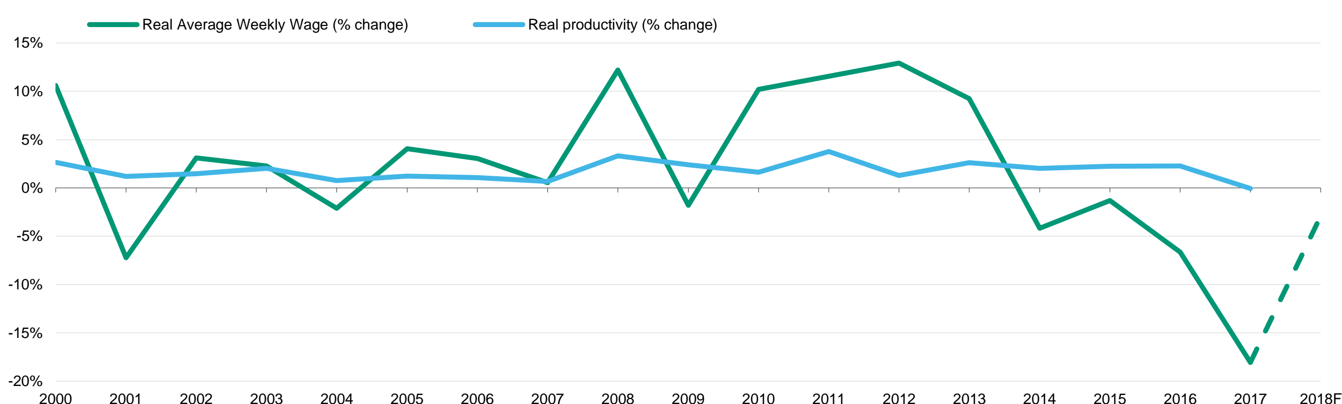
To shield the budget from future energy price fluctuations, starting this month the government has adopted an automatic fuel pricing mechanism for 95-octane fuel which is one type of fuel for which cost effectiveness has already been established. This indexation mechanism, which is reflective of international energy price trends, will be extended to other types of fuel once full cost effectiveness has been achieved at the end of fiscal 2019.

The budget also includes a salary scale adjustment in the public sector, including a 66% increase in the minimum wage starting in June 2019. This is the first wage increase in the public sector since fiscal 2014 and will result in the wage bill remaining at about 5% of GDP as compared to a further reduction to below 5% of GDP under IMF program parameters, and significantly lower than the 8.5% of GDP registered in fiscal 2014. In light of the significant real wage and purchasing power erosion that middle- and low-income households have faced following Egypt's currency flotation in November 2016, we expect calls for similar minimum wage adjustments in the private sector to follow. Exhibit 2 shows that while a one-off wage increase can be accommodated and is likely to support private consumption, a sustained increase in real wages would erode some of Egypt’s regained price and wage competitiveness relative to peers unless it is supported by sustained increases in labor productivity growth.

Exhibit 2
Egypt's real wage and real productivity growth comparison
Percent change



Sources: Haver Analytics and Moody’s Investors Service

In contrast to the IMF program parameters, the fiscal 2020 budget includes a higher share of public investment spending (purchase of non-financial assets) at 3.4% of GDP versus 2.8% in fiscal 2019. Part of this spending increase will be funded with the sale of minority stakes in public enterprises and can be sequenced accordingly.

The largest spending item will remain the interest bill at 9.2% of GDP, a similar amount to what we estimate for fiscal 2019. We expect a gradual reduction to 8.5% of GDP in fiscal 2021 as inflation trends down with the end of the one-off price level effects of subsidy reform and tariff hikes, allowing the central bank to lower interest rates while preserving price stability.

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Moody's related publications

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Outlook: Sovereigns – Global: 2019 outlook still stable, but slowing growth signals increasingly diverging prospects, November 2018

Rating Methodology: Sovereign Bond Ratings, 27 November 2018

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