FY2017/18 Budget

Bridging the Fiscal Gap

Executive Summary

- Rearranging the fiscal puzzle remains the most challenging part of Egypt's economic reform program. The **key pillars of the fiscal reform** include:
    1. Current expenditure discipline by cutting fuel and electricity subsidies, efficient food subsidy program and gradually moving towards cash-subsidies
    2. Expanding revenues through a wider tax base and a more efficient tax payment system
    3. Gradually increase capital expenditure, which is needed to improve Egypt's infrastructure/productivity, will help attract more foreign direct investment.

    Such an inclusive-growth friendly approach will enable the Egyptian government turn its fiscal primary deficit into a surplus over the coming years. Accordingly, the gross debt level will decline gradually to reach a more sustainable level.
- We believe that the draft budget of FY2017/18, which is being currently discussed in the Parliament, is in line with the aforementioned strategy and is based on realistic assumptions. However, we estimate a slightly lower nominal GDP, a weaker EGP exchange rate and less favorable disinflation path in FY2017/18. Accordingly, we expect the **overall budget deficit** to exceed the budget target, recording 10.1% of GDP in FY2017/18.

		FY2017/18	
Key Budget Assumptions:	**FY2016/17**	**Ministry of Finance**	**Pharos research**
Nominal GDP (EGPbn)	3,358.2	4,107.0	4,085.0
Oil price (USD per barrel)	50.0	55.0	56.8
Exchange rate (EGP per USD), average	15.0	16.0	17.0
CPI (%YoY), average	23.7%	15.0%	16.8%

Source: Ministry of Finance, Pharos research

- On **the revenue side**, we expect the pickup in the economic activity, in addition to the less favorable disinflation pace to raise **tax revenues** slightly above the draft budget estimates. On the other hand, we believe that the government's tax system reform will take more time to deliver. Accordingly, we do not expect a significant increase in the effective tax rates in FY2017/18.
- On **the expenditure side**, we expect the slower disinflation pace and a higher than budgeted oil prices to slightly offset the government fiscal discipline plans. We estimate that the total expenditure will exceed the draft budget expenditure by EGP56.7 billion in FY2017/18. Therefore, we forecast **a primary deficit** of 0.4% of GDP versus the draft budget projected primary surplus of 0.3% of GDP in FY2017/18.
- On the most debatable topic, we expect the government to strictly keep petroleum subsidies within the draft budget amount. This will be supported by a stable exchange rate and firming international oil prices in FY2017/18. According to our initial calculations, the government would cut **fuel subsidies** by c.EGP21 billion and **electricity subsidies** by c.EGP5 billion to maintain the projected amount.
- Securing the needed funds to close **the funding gap** in FY2017/18, we reiterate that the current high foreign interest in the EGP-denominated treasuries helps keep the borrowing costs at reasonable level.

		FY2017/18	
Key Budget targets:	**FY2016/17**	**Ministry of Finance**	**Pharos research**
Real GDP growth	3.8%	4.6%	4.5%
Overall budget deficit (% of GDP)	10.8%	9.0%	10.1%
Primary balance (% of GDP)	-1.3%	0.3%	-0.4%

Source: Ministry of Finance, Pharos research

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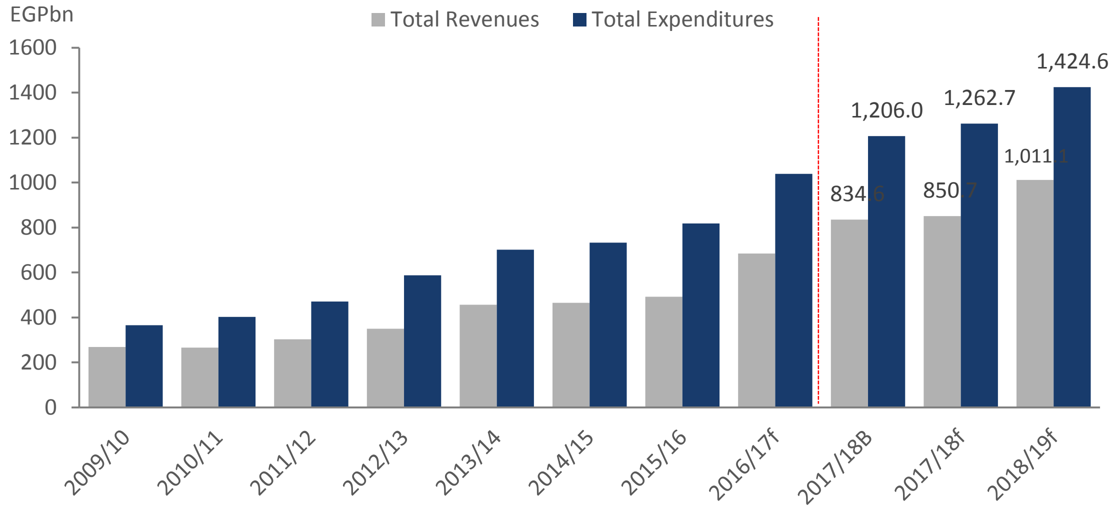
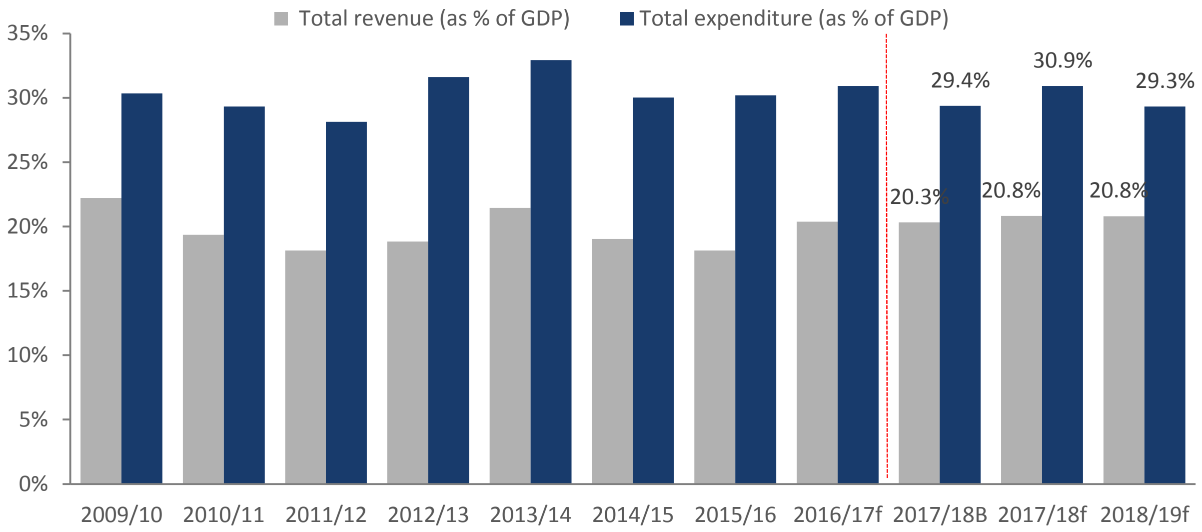
We expect the total revenue to reach EGP850.7 billion, while total expenditure will rise to EGP1262.7 billion in FY2017/18



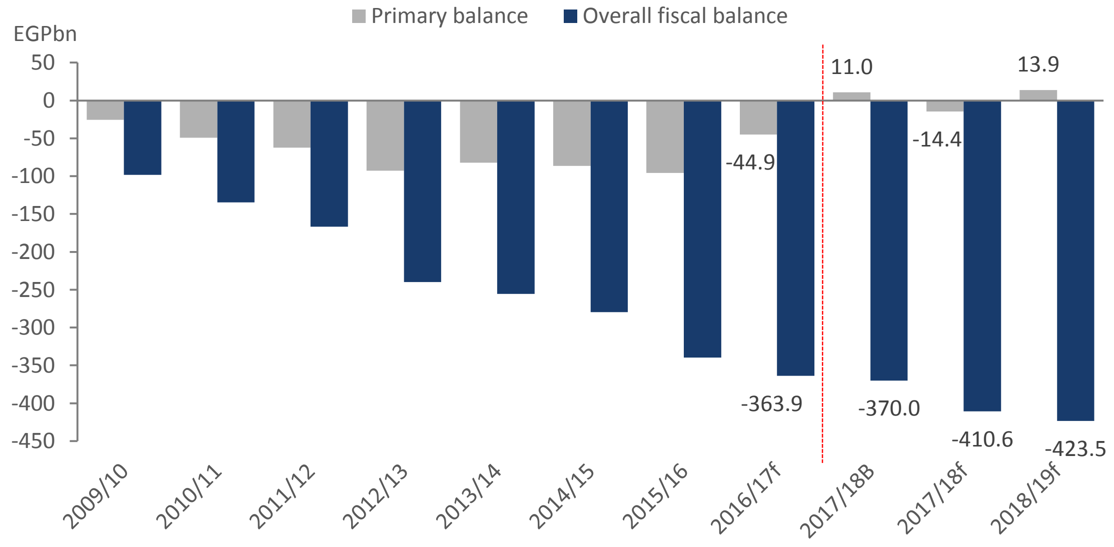
Source: Ministry of Finance, Pharos research

As a percent of GDP, the total revenue will grow to 20.8%, while the total expenditure will record 30.9% in FY2017/18



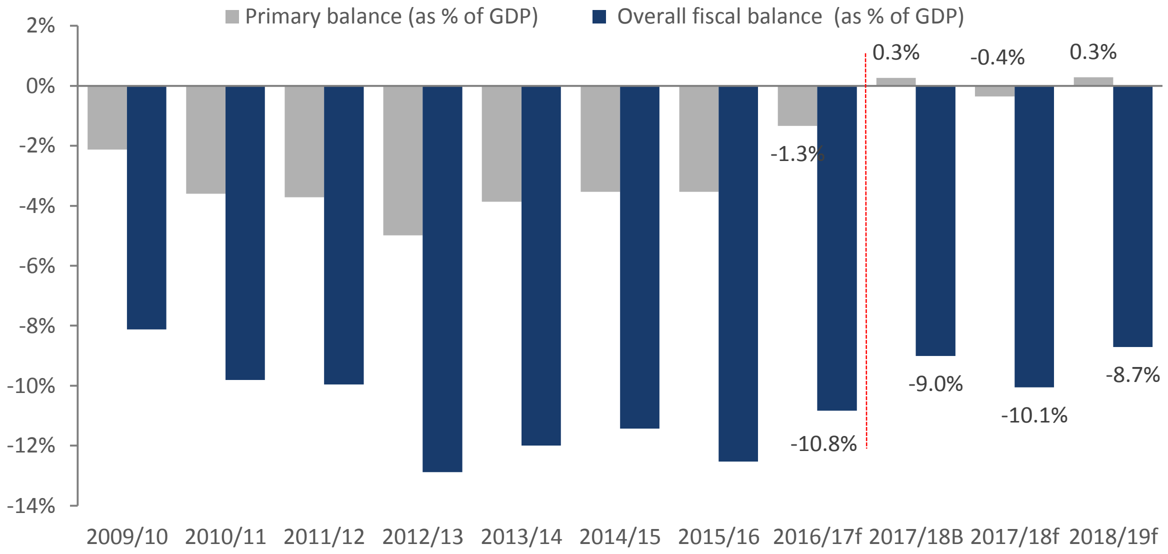
Source: Ministry of Finance, Pharos research

We estimate the primary deficit to shrink to EGP14.4 billion as the overall budget deficit rises to EGP410.6 billion in FY2017/18



Source: Ministry of Finance, Pharos research

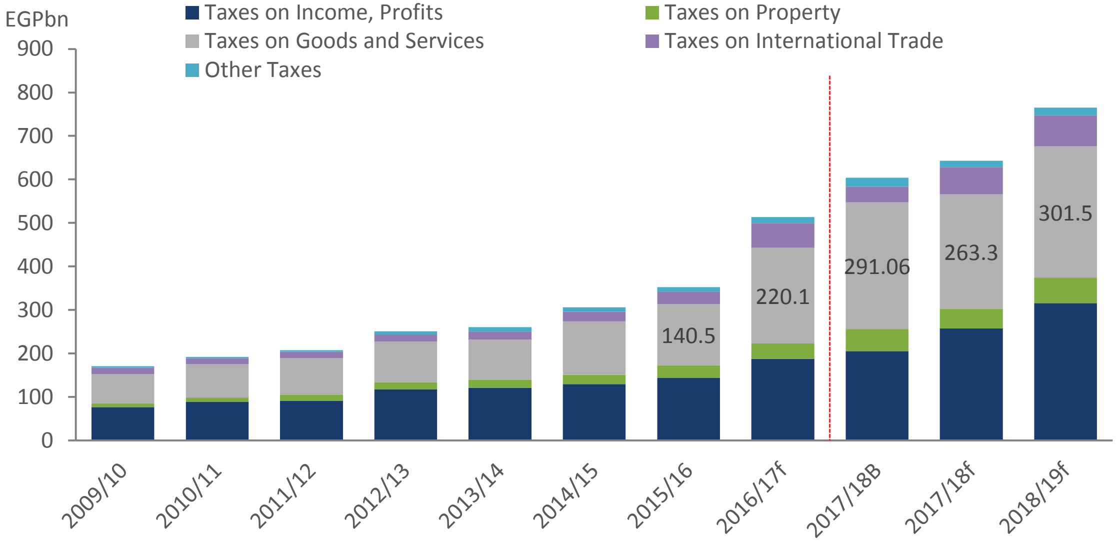
We forecast the primary deficit to record 0.4% of GDP as the overall budget deficit slides slightly to 10.1% of GDP in FY2017/18. This is above the government target of 9% in the draft budget.



Source: Ministry of Finance, Pharos research

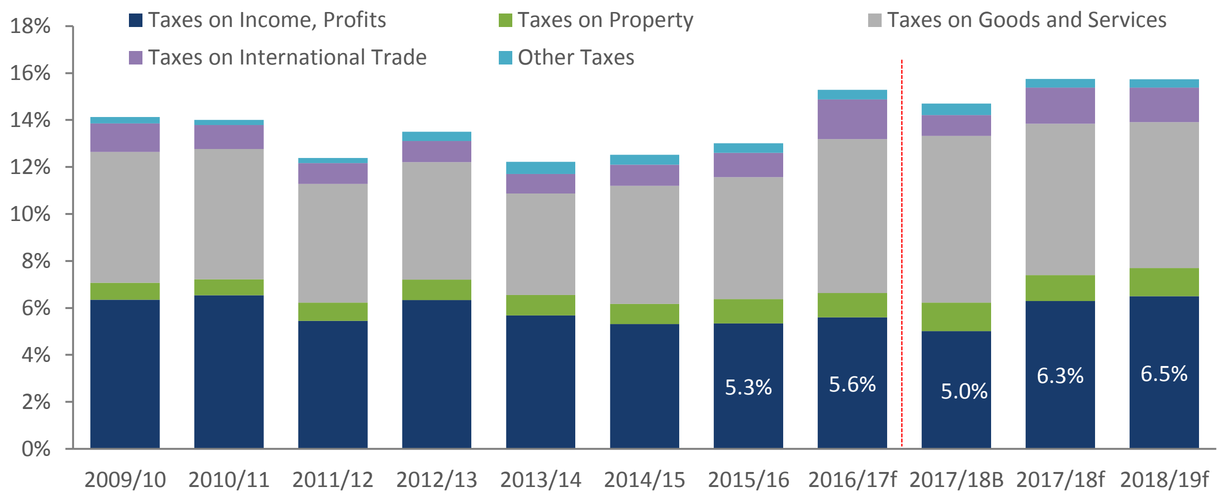
Revenue| Generating more revenue does not require further tax rate hike

The implementation of the VAT will continue to pay off in FY2017/18 as taxes on goods and services revenue rises to EGP263.3 billion versus EGP220.1 billion in FY2016/17



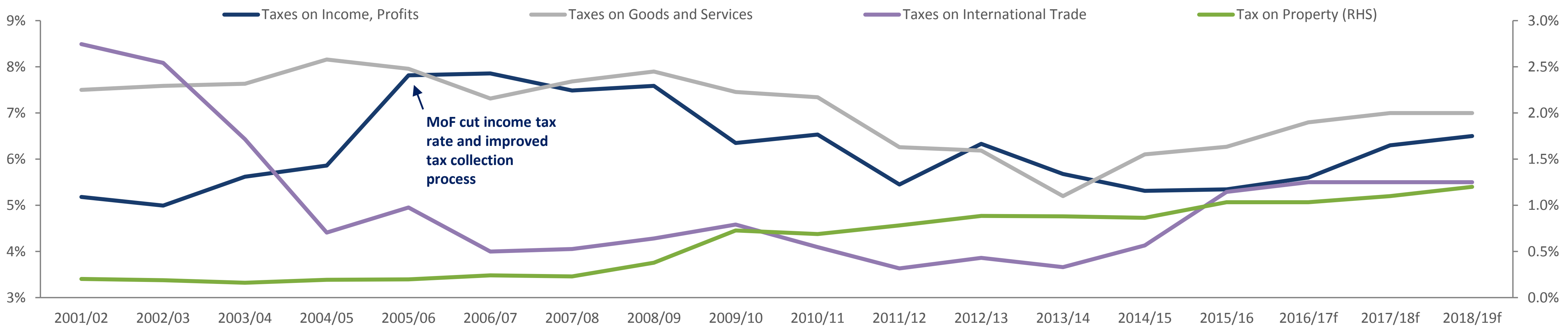
Source: Ministry of Finance, Pharos research

We estimate the income tax revenue to rise to 6.3% of GDP in FY2017/18 as the economic activity picks up, in addition to a higher contribution from EGPC due to the accelerated gas production and higher than budgeted oil price.



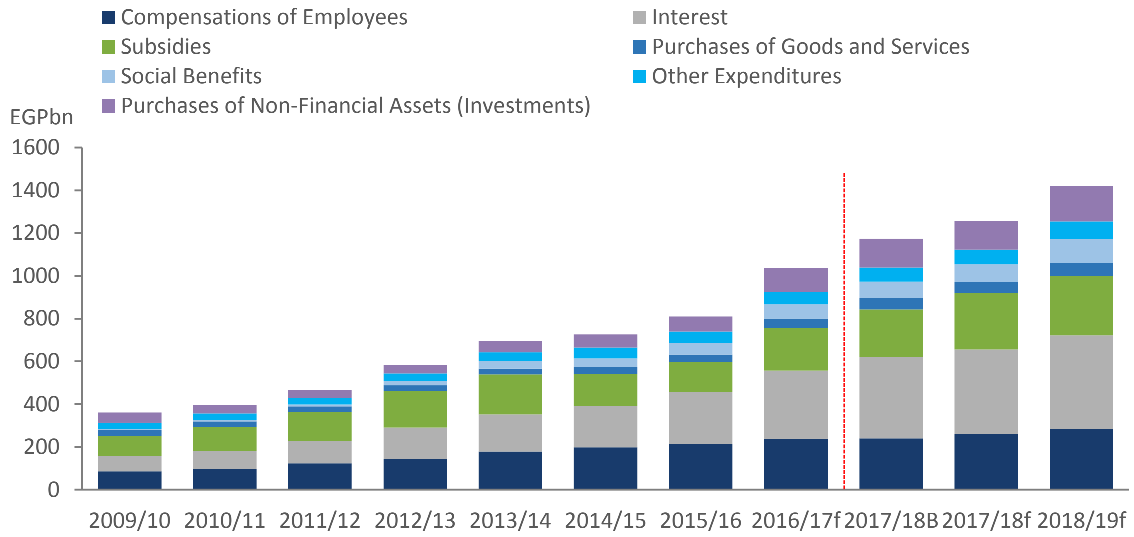
Source: Ministry of Finance, Pharos research

The current low **tax effective rates** prove that the most appropriate approach to raise more revenues in the Egyptian case would be through a more efficient tax payment system, rather than tax rate hikes. For example, corporate tax payments rose from 4.1% of GDP in FY2005/06 to 6.6% of GDP in FY2006/07 in a reaction to a tax rate cut and improved tax collection procedures. Going forward, we believe that the government's recently announced tax/custom system reforms will take more time to deliver. Accordingly, we do not expect a significant increase in the effective tax rates.



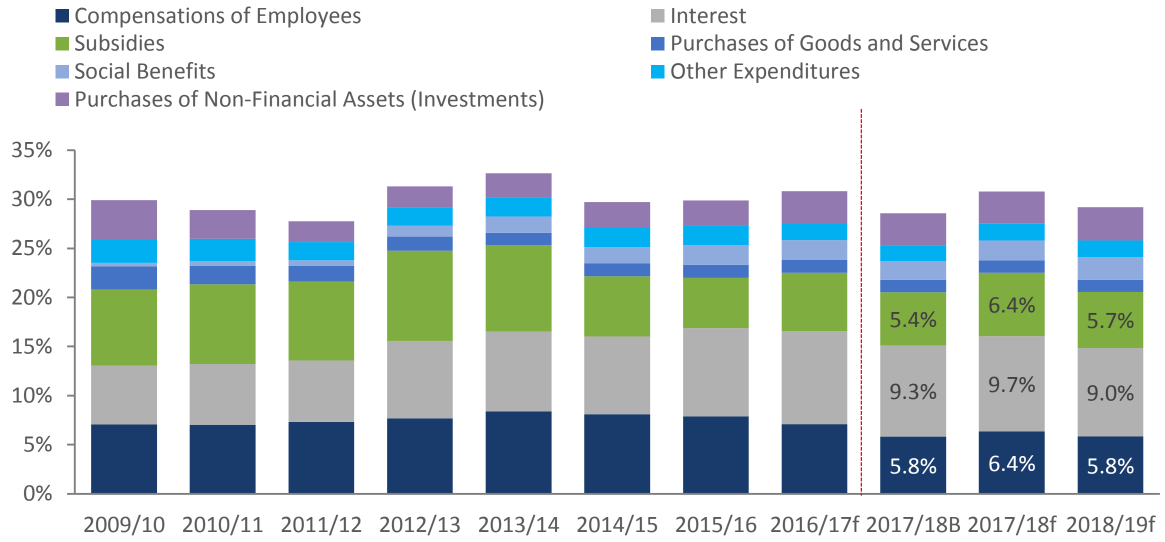
Source: Ministry of Finance, Pharos research

Public wages, subsides and interest payments continue to squeeze any room for the required capital expenditure increase to shore up Egypt's infrastructure and raise productivity



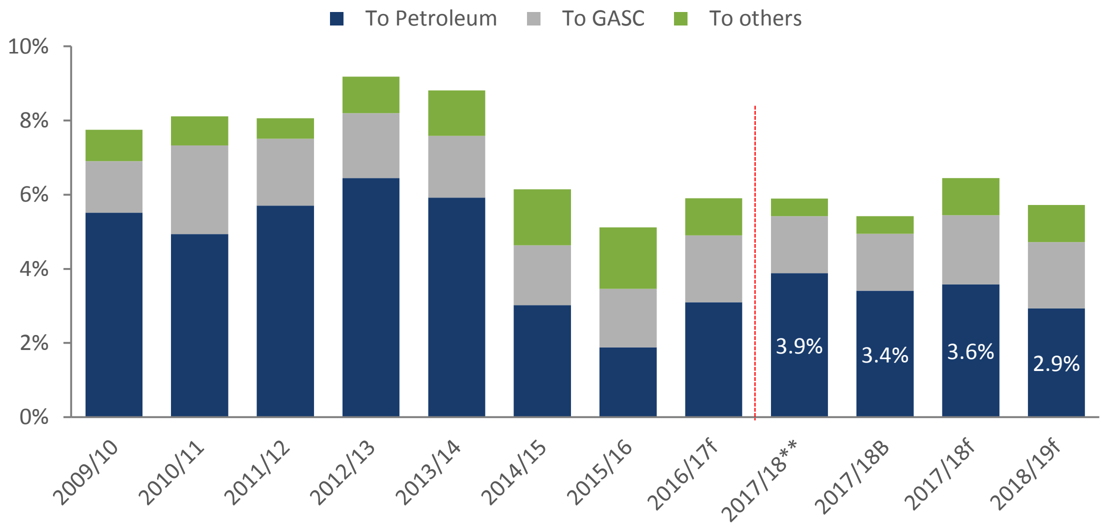
Source: Ministry of Finance, Pharos research

We expect the government's economic reform program to keep the current expenditure in check (as % of GDP), albeit we forecast higher expenditure than estimated in the draft budget



Source: Ministry of Finance, Pharos research

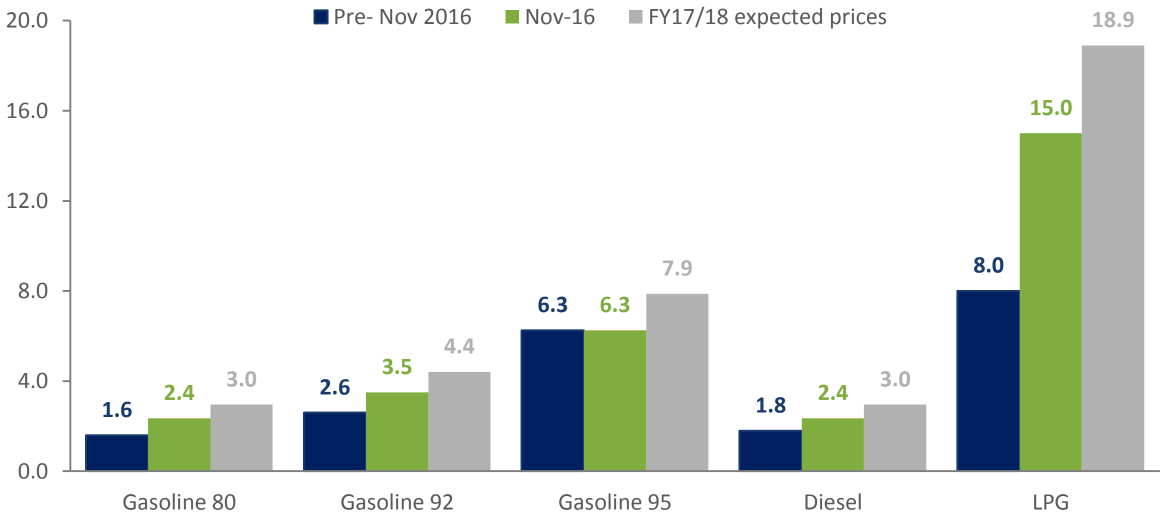
We estimate petroleum subsidies to be cut by c. EGP26 billion in order to remain within the targeted amount of EGP145 billion in FY2017/18



FY2017/18** implies no fuel subsidy cut

Source: Ministry of Finance, Pharos research

Assuming that the fuel subsidy cut will be according to fuel products' consumption, we see gasoline 92 price rising to c. EGP4.4 per litre in FY2017/18. However, this remains sensitive to the timing of the decision among other various factors



Source: Ministry of Finance, Pharos research

Budget forecast

PHAROS

EGP billion	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17f	2017/18B	2017/18f	2018/19f
Total Expenditures	351.5	366.0	401.9	471.0	588.2	701.5	733.4	817.8	1038.5	1206.0	1262.7	1424.6
Compensations of Employees	76.1	85.4	96.3	122.8	143.0	178.6	198.5	213.7	238.3	239.6	259.6	284.2
Purchases of Goods and Services	25.1	28.1	26.1	26.8	26.7	27.2	31.3	35.7	44.4	51.6	52.6	60.6
Interest	52.8	72.3	85.1	104.4	147.0	173.2	193.0	243.6	319.0	381.0	396.2	437.4
Subsidies, Grants and Social Benefits	127.0	103.0	123.1	150.2	197.1	228.6	198.6	201.0	268.8	332.7	350.0	394.6
Subsidies	93.8	93.6	111.2	135.0	170.8	187.7	150.2	138.7	198.3	222.7	263.4	278.0
To Petroleum	62.7	66.5	67.7	95.5	120.0	126.2	73.9	51.0	104.2	140.1	146.4	142.7
To GASC	21.1	16.8	32.7	30.3	32.6	35.5	39.4	42.7	60.5	63.1	76.1	86.6
To others	10.1	10.2	10.8	9.1	18.2	26.0	36.9	44.9	33.6	19.5	40.8	48.6
Grants	4.2	4.4	5.3	5.3	5.0	5.2	6.2	7.8	3.4	4.9	4.9	4.9
Social Benefits	28.7	4.5	6.1	9.4	20.8	35.2	41.0	53.9	67.2	77.9	81.7	111.8
Other Expenditures	27.0	28.9	31.4	30.8	35.0	41.1	50.3	54.6	57.1	65.8	69.4	82.6
Purchases of Non-Financial Assets (Investments)	43.4	48.4	39.9	35.9	39.5	52.9	61.8	69.3	110.8	135.4	134.8	165.2
Total Revenues	282.5	268.1	265.3	303.6	350.3	456.8	465.2	491.5	684.5	834.6	850.7	1011.1
Tax Revenues	163.2	170.5	192.1	207.4	251.1	260.3	306.0	352.3	513.4	603.9	643.1	764.9
Taxes on Income, Profits	79.1	76.6	89.6	91.2	117.8	120.9	129.8	144.7	188.1	205.7	257.4	315.9
Taxes on Property	3.9	8.8	9.5	13.1	16.5	18.8	21.1	28.0	34.7	50.3	44.9	58.3
Taxes on Goods and Services	62.7	67.1	76.1	84.6	92.9	91.9	122.9	140.5	220.1	291.1	263.3	301.5
Other Taxes	3.5	3.3	3.1	3.7	7.2	11.1	10.2	11.0	13.6	20.5	14.8	17.6
Other Revenues	111.3	93.3	70.9	86.1	94.0	100.6	133.8	135.6	171.1	229.6	207.5	246.2
Primary balance	-19.0	-25.7	-49.4	-62.3	-92.7	-82.3	-86.4	-95.8	-44.9	11.0	-14.4	13.9
Overall fiscal balance	-71.8	-98.0	-134.5	-166.7	-239.7	-255.4	-279.4	-339.4	-363.9	-370.0	-410.6	-423.5
Primary balance (% of GDP)	-1.8%	-2.1%	-3.6%	-3.7%	-5.0%	-3.9%	-3.5%	-3.5%	-1.3%	0.3%	-0.4%	0.3%
Overall fiscal balance (% of GDP)	-6.9%	-8.1%	-9.8%	-10.0%	-12.9%	-12.0%	-11.4%	-12.5%	-10.8%	-9.0%	-10.1%	-8.7%

Source: Ministry of Finance, Pharos research

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