Ref: EG24CRA00-02 23 August 2024

Egypt – Outlook Revised to Stable; Ratings Affirmed

Rating Action

Capital Intelligence Ratings (CI Ratings or CI) today announced that it has revised the Outlook on Egypt's Long-Term Foreign Currency Rating (LT FCR) and Long-Term Local Currency Rating (LT LCR) to Stable from Negative. At the same time, CI Ratings has affirmed the sovereign's LT FCR and LT LCR at 'B', and Short-Term (ST) FCR and ST LCR at 'B'.

Rating Rationale

The change in the outlook reflects the decline in external financing risks and improving shock absorption capacity since our last review. This is attributable to the availability of significant reform-linked financial assistance from the IMF, the World Bank (WB) and EU, and to the proceeds of the Ras Al Hikma investment agreed with the Abu Dhabi Developmental Holding Company (ADQ). These developments have largely resolved the latest foreign currency shortages in the local market, allowing the government to move to a more flexible exchange rate regime. The ratings and outlook take into consideration our assumption that the government will maintain the reform momentum and continue to operate a flexible exchange rate in the short to medium term to stabilise the economy. The latter should help reduce Egypt's vulnerability to external shocks and increase its foreign reserve buffer to provide adequate coverage of short-term external debt on a remaining maturity basis.

The ratings remain supported by the moderate level of external debt, ongoing efforts to improve data compilation and quantify the informal economy in order to tax it, and by the government's commitment to fiscal reforms aimed at putting central government debt on a declining trajectory, as well as a relatively resilient banking system.

Notwithstanding the positive developments, Egypt's ratings are constrained by considerable weaknesses in the public finances, including very high government debt and interest expense, as well as large socioeconomic vulnerabilities such as low GDP per capita and widespread poverty, in addition to high geopolitical risk factors.

Short- to intermediate-term financing risks have eased significantly since our last review, supported by the net inflow of USD24bn from the Ras Al Hikma agreement and the move to a flexible exchange regime, which diminished the divergence with the parallel market. Following the implementation of these reforms, Egypt secured from the IMF a 46-month USD8bn Extended Fund Facility (EFF) loan in March, as well as financing from the WB and EU, mainly in the form of soft long-term loans. This has contributed to restoring confidence in the Egyptian economy as evidenced by tentative signs of return of portfolio investments and declining spreads on credit default swaps (CDS) of Egyptian eurobonds from their peaks in January 2024.

The Ras Al Hikma agreement underscores the vital importance of ongoing support from GCC allies for Egypt's economy and government, in our view. This UAE investment in Ras Al Hikma – which led to FDI inflow of USD24bn and the conversion of USD11bn at the central bank of Egypt (CBE) into local currency investments in developmental projects – has helped to reduce the need to issue new debt and concurrently increase the level of foreign exchange reserves. Moreover, reform-linked financing from the IMF and the EU – estimated at USD5.1bn annually in FY25 and FY26 – is expected to partially cover the government's external funding gap. According to the IMF, the residual external funding gap is estimated to be on average USD4bn in FY25-26 and is expected to be covered through divestment proceeds.

Egypt's external strength remains moderately weak. The current account deficit is expected to have widened to 6.3% of GDP in FY24, from 1.2% in FY23, reflecting lower hydrocarbon exports in addition to declining revenues from the Suez Canal as a result of the regional spillover of the war in Gaza. CI notes that the net inflows in the capital and financial accounts offset the current account deficit in the first three quarters of FY24. As a result, the balance of payments registered a surplus of USD4.1bn (1.2% of GDP) during July 2023-March 2024. This was attributable to an increase in net FDI to USD23.7 (supported by the Ras Al Hikma proceeds) and a shift in portfolio investment, with the latter registering a net inflow of USD14.6bn (4.2% of GDP) during the period. CI believes that further increases in FDI hinge on continued reform implementation, especially the maintenance of a flexible exchange rate regime and further divestments. Portfolio investments are not considered to be a stable source of external financing given their high sensitivity to risk perceptions and external shocks, including geopolitical risk factors.

Although foreign exchange reserves increased to USD46.4bn in June 2024, compared to USD34.8bn in June 2023, their coverage of short-term external debt is projected to improve to a still low 81.2% in FY25 (or 97.1% excluding relatively stable deposits of GCC member states at the CBE and including foreign holdings of domestic debt). External debt continues to be viewed as moderate at an expected 169% of CARs in FY25. Around 84.6% of external debt is long term (by original maturity), which we continue to view as a supporting factor for the ratings.

Risks to the external outlook remain significant and stem from lower than projected current account receipts, given the continued weakness of the hydrocarbon sector and high geopolitical uncertainties. Other risks arise from potential renewed outflow of portfolio investments triggered by an increase in risk perceptions and/or significant and premature easing of local monetary policy. Moreover, CI views that continued reform implementation and maintaining a flexible exchange rate are crucial in reducing the country’s vulnerability to external shocks, partially mitigating external financing risks, and securing the disbursement of future IMF EFF and EU financial assistance.

Fiscal strength is low given the very high debt and the government’s limited fiscal leeway to shield the budget from the impact of domestic and external shocks. The central government budget deficit narrowed to 3.6% of GDP in FY24, compared to 6.1% in FY23. This is attributable to improved tax collection, gradual reversal of subsidies, as well as an increase in privatisation proceeds that offset the increase in interest expense. The central government primary budget surplus increased to 6.1% of GDP in FY24, from 1.5% in FY23. Excluding the revenues from Ras Al Hikma, the budget deficit would have widened to 8.2% of GDP in FY24 and the primary surplus would have declined to 2.5%. Moving forward, the government is expected to increase fuel prices and adjust government tariffs, especially electricity to offset spending pressures, as part of its fiscal consolidation measures. As a result, the central government budget deficit is expected to average 6.5% of GDP in FY25-26.

The ratio of central government debt to GDP is expected to have declined slightly to 98% in FY24, from 98.8% in FY23, and is projected to fall to 85.3% of GDP in FY25, reflecting continued primary budget surpluses and the partial use of divestment proceeds – especially Ras Al Hikma – to reduce the debt. Moreover, the authorities have started to shift from issuing short-term debt to medium-term note issuances in order to increase the average time to maturity of the domestic debt portfolio. This was evidenced by the recent issuance of EGP1bn 2-year treasury notes and EGP5bn 3-year treasury notes. Interest expense is however also very high, and is estimated at 69.9% of revenues in FY25. Liquidity risks are partially mitigated by the willingness of the country’s relatively liquid banks to purchase sovereign debt, in addition to the availability of external support from international organisations.

Although CI sees the government’s commitment to structural and fiscal reforms as being a supporting factor for the ratings, implementation risks persist and stem from the impact of fiscal consolidation and a flexible exchange rate on inflation, interest rates and socioeconomic vulnerability. A reversal of or even a slowdown in reform implementation could jeopardise the timely disbursement of financial assistance from international sources and dampen investor sentiment, leading to outflows of portfolio investments.

Economic strength remains moderate, with real GDP growth decelerating to 3.0% in FY24, compared to 3.7% in FY23. This is attributable to the impact of very high inflation and tight monetary policy on domestic consumption, as well as the impact of geopolitical risks and weak exporting sectors on net exports. Moving forward, the economy is expected to recover, growing by an average of 4.4% in FY25-26, fuelled by foreign investment and recovering domestic demand in line with decelerating inflationary pressures. We expect CPI inflation to remain above the CBE’s target of 7% in the short to medium term, however it is projected to decelerate to an average of 25.7% in FY25 and 13.1% in FY26, assuming relative stability in the exchange rates and absence of significant external shocks.

The Egyptian banking sector continues to weather the challenges in the operating environment, with the risk having declined slightly following the easing of foreign currency shortages and tentative signs of economic stability. However, a significant contingent credit risk comes from the high level of government securities held by most banks (31.2% of total assets in March). The aggregate capital adequacy ratio of banks declined to 18.1% in March 2024, compared to 18.6% in December 2023, while NPLs declined to 3% of gross loans. It should be noted however that the capital ratios of all Egyptian banks are boosted by the zero-weighting of the usually substantial holdings of government securities.

Rating Dynamics: Upside Scenario

The Outlook could be revised to Positive in a year's time if Egypt manages to lower its external financing risks and vulnerability to external shocks significantly by building up a higher than currently projected level of foreign exchange reserves, supported by a credible exchange rate regime and stronger than projected FDI from the planned sale of government assets. The ratings could be upgraded if the government implements durable fiscal reforms that reduce central government debt and interest expense at a faster than projected pace. The ratings could also be upgraded if the government reduces socioeconomic imbalances sustainably and addresses the significant weaknesses in the local private sector.

Rating Dynamics: Downside Scenario

Conversely, the outlook could be revised to negative in the next 12 months should the government reverse key reforms, including the flexible exchange regime, thereby jeopardising future disbursements of financial assistance and leading to a reduced capacity to absorb external shocks. The ratings could be lowered in the event of a substantial increase in external financing risks as a result of the materialisation of geopolitical risk factors, new bouts of external shocks and/or a significant decline in the level of foreign exchange reserves. The ratings could also be lowered in the event of unexpected increases in central government debt or debt service, triggering higher financing risks.

Credit Ratings

Foreign Currency		Local Currency		Outlook	
LT	ST	LT	ST	FC	LC
B	B	B	B	Stable	Stable

Contact

Primary Analyst: Dina Ennab, Sovereign Analyst; E-mail: dina.ennab@ciratings.com
Committee Chairperson: Morris Helal, Senior Credit Analyst

About the Ratings

The credit ratings have been issued by Capital Intelligence Ratings Ltd, P.O. Box 53585, Limassol 3303, Cyprus.

The ratings, rating outlook and accompanying analysis are based on public information. This may include information obtained from one or more of the following sources: national statistical agencies, central banks, government departments or agencies, government policy documents and statements, issuer bond documentation, supranational institutions, and international financial institutions.

Other material sources include: Regional Economic Outlook issued by the IMF (April 2024)

CI considers the quality of information available on the rated entity to be satisfactory for the purposes of assigning and maintaining credit ratings, but does not audit or independently verify information published by national authorities and other official sector institutions.

The principal methodology used to determine the ratings is the Sovereign Rating Methodology dated September 2018 (see www.ciratings.com/page/rating-methodologies/sovereign-ratings). Information on rating scales and definitions, the time horizon of rating outlooks, and the definition of default can be found at www.ciratings.com/page/our-policies-procedures. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at http://cerep.esma.europa.eu

This rating action follows a scheduled periodic (semi-annual) review of the rated entity. Ratings on the entity were first released in December 1997. The ratings were last updated in February 2024. The ratings and rating outlook were disclosed to the rated entity prior to publication and were not amended following that disclosure.

The ratings have been initiated by CI. The following scheme is therefore applicable in accordance with EU regulatory guidelines.

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation:	Yes
With Access to Internal Documents:	Yes
With Access to Management:	Yes

Conditions of Use and General Limitations

The information contained in this publication including opinions, views, data, material and ratings may not be copied, distributed, altered or otherwise reproduced, in whole or in part, in any form or manner by any person except with the prior written consent of Capital Intelligence Ratings Ltd (hereinafter "CI"). All information contained herein has been obtained from sources believed to be accurate and reliable. However, because of the possibility of human or mechanical error or other factors by third parties, CI or others, the information is provided "as is" and CI and any third-party providers make no representations, guarantees or warranties whether express or implied regarding the accuracy or completeness of this information.

Without prejudice to the generality of the foregoing, CI and any third-party providers accept no responsibility or liability for any losses, errors or omissions, however caused, or for the results obtained from the use of this information. CI and any third-party providers do not accept any responsibility or liability for any damages, costs, expenses, legal fees or losses or any indirect or consequential loss or damage including, without limitation, loss of business and loss of profits, as a direct or indirect consequence of or in connection with or resulting from any use of this information.

Credit ratings and credit-related analysis issued by CI are current opinions as of the date of publication and not statements of fact. CI's credit ratings provide a relative ranking of credit risk. They do not indicate a specific probability of default over any given time period. The ratings do not address the risk of loss due to risks other than credit risk, including, but not limited to, market risk and liquidity risk. CI's ratings are not a recommendation to purchase, sell, or hold any security and do not comment as to market price or suitability of any security for a particular investor.

The information contained in this publication does not constitute investment or financial advice. As the ratings and analysis are opinions of CI they should be relied upon to a limited degree and users of this information should conduct their own risk assessment and due diligence before making any investment or other business decisions.