CREDIT OPINION
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Update

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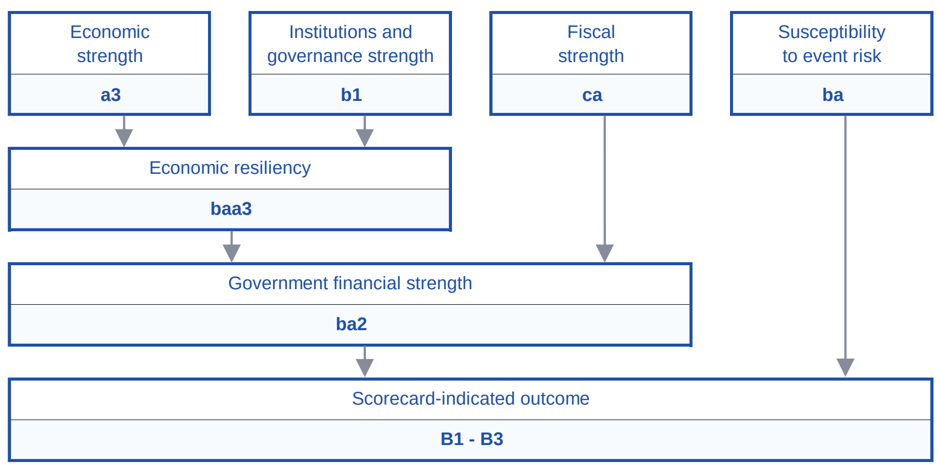
Government of Egypt – B2 stable

Update following forecast change

Summary

A track record of economic and fiscal reform implementation support Egypt's credit profile, balanced by large funding requirements and weak debt affordability. A broad domestic funding base and a robust foreign exchange reserve at over six months of import cover that exceeds external debt payments over the next year provide buffers against significant capital outflows from emerging markets in the wake of the coronavirus pandemic. Primary budget surpluses have been restored and are likely to be maintained. This balances the government's financing needs of 30%-40% of GDP, still high, although declining, debt burden at over 80% of GDP and low debt affordability, exposing fiscal accounts to shocks in borrowing costs.

Exhibit 1
Egypt's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Large and diversified economy, supported by a track record of reform commitment

» Large domestic funding base and strengthened foreign-exchange buffer

Credit challenges

» High government debt, low debt affordability and very large refinancing needs

» Social pressures from high youth unemployment, high inflation and lingering susceptibility to political event risks

Rating outlook

The stable outlook captures both upward and downward rating pressures.

Debt affordability as measured by interest/revenue will remain very weak and financing needs very large, around 30%-40% of GDP, in the next few years, leaving Egypt's credit profile vulnerable to a sharp and sustained tightening in financing conditions. Moreover, we expect continued reform implementation to remain subject to sporadic social tensions as captured in the moderate political event risk assessment.

On the upside, strong reform commitment could deliver higher sustained growth than we expect. A structural reduction in the current account deficit in light of renewed natural gas exports may also reduce the economy's borrowing needs and shore up resilience to changing financing conditions to a greater extent than currently assumed.

Factors that could lead to an upgrade

Over the medium term, a marked improvement in debt affordability and reduction in gross financing needs, resulting from a lengthening track record of credible and effective fiscal, economic and debt management, would likely lead us to upgrade the rating. Evidence of a sustained improvement in the labor market and in non-hydrocarbon exports would also support an upgrade by signaling higher competitiveness that would facilitate a more rapid improvement in fiscal metrics and boost Egypt's resilience to shocks.

Factors that could lead to a downgrade

Evidence that the government was unable to mitigate the negative coronavirus financing shock in a way that prevented a sharp worsening of debt affordability could lead to a downgrade of the rating, particularly if accompanied by sustained heavy pressure on foreign-exchange reserves. Relatedly, an erosion in policy effectiveness and credibility, resulting in either sustained lower growth levels or higher inflation that raises the cost of government debt and erodes competitiveness, would also put negative pressure on the rating.

Key indicators

Egypt [1]	2014	2015	2016	2017	2018	2019E	2020F	2021F
Real GDP (% change)	2.9	4.4	4.3	4.2	5.3	5.6	4.4	2.7
Inflation (CPI, % change, Dec/Dec)[2]	8.2	11.4	14.0	29.8	14.4	9.4	8.5	7.4
Gen. gov. financial balance/GDP (%)	-12.0	-11.6	-13.7	-10.6	-9.6	-8.0	-7.9	-7.7
Gen. gov. primary balance/GDP (%)	-4.5	-4.3	-5.4	-2.4	-0.2	1.5	1.3	1.1
Gen. gov. debt/GDP (%)	85.0	88.5	96.9	103.2	92.6	84.2	82.6	83.0
Gen. gov. debt/revenues (%)	348.7	401.7	478.3	474.5	448.8	414.8	421.4	419.2
Gen. gov. interest payment/revenues (%)	30.7	33.3	41.0	37.7	45.3	46.9	46.9	44.4
Current account balance/GDP (%)	-0.9	-3.7	-6.0	-6.1	-2.4	-3.6	-4.5	-3.6
External debt/CA receipts (%)[3]	62.2	72.7	107.3	132.9	124.1	206.9	315.6	290.2
External vulnerability indicator (EVI) [4]	85.2	67.7	43.7	95.2	85.0	62.5	56.1	62.1

1 Fiscal years ending June 30, e.g. 2011 refers to fiscal year 2010/2011
2 Figure as end of June
3 Current Account Receipts
4 (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/ Offical Foreign Exchange Reserves
Source: Moody's Investors Service

Detailed credit considerations

Egypt's "a3" **economic strength** is supported by its large and diversified economy. Improved competitiveness after the floating of the pound and the development of the Zohr gas field support investment activity in energy and non-energy sectors and higher growth averaging about 5.4% over the past two years. Over the medium-term, continued effective implementation of business environment reforms, including investment and bankruptcy laws and an improved land allocation mechanism, will continue to support Egypt's growth potential. Higher growth has reduced the unemployment rate to 8% in the fourth quarter of 2019, close to the lowest level in decades. Taken together, these factors provide a degree of economic shock absorption capacity.

Structural challenges include the rapidly expanding population, and persistently high unemployment rates especially among the youth, despite the recent decline, which can pose a risk to social stability. In addition, lengthy bureaucratic processes and infrastructure bottlenecks weigh on the business environment and are reflected in comparatively weak, although improving, competitiveness survey rankings.

Our assessment of Egypt's **institutions and governance strength** at “b1” is based on the Worldwide Governance Indicators as a starting point, according to which Egypt ranks in the 21st percentile of sovereigns we rate for Government Effectiveness, in the 26th percentile for Control of Corruption and in the 31st percentile for Rule of Law in 2018.

Quality of Legislative and Executive Institutions at “b” indicates a still comparatively low but steadily improving government effectiveness. This assessment is supported by a growing track record of completed economic and fiscal reforms ranging from full currency flotation and shift to inflation targeting, to energy subsidy reform and liberalization of the domestic gas market that have been implemented under the umbrella of a three-year IMF program completed in July 2019.

The Strength of Civil Society and the Judiciary assessment at “caa” is based on the weak performance on Voice and Accountability indicator at the 10th percentile and the perception of relatively few formal checks on the exercise of government power, including from the side of civil society amid relatively steady control of corruption and rule of law indicators around the 30th percentile.

Fiscal policy effectiveness at “ba” reflects the structural shift toward general government primary surpluses starting fiscal 2019, and trending toward 1% of GDP over the next few years albeit under pressure in the near term associated with the coronavirus shock. Structural reforms, including VAT implementation and energy subsidy reform, make the fiscal adjustment sustainable while the interest bill will be gradually reduced in line with the central bank's inflation targeting credentials under the floating exchange rate regime. Monetary and Macroeconomic Policy Effectiveness at “ba” incorporates the high degree of price stability maintained by the Central Bank of Egypt after the currency flotation in late 2016 and during periods of administered price hikes until July 2019 that have contributed to the central bank's price stability credentials as it gradually shifts to an inflation-targeting regime.

We assess Egypt's **fiscal strength** score “ca”, reflecting the still high, although declining, debt stock run up in the aftermath of the Arab Spring upheavals. After peaking at 103.5% at the end of fiscal 2017, the debt/GDP ratio declined to 84.2% at the end of fiscal 2019. We project the debt ratio to continue to decline including when taking into account the growth and fiscal shock impact of the coronavirus pandemic in our central scenario. That said, Egypt's debt affordability indicators as measured by interest/revenue are among the weakest of all the sovereigns that we rate, with interest payments at over 45% of government revenues even as we expect the interest bill to gradually decline over the next few years.

In the aftermath of the flotation, the share of foreign-currency debt in overall government debt doubled to about 35%, which is in line or lower than for Egypt's rating peers but exposes the debt trajectory to valuation effects resulting from a potential currency depreciation.

Meanwhile, the elimination of most fuel subsidies at the end of fiscal 2019 and the implementation of a consumer price indexation mechanism since then will improve government spending efficiency and predictability through commodity price cycles. Maintained primary budget surpluses combined with strong nominal GDP growth will result in a steady decline in the debt burden.

We assess Egypt's **susceptibility to event risk** at “ba”, driven by political, banking sector and government liquidity risk assessed at the same level.

The political risk assessment at “ba” reflects a combination of factors, including the measures taken by the government to distribute the proceeds of strong growth more effectively and provide jobs to a large and fast-rising number of new entrants in the labor force. We believe these measures have lowered the risk of social upheaval or reform reversal over the next few years. That said, over the longer term, the removal of structural impediments to a shift to a more inclusive, private sector-led growth model will be a gradual process that remains exposed to longstanding vested interests or to the risk of reform reversal. Moreover, Egypt's geographic location in an unstable region exposes it to a moderate degree of geopolitical event risk and lingering security risks in North Sinai.

Banking sector risk at “ba” reflects the relatively large size of the system which increases the size of potential contingent liabilities accruing to the government's balance sheet. This risk is balanced by the banks' stable funding structure, large liquidity buffers, strong profitability and resilient loan performance.

We assess Egypt's government liquidity risk as “ba”, reflecting gross borrowing requirements in the 30%-40% of GDP range over the next few years, which are one of the highest amongst the sovereigns rated by Moody's. The expected reduction in domestic borrowing costs over the longer term underpins the government's maturity lengthening strategy in the domestic market. In the meantime, fiscal accounts remain exposed to a sudden tightening in borrowing costs which would quickly feed through the interest bill and debt dynamics.

That said, Egypt's external liquidity position is supported by the re-establishment of a material foreign-exchange reserve buffer to help absorb sudden capital flow reversals. On the domestic financing side, Egypt benefits from a deep and stable domestic funding base in its large banking sector, with an established track record of financing support to the government, including in times of stress.

We assess Egypt's external vulnerability risk at “a”, reflecting the shift to a basic balance, when the current account deficit of about 2.5-4.0% of GDP will be broadly covered by foreign direct investment inflows. Renewed natural gas net exports that resumed in 2019 support Egypt's external position. Egypt’s foreign-exchange reserve buffer stood a over six months of import cover as of December 2019. Despite the anticipated significant capital outflows from emerging markets in the wake of the coronavirus crisis, we estimate the FX buffer to consistently exceed the economy's projected external debt service requirements over the next few years, as indicated by the external vulnerability indicator reading below 100%.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Egypt

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sovereign issuers’ economic, institutions and governance and fiscal strength and their susceptibility to event risk. In the case of Egypt, the materiality of ESG to the credit profile is as follows:

Egypt is significantly exposed to environmental risks through its water dependency on the Nile. The Nile flow has been affected by the decreasing rate of annual rainwater, which is coming from the Ethiopian Highlands, and it remains exposed to climate change induced reductions in rainwater over the next few years, according to the Ministry of Water Resources and Irrigation. Egypt is seeking to reduce its water dependency on the Nile via the installation of desalination plants and via the application of strict rules for the cultivation of water-intensive crops such as rice and sugarcane, among other measures. The government is also negotiating a strategy with Ethiopia (B1 negative) and Sudan for the filling period of the Grand Ethiopian Renaissance Dam once construction is complete. These negotiations are ongoing.

Egypt is significantly exposed to social risks as highlighted in sporadic protests which reflect the high adjustment costs carried by the population from the government’s economic reform program implemented over the past few years. We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety.

Governance is an important driver of Egypt's institutional strength assessment and benefits from the track record of reform commitment established over the past few years. The subscription to the IMF's Special Data Dissemination Standard since 2015 also attests to the government's commitment to financial data transparency to implementing international best practices in statistics.

All of these considerations are further discussed in the “Detailed credit considerations” section above. Our approach to ESG is explained in our report on how ESG risks influence sovereign credit profiles and our cross-sector methodology General Principles for Assessing ESG Risks.

Recent developments

Egypt allocates $6 billion (2% of GDP) and continues monetary easing to combat the negative effects of the coronavirus financial shock

As of April 13, Egypt counted 2,190 cases and 164 deaths, according to the Worldometers website. In response to the global outbreak the government has adopted significant measures, including the suspension of flights to and from Egypt thereby bringing the tourism industry to a standstill. The tourism and travel sector contributes 12% of Egypt's GDP and employs 9% of the country's workforce, Starting mid-March the government has also closed universities and schools, and imposed a partial curfew while all restaurants, cafes, malls, and other local shops shut down completely until April 14, 2020.

On April 7, the government announced a two-month extension for businesses to pay their income taxes, effectively moving the deadline for payment to June 30th from April 30th while also providing the option to pay their income taxes in three installments. Those who pay by June 30th will not incur any fines, interest or late fees. For businesses in the tourism industry, the income tax extension is for three months instead of two. Furthermore, the government also extended the corporate real estate taxes by three months. For businesses in the tourism industry will get a full six month tax holiday for their real estate taxes. The government will also provide loans to the aviation industry with a two-year grace period. Day laborers will receive EGP 500 per month for 3 months.

On March 22, President Abdel-Fattah El-Sisi provided details about the allocation of a EGP100 billion (about $6 billion or 2% of GDP) economic and fiscal stimulus package in order to mitigate the economic impact of the coronavirus pandemic. EGP 50 billion has been earmarked for the tourism industry and to keeping hotels afloat. Under the Social Solidarity scheme, EGP 27.6 billion will be disbursed to 2.4 million families, totaling some 10 million citizens. Another EGP20 billion will be channeled through the Central Bank of Egypt (CBE) for the direct purchase of shares in the stock exchange. The President also announced a 14% annual raise for pensioners, and a two-year freeze on the implementation of the tax on agricultural land.

Meanwhile, on March 16, the CBE announced a 300 basis point (bps) rate cut, lowering the rates to its lowest since 2016. The overnight lending rate moved from 13.25% to 10.25% and the overnight deposit rate decreased from 12.25% to 9.25%. In addition to the aggressive rate cut, the CBE extended the tenor of all bank loans for a period of 6 months to mitigate the negative effects of the coronavirus financial shock. Following the rate cut, CBE announced a new debt relief package for individuals at risk of default that will waive marginal interest on debt under EGP 1 million, and that will have those who pay off half of their original debt removed from CBE's blacklist and have their asset restrictions lifted. The aggressive rate cut followed by the debt relief package will improve the Egyptian economy's resilience and partially offset the anticipated increase in domestic borrowing costs following significant capital outflows by non-resident investors.

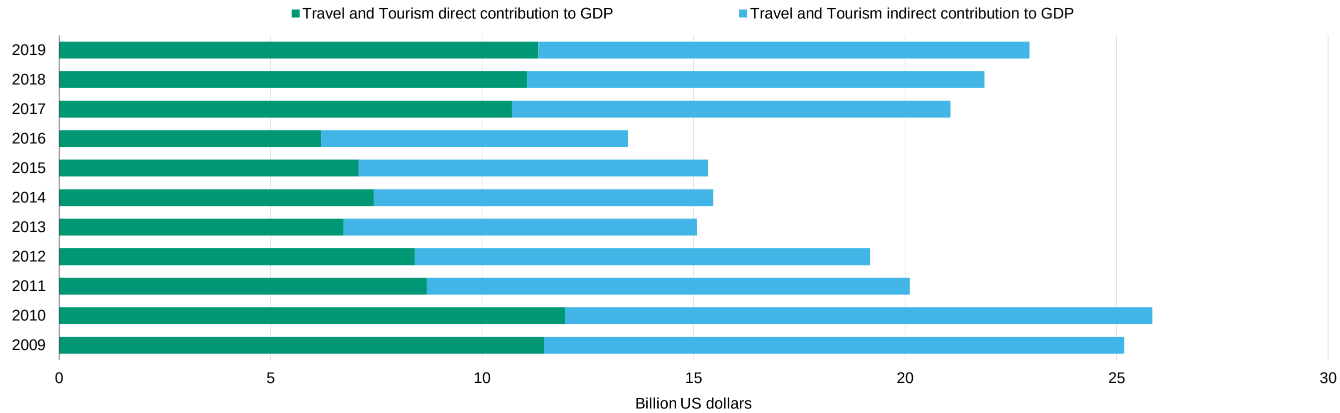
Overall, we expect the negative growth impact to be more pronounced in fiscal 2021 (starting July 2020-June 2021), with economic activity slowing to 4.4% in fiscal 2020 and declining further to 2.7% in fiscal 2021, mainly owing to tourism, investment and trade disruptions. On the fiscal side we expect a slower pace of fiscal consolidation than budgeted, with the fiscal deficit remaining close to the 8% recorded in fiscal 2019, partially owed to lower revenues and partially to higher social spending. That said, in our central scenario we expect the primary balance to remain in surplus and the fiscal consolidation trend to resume starting fiscal 2022, while the reduction in the debt ratio will pause in fiscal 2021 before resuming thereafter.

The decline in tourism will put downward pressure on growth and on external accounts

After a large decline in Egypt's tourism revenue between 2011 and 2016, the sector had entered a recovery period in 2017. However, the coronavirus pandemic put a halt on this growth. As a response to the outbreak, the government of Egypt closed all airports, which put tourism and travel sector at risk. On March 15, Tourism and Antiquities Minister announced that the coronavirus would cause tourism losses of a billion dollars a month to the Egyptian economy. The length of the pandemic response will be key in determining the level of impact on the economy supported by the effectiveness of the fiscal and monetary response. With respect to external accounts, we expect the temporary but sharp decline in tourism revenues and in remittances to more than offset the savings from lower oil prices, thus informing our current account deficit forecast at 4.5% of GDP in fiscal 2020, followed by 3.6% in fiscal 2021 from a similar amount in fiscal 2019.

Exhibit 3

Tourism was in a recovery period but travel restrictions will reverse the recovery in 2020



Source: World Tourism and Travel Council

Moody's rating methodology and scorecard factors: Egypt - B2 Stable

				Initial Factor score	Final Factor score	Weights
Factor 1: Economic strength				a3	a3	50%
Growth dynamics	Average real GDP growth (%)	2014-2023F	4.4	aa3		25%
	Volatility in real GDP growth (%)	2009-2018	1.3	aaa		10%
Scale of the economy	Nominal GDP ($ billion)	2018	249.6	a3		30%
National income	GDP per capita (PPP, Intl$)	2018	13,358	ba1		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				b1	b1	50%
Quality of institutions	Quality of legislative and executive institutions			b		20%
	Strength of civil society and the judiciary			caa		20%
Policy effectiveness	Fiscal policy effectiveness			ba		30%
	Monetary and macroeconomic policy effectiveness			ba		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				baa3	baa3	
Factor 3: Fiscal strength				ca	ca	
Debt burden	General government debt/GDP (%)	2018	92.6	b2		25%
	General government debt/revenue (%)	2018	448.8	b3		25%
Debt affordability	General government interest payments/revenue (%)	2018	45.3	ca		25%
	General government interest payments/GDP (%)	2018	9.4	ca		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-3	-3	max ±6
	Debt trend	2015-2020F	-5.9	0	0	
	Foreign currency debt/general government debt	2018	35.8	-3	-3	
	Other non-financial public sector debt/GDP	2018	16.5	0	0	
	Public sector assets/general government debt	2018	0.0	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				ba2	ba2	
Factor 4: Susceptibility to event risk				ba	ba	Min
Political risk				ba		
	Domestic political risk and geopolitical risk			ba		
Government liquidity risk				ba	ba	
	Ease of access to funding			ba		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				ba	ba	
	Risk of banking sector credit event (BSCE)	Latest available	b2	ba3-b3		
	Total domestic bank assets/GDP	2018	114.5	80-180		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				B1 - B3	B1 - B3	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories** for quantitative sub-factors: aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

» **Credit Analysis**: Government of Egypt – B2 stable: Annual credit analysis, 28 August 2019

» **Issuer in-Depth**: Government of Egypt: FAQ on the sustainability of economic and fiscal improvements amid persistently high financing needs, 8 May 2019

» **Country Statistics**: Egypt, Government of, 27 April 2019

» **Outlook**: Sovereign – Levant & North Africa 2020 outlook negative as increased social tensions weaken reform drive, 8 January 2020

» **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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