It's Not About Devaluation

It's About Availability and Rate Expectations

Egypt Ready to Unlock IMF Facility; Egypt Ready for "Devaluation"

IMF Pre-requisite External Funding of USD5-6 billion Secured; Eurobond Issuance Around the Corner

The government has successfully secured the USD5-6 billion in external funding needed to unlock the IMF funding. With USD1 billion transfer from the UAE, USD1.5 billion combined for second tranche WB/AfDB facilities, USD2-3 billion in deposits from Saudi Arabia and USD2 billion loan from China, Egypt is on track to unlock at least the first tranche of the IMF USD12 billion facility. In addition, the government has appointed international advisors for USD3-5 billion Eurobond issuance, for which we project the funding cost to be 6-7%.

Two Objectives in Place: Budget Deficit at Single Digit; NIR Buildup/ Currency Adjustment

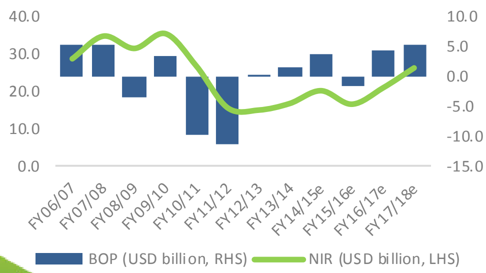
There has been various emphasis on what other reforms would precede/come along with the funding. Announcements have been pointing to: reducing the budget deficit to less than 10% of GDP as a key priority and beefing up reserves along with currency/monetary policy adjustment to revive business activity and potentially spur foreign investor interest.

Fiscal Reforms on Track

Post VAT implementation, the government is looking at a comprehensive plan to widen the tax base and increase total tax revenue. On the expenditure side, the government is targeting a lower wage and energy subsidy bill. We acknowledged in our previous notes that inflation will shoot up initially, and disposable income will be under pressure, jeopardizing growth due to weaker private consumption.

NIR Will be Boosted by External Packages and Eurobond; Could Reach USD25 billion by FYE

The External packages should provide USD9-10 billion of USD inflows over the next 8-12 weeks, along with USD3-5 billion in Eurobond issuance. This could potentially boost the NIR to USD25 billion by FY16/17 end.



All Eyes on Monetary policy: Not Devaluation, But Availability and Rate

Timeline of Events Depicts Imminent Devaluation; Reiterate Higher Rates

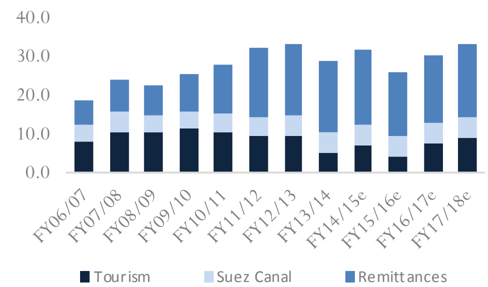
After reassurances from the government the USD5-6 billion are secured, and that the IMF board should ratify the USD12 billion funding, market consensus has shifted that the CBE will devalue the currency before the IMF Annual Spring Meetings that should take place on October 7-9 in Washington, DC.

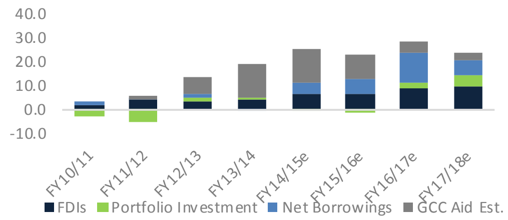
We already noted that the MPC will raise policy rates by 1% during its upcoming meeting on September 22nd, mostly due to inflationary concerns and in preparation for devaluation, in order to increase the attraction of holding EGP versus USD and in a bet to attract foreign fund inflows into the EGP fixed income market, post-devaluation. We believe that another 1% hike in policy rates is much needed for EGP defense, but would probably be implemented on the November 17th MPC meeting, to account for the inflation spike induced by VAT and depreciation.

Market Expecting USD Availability at an Official Rate of 11.00-11.50; But Will it Happen?

According to our calculations, based on EGP versus USD interest rate parity between 2010-2017, the value of the EGP/USD should not go above 11.75 by the end of 2017. The market is expecting a shift in the official exchange rate from EGP8.85/USD to EGP11.00-11.50/USD and is awaiting a once and for all resolution of the foreign currency "unavailability" within the banking system, in an attempt to slowly attack and weaken the parallel market.

These expectations on both the rate and the availability has shifted the name of the game from devaluation timing to how effective it will be, and whether it will mean that the budget deficit will indeed move down to single digits in FY16/17, given the high importation bill and weak sustainable sources of USD, at least over the ST.





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Cheer Devaluation Hype; Beware of the Meet/Fail Game of Expectations

Market Will Definitely Cheer Devaluation "Expectations"; But Will be Highly Volatile to "Below Expectation" News; Needs Higher Foreign Participation to Drive Another Major Spike

We believe that the market has been back and forth between cheering the IMF reforms/ FX shortage resolution and retreating on conservative profit taking. In addition, if we look at the big caps and highly liquid names, we would see current market prices closer to fundamental fair values, which creates less room for price appreciation beyond c.20%. This tells us that the market will probably trade within the 7,700-8,500 range and would need higher foreign participation to break above the high end of that range. Foreign participation, whether on the fixed income market, or equity market, will await currency stability and a single, rather than two, exchange rate. In addition, the market will definitely be disappointed with any "below expectation" news.

Maintain Conservative ST Trading Tactics: Seize the Opportunity But Watch the Downside; Security Selection is Key

Banks' margins will continue to benefit from the hike in rates, given the high allocation to treasury investments (CIEB, HDBK). If FX shortage is resolved, balance sheet growth will revive. EFG-Hermes and EK Holding are well positioned in their respective space and offer good value/growth dynamics. Real estate developers (TMGH, PHDC, OCDI) will continue to deliver strong results, at least over the next 2-3 quarters, driven by higher inflation/ devaluation concerns. Do not forget land bank owners (MNHD). High infrastructure spending beneficiaries including Orascom Construction and El Sewedy Electric are amongst our picks. ORWE is another industrial player, shielded from FX shortage and a direct beneficiary of export incentivizing programs. SKPC and AMOC revenues are USD-based and driven by tight PE and refining markets, respectively, which creates a decent upside, in addition to potential attractive dividend yield.

Seize the opportunity, but watch the downside; Market trading within a downward sloping channel

Source: Reuters, Pharos Research

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