# egypt

## Demographics

| | |
|---|---|
| **Population:** | 86 895 099 (July 2014 est.) |
| **Population: world ranking** | 16 out of 240 countries (CIA) |
| **Life expectancy (years)** | Total population: 73.45; male: 70.82; female: 76.2 (2014 est.) |
| **Main ethnic groups** | Egyptian 99.6%, other 0.4% (2006 census) |
| **Business language** | Arabic, English, French |
| **Urban population** | 43.7% |
| **Population below national poverty line** | 25.2% (2011 est.) |

Sources: CIA, World Bank

## Geography

| | |
|---|---|
| Area in sq km | 1 001 450 |
| Area: World ranking | 30 out of 252 countries (CIA) |
| Climate | Desert; hot, dry summers with moderate winters |
| Natural resources | Petroleum, natural gas, iron ore, phosphates, manganese, limestone, gypsum, talc, asbestos, lead, rare earth elements, zinc |

Sources: CIA, World Bank

## Sovereign ratings

| | |
|---|---|
| S&P | B-/Stable |
| Fitch | B-/Stable |
| Moody's | Caa1/Negative |

Source: NKC Research

## Economy in 2013

| | | | |
|---|---|---|---|
| **Nominal GDP (US$bn)** | 270.12 | **Total government debt as % of GDP** | 93.87 |
| **Nominal GDP: World ranking** | 42 out of 188 countries (IMF) | **Total external debt as % of GDP** | 18.24 |
| **Real GDP (% y-o-y)** | 2.10 | **Consumer price inflation (average, %)** | 9.47 |
| **GDP growth: World ranking** | 123 out of 189 countries (IMF) | **Current account balance as % of GDP** | -1.60 |
| **GDP per capita (US$)** | 3,291.84 | **Equity market: Size in US$** | US$74.4bn |
| **Agriculture as % of GDP** | 14.51 | **Equity market: Listed companies** | 238 including NILEX listings |
| **Industry as % of GDP** | 39.17 | **Bond market size** | US$135bn govt bonds outstanding in the domestic market |
| **Services as % of GDP** | 46.32 | | |

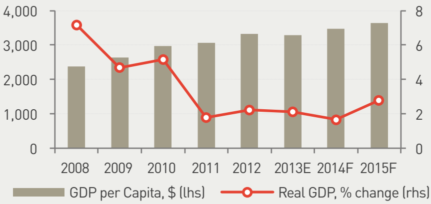
Sources: IMF, NKC Research, Bloomberg, Ministry of Finance

| Political environment | |
|---|---|
| Government type | Republic |
| Head of state | President Abdel Fattah Al-Sisi |
| Head of government | Prime Minister Ibrahim Mehleb |
| Ruling political party | None (parliamentary elections to be held) |
| Main opposition parties | Karama Party, Al-Nour, Strong Egypt, Al-Wafd |
| Elections | Presidential held in May 2014, legislative to be held before end 2014 |

Source: NKC Research

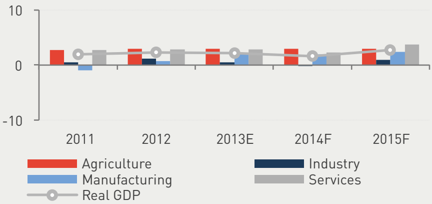
## Economic outlook

### GDP per capita vs real GDP




Source: NKC Research

### Real GDP by sector (% change pa at factor costs)




Source: NKC Research

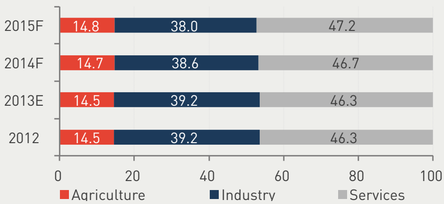
The Egyptian economy is well diversified, covering sub-sectors as diverse as hydrocarbons, manufacturing, tourism, financial services, and construction. In addition, the Suez Canal and remittances are important sources of foreign exchange earnings.

Political uncertainty has, however, put all these activities at risk. The government maintains significant involvement in the economy, with official figures asserting that the public sector accounts for 39% of GDP. The state's involvement is particularly large in a few sectors, such as oil and gas (where the Egyptian General Petroleum Company dominates the sector), water, electricity, the Suez Canal, financial services, insurance and social security. The government also has a notable share of between 25% and 35% in the transport, information and communications sectors.

In contrast, the agricultural, manufacturing, retail trade and tourism sectors are the strongholds for the private sector. Egypt has a large, inefficient and underpaid civil service and the size of the public sector needs to be reduced in order to improve the competitiveness of the economy. Unfortunately, social pressures have meant that the public sector has increased in size since the revolution, rather than decreased. According to the African Development Bank (AfDB), Egypt has more state-owned enterprises (SOEs) than the average for developing countries, with many of these SOEs being overstaffed and underequipped. The military also holds a substantial stake in SOEs, though not much is publicly known about the extent or productivity of these military holdings.

**Note:** In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

## GDP by sector (% of GDP)




Source: NKC Research

Over the past three fiscal years (FYs, July - June), real GDP growth has averaged only 2% per annum due to political turmoil since 2011. During the most recent FY (2012/13), real GDP expanded by 2.1%. As in the previous two FYs, GDP growth in the 2012/13 FY was driven by consumption expenditure: real private consumption rose by 2.8%, and real government consumption grew by 3.5%. Meanwhile, real investment contracted by 9.6%.

## International trade

Egypt's current account deficit narrowed significantly last year – from US$10.7 billion in 2012 to US$3.3 billion in 2013. Most of this improvement is attributable to foreign grants to the value of US$6 billion received from Arab Gulf governments after the military coup in July 2013, which led to the current transfers surplus increasing from US$19.8 billion in 2012 to US$24 billion last year. The other main contributor to the narrowing current account deficit was a 7.8% drop in imports from US$59.9 billion to US$55.3 billion. This was partly because Egypt struggled with severe foreign exchange shortages, especially during the first half of the year, which made it difficult to import goods. The aid received since July last year has eased these forex shortages and has helped to shore up the value of the currency, which in turn has had a positive impact on Egypt's ability to import goods.

Nevertheless, imports were kept low by Gulf aid in the form of petroleum products. Export earnings increased by 8.3% in 2013 – from US$23.2 billion to US$25.1 billion. This was due to a notable increase in crude oil exports – from US$3.3 billion to US$6.5 billion.

This is somewhat surprising, since Egypt's crude oil production declined in 2013. The most likely cause is that fuel donations from Arab countries meant that less crude oil needed to be refined for domestic consumption, thereby freeing up crude oil for exportation. Excluding crude oil, all other exports combined declined by 6.3% in 2013. Finished goods exports, which account for 40% to 45% of total exports, declined by 5.5% in 2013. This represents a deterioration in a range of manufacturing industries.

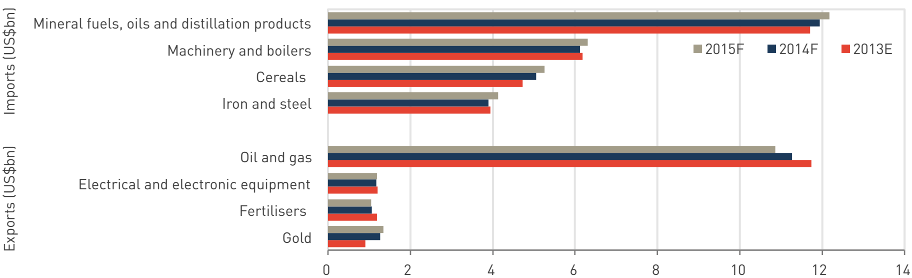
### Foreign trade flows, 2013

| Main exports | (US$ billion) | Main imports | (US$ billion) |
|---|---|---|---|
| Oil and gas | 10.94 | Mineral fuels, oils, distillation products | 12.08 |
| Gold | 1.70 | Machinery and boilers | 5.35 |
| Fertilisers | 1.20 | Cereals | 4.90 |
| Electrical and electronic equipment | 1.05 | Iron and steel | 4.01 |

Source: NKC Research

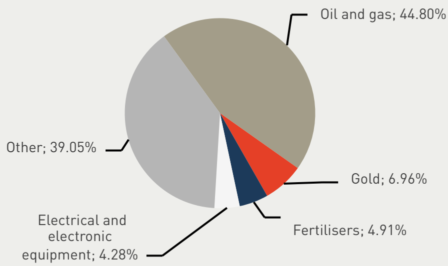
**Note:** In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

## Egypt top four exports and imports (US$ billion)



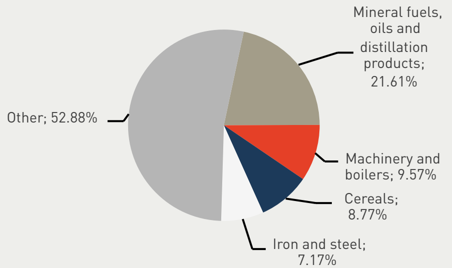

Source: NKC Research

## 2013 exports (% of total)



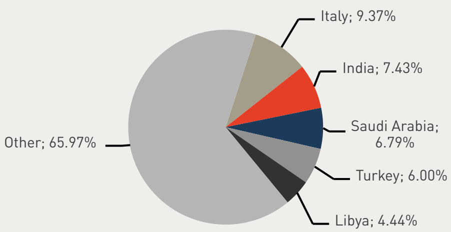

Source: NKC Research

## 2013 imports (% of total)



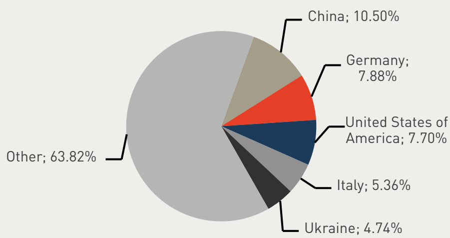

Source: NKC Research

## 2013 top destinations of exports (% of total)




Source: Trade Map

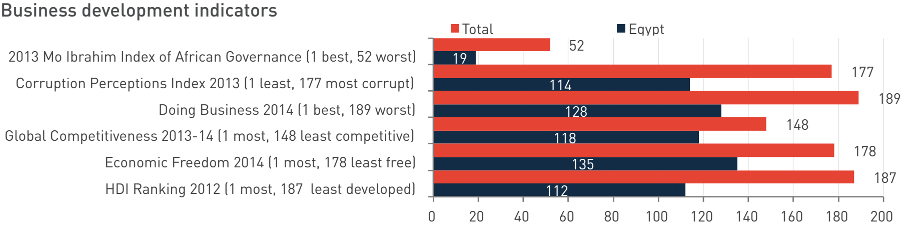
## 2013 top origins of imports (% of total)




Source: Trade Map

**Note:** In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

Business development indicators




Source: NKC Research

## Policy environment

### Monetary policy:

The Monetary Policy Committee has lowered interest rates by a cumulative 150 basis points since July 2013 in an attempt to reduce borrowing costs and stimulate economic growth. The interest rate cuts have helped to reduce borrowing costs for the government, with treasury bill and treasury bond rates falling by around four percentage points since July 2013. In turn, this has made it easier for the government to finance its fiscal deficit. However, it is not so clear whether the interest rate cut will stimulate business activity in the private sector. Although real lending rates are close to zero, private sector credit extension remains sluggish, largely due to a decline in lending to private businesses. This suggests that, despite lower interest rates, banks remain wary of lending to businesses due to the high level of risk. We expect the Central Bank of Egypt (CBE) to maintain its accommodative monetary policy stance in the near term in an attempt to boost economic growth, especially since inflation has moderated in recent months.

### Exchange rate policy:

Since early-2011, the CBE has heavily managed the Egyptian pound. However, with reserves having reached critically low levels at the end of 2012, the authorities had to allow the pound to depreciate. The pound subsequently fell from E£6.18/US$ on 30 December 2012 to E£7/US$ in June 2013. Since then, Egypt has received billions of dollars in aid, which has allowed the monetary authorities to manage the pound once again. Almost one year later, the pound has weakened only slightly to E£7.15/US$.

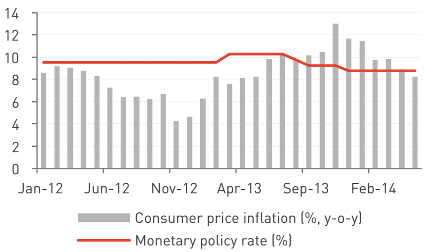
### Fiscal policy:

Egypt's budget deficit narrowed significantly over the first three quarters of the 2013/14 FY on the back of an influx of foreign aid. Over this period, the budget deficit was equivalent to roughly 7.2% of the full year's GDP. However, excluding grants, the deficit was 9.8% of GDP. Over the same period last year, the deficit equalled 9.9% of GDP including grants, and 10.1% of GDP excluding grants. In addition to monetary grants, Egypt also receives grants in the form of petroleum products from Arab Gulf countries, which has meant that the government's energy subsidy bill has declined substantially this year.

According to the Ministry of Finance, energy subsidies decreased from E£72.2 billion over the first three quarters of 2012/13 to E£49.8 billion over the same period this fiscal year. In turn, this was a major contributing factor to why total government spending increased by 'only' 10.6% y-o-y over the corresponding period.

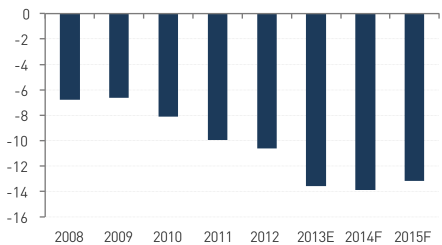
Revenues increased by 35.8% y-o-y, mainly due to the massive increase in grants. The public debt to GDP ratio declined from 94% to 90% over the first half of the FY, which illustrates how much relief the Arab aid has provided. The aid, combined with a loose monetary policy stance, has also led to a decline in treasury bill yields, which have helped to contain debt interest costs this year. Even so, debt interest payments are still equivalent to over 40% of fiscal revenues, and around 50% of revenues after excluding grants. This is extremely high by international standards and shows that structural reforms are needed to reduce the dependence on aid and borrowing. It is worth noting that, in addition to the official public debt figure, the state oil company reportedly had arrears worth US$5.7 billion at the end of March 2014, up from US$4.9 billion in December 2013, which it owed to foreign oil companies. Energy companies remain reluctant to invest in Egypt, partially due to the risk of not being paid.

**Consumer price inflation and monetary policy rate**




Source: Central Bank of Egypt

**Budget balance (% of GDP)**




Source: NKC Research

## Regulatory and tax environment:

Egypt was amongst the top global reformers in the World Bank's Doing Business surveys in the years leading up to the uprising.

However, progress has stopped since then: according to the past three surveys, Egypt has made no positive reforms, and one negative reform since 2011. Issues that are particularly challenging are dealing with construction permits (where Egypt is ranked 149th out of 189 countries in the most recent 2014 Index), enforcing contracts (ranked 156th), paying taxes (148th), resolving insolvency (146th), and protecting investors (147th). In contrast, starting a business is quite easy: it takes eight days to start a business, compared to an average of 11 in Organisation for Economic Cooperation and Development (OECD) countries, and no paid-in minimum capital is required. Nevertheless, as noted above, paying taxes is cumbersome: it takes an average of 392 hours per year for a business to pay taxes, which is more than twice as long as in OECD countries. Furthermore, the total tax rate of 42.6% is slightly above that of OECD countries.

There has been a trend recently to increase tax rates in an attempt to improve the fiscal position.

Specifically, the government imposed a 10% capital gains tax on profits and dividends earned on the Egyptian Exchange; it announced an additional 5% tax on individuals and companies earning more than E£1 million per annum; and the finance minister said that a 10% property tax on rentable value above a specified minimum is set to come into effect on 1 July 2014.

## Political environment

In May 2014, Field Marshal Abdel Fattah Al-Sisi was elected president in a landslide, with just under 97% of the vote. The election re-establishes legitimate rule in Egypt after the chaotic 11-month period that followed the ouster of Egypt's previous elected president, Mohammed Moursi, and the subsequent military moves to contain the Muslim Brotherhood (MB), to which Mr Moursi belongs. Mr Sisi is undoubtedly very popular, but risk remains in Egypt for various reasons. Most obvious is continued opposition by the MB, which is fuelling terrorism.

There is also opposition to Mr Sisi from liberals, who fear that he will turn into the kind of autocratic military ruler that Egypt knows too well.

**Note:** In the graphs above, E and F are the abbreviations for estimate and forecast respectively.

The new government does place some restrictions on civil liberties, but this was to be expected in the context of the threat from the MB, and most Egyptians support these restrictions.

More political risk in Egypt flows from economic issues. Problem areas are labour rights, wages, and the price of subsidised goods. For the moment, strong support from Gulf countries has allowed the government to keep the existing system in place, but it is clear that deep reforms of the subsidy system are necessary, and the implementation of these reforms will be disruptive. What actions dissidents take, and how the State then reacts, will determine exactly how disruptive.

## Economic environment

### Ratings:

Since 2011, Egypt's sovereign credit ratings have been downgraded by between five and six notches by the three major international credit ratings agencies. More recently, though, there has been a turnaround: Standard and Poor's (S&P) upgraded Egypt's rating by one notch to 'B-' in November 2013, while Fitch Ratings improved the outlook on its 'B-' rating from negative to stable in January 2014. Both S&P and Fitch attributed their decisions to strong financial support from Gulf Cooperation Council (GCC) governments.

On 5 June 2014, Fitch stated that 'there have been some positive developments on the political side – maybe we are at the low point for the ratings.' Moody's Investors Service continues to rate Egypt 'Caa1' (equivalent to 'CCC+' on S&P's rating scale) with a negative outlook.

**Key indicators to watch**

| | |
|---|---|
| **Foreign aid** | Egypt has large fiscal and external shortfalls – in fact, Egypt's fiscal metrics are looking worse than various other countries that defaulted on their debt in recent years. Thus, the continued support from Arab countries will be pivotal for Egypt to avoid financing difficulties. For now, though, Egypt has the full support of Saudi Arabia and the United Arab Emirates. |
| **Forex reserves** | A drop in foreign aid or an inability to implement reforms that lead to structural improvements in Egypt's macroeconomic balances would lead to a further drop in foreign exchange reserves, which could result in a currency crisis, and goods shortages. |
| **Economic growth** | We project that real GDP growth will average only 2.5% per annum in the 2013/14 to 2015/16 fiscal years, which is too low to ensure a sustainable decrease in unemployment. Strong growth is also needed to boost fiscal revenues. Investment is expected to remain limited due to political and economic policy uncertainty, as well as the effects of slow economic growth and high inflation on demand. |

Source: NKC Research

| Key vulnerabilities | What is the government doing to address this? |
|---|---|
| **Limited economic freedom and challenging business environment.** | Egypt was one of best reformers on the World Bank Doing Business Index in the five years prior to the uprising, but there has been a downward trend ever since. |
| **State subsidies for food and fuel make the fiscal position vulnerable to an increase in global commodity prices.** | Some fuel price increases have been announced, especially for industrial companies. Much more needs to be done to ensure fiscal sustainability. |
| **Currency risk is high due to a sharp decline in foreign exchange reserves since the uprising.** | The government is expected to continue receiving aid from Arab countries to shore up its foreign exchange reserves. |

Source: NKC Research

| Market participation | |
|---|---|
| **Foreign investors** | No restrictions exclude foreign investors from participating in Egyptian capital markets. Foreign investors are required to conduct their trading activities through a licensed member or firm approved by the local Financial Markets Authority. Withdrawals for corporations are limited to US$30 000 per day to curb currency speculation. |
| **Local investors** | The local investor base is narrow, with institutional investors having the predominant market share. Commercial banks are the largest institutional investors, while social insurance funds and the post office are the largest savings institutions in the country. |

Source: NKC Research

## Financial market

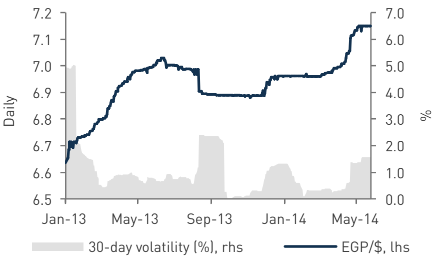
### Foreign exchange

| Security | Average size of a single transaction | Average daily turnover range | Bid/offer spread | Tenor/maturity | Quotation/ settlement | Reuters page | Additional information |
|---|---|---|---|---|---|---|---|
| Spot | N/A | N/A | 0.24 bps (average since 2012) | Liquid up to 1 year | T+2 | EGP= | Main cross is US$/EGP |
| Forwards (deliverable) | N/A | N/A | N/A | Liquid up to 1 year; 3 month most liquid | T+2 | - | Main benchmark is US$/EGP |

Source: Reuters

## Exchange rate

### Egyptian pound




Source: Reuters

With the external position having weakened substantially since the uprising, underlying pressure on the Egyptian pound has been severe in recent years. This culminated in a sharp depreciation at the start of 2013.

Following the military coup in July 2013, Egypt received large quantities of aid, which shored up reserves and allowed the authorities to protect the currency. The pound subsequently strengthened from E£7/US$ in mid-2013 to as strong as E£6.88/US$ at the end of November 2013. After that, the pound weakened gradually to E£7.01/US$ at the start of May 2014.

However, in the run-up to the presidential election at the end of May, the pound weakened significantly to E£7.15/US$. In the two weeks since the election, the pound has remained steady at E£7.15/US$. The average rate for 2013 was E£6.87/US$, compared to E£6.07/US$ in 2012. With international reserves at only US$17.3 billion (3.1 months of import cover), the authorities' ability to keep the pound stable will depend on how much aid Egypt can secure. At present, however, support from Arab Gulf governments remains strong.

## Equities

| Stock market | Listed companies | Liquidity | Total market capitalisation | Settlement | Most liquid sector | Daily trading volume |
|---|---|---|---|---|---|---|
| Egyptian Exchange (EGX) | 238 | Liquid | US$74.4bn | T+2 | Telecoms, Construction, Financials | 269.2 million shares |

Source: Bloomberg

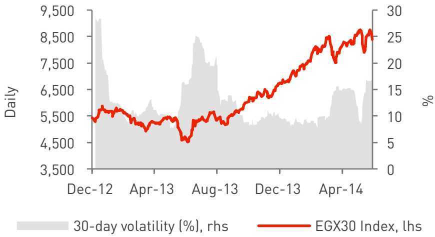
The main index of the Egyptian Exchange – the EGX30 index – has climbed significantly since the coup in July 2013. In fact, by January this year it reached its pre-uprising level of around 7,200 points. The Gulf Cooperation Council's (GCC) continued support for Egypt has buoyed investor confidence in the country. That said, aid cannot continue indefinitely. As Egypt's macroeconomic fundamentals are significantly worse than before the uprising, the rally over the past year is fragile.

Political uncertainty in Egypt is projected to continue for the foreseeable future, and should aid be significantly reduced, we will probably see large losses on the bourse. Another contributor to the rally has been the loose monetary stance, which has resulted in negative real interest rates, which means holders of cash earn an interest rate lower than the rate of rising consumer prices. This kind of policy is very positive for nominal gains in the equity market as people are forced to speculate to earn a return on their cash holdings. Since the end of May, however, the bourse has performed weaker. This follows a decision by the government to impose a 10% capital gains tax on profits and dividends earned on the Egyptian Exchange.

| Top-five listed companies | Market capitalisation |
|---|---|
| Orascom Construction | US$8.2bn |
| CIB Egypt | US$4.6bn |
| Global Telecom | US$3.9bn |
| Telecom Egypt | US$3.4bn |
| Vodafone Egypt | US$3.4bn |

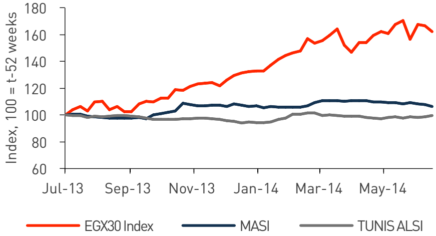
Source: Bloomberg

Egyptian exchange - EGX30




Source: Bloomberg, Reuters

North Africa SEs performance indices




Source: NKC Research, Reuters

## Fixed income

| Security | Tenor/maturity | Auction frequency | Liquidity | Quotation/ settlement | Auction participation | Bid/offer spread |
|---|---|---|---|---|---|---|
| Treasury bill | 91, 182, 259, 266, 273 and 350 day | Weekly | Good | T+1 | Licenced primary dealer | N/A |
| Treasury bonds | 2 to 25 year | Weekly or as set out in provisional auction calendar | Good | T+1 | Licenced primary dealer | N/A |

Source: CBE

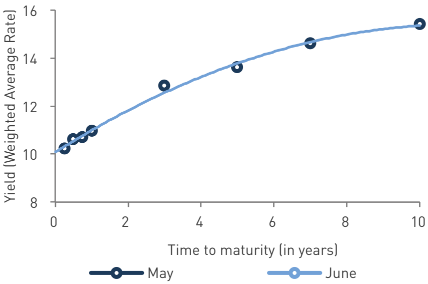
The Egyptian fixed-income market is dominated by government issuances, although corporate issuances have increase over the past few years.

Nevertheless, the market offering is relatively sophisticated, with local investors being exposed to various bond structures, such as amortising and callable structures with fixed and floating coupons. Egypt's treasury bill yields have surged since early-2011 due to a combination of factors.

These include heightened uncertainty about the political environment and the future direction of economic policy, a widening of the budget deficit (and therefore an increase in the amount of treasury bills on offer), and an increase in currency risk.

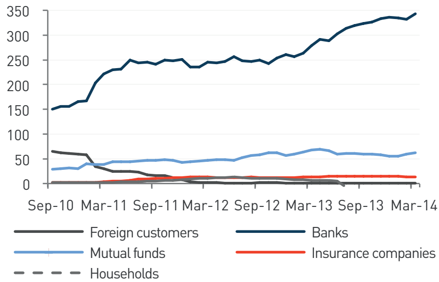
The yield on one-year local-currency treasury bills increased from 10.5% before the uprising to more than 15% at the start of July 2013. However, since that peak, yields have declined by around four percentage points owing to ample liquidity conditions at commercial banks and strong financial support from Arab Gulf countries. While at present we do not foresee a deterioration in Egypt's relationship with key allies, the longer-term outlook for Egyptian bonds is bearish due to relatively high political risk and the lack of structural economic reforms.

### Egypt (benchmark) yield curve



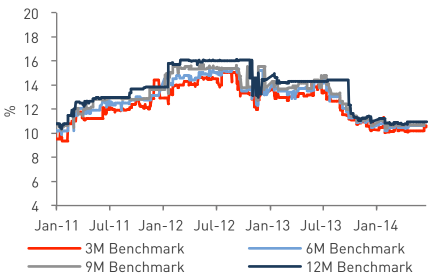

Sources: NKC Research, Reuters

### Main holders of Egyptian treasury bills (E£'bn)




Sources: CBE

### Egypt treasury bills (secondary market)




Sources: NKC Research, Reuters

Although aid pledges were instrumental in warding off a balance of payments crisis, foreign investors will remain on the side-lines while exchange rate risk remains elevated and political and policy uncertainty persists. As shown in the accompanying graph, foreign investors have yet to show much interest in holding Egyptian debt. On the other hand, local banks' holdings of treasury bills have risen substantially. This has proven a profitable source of revenue for Egyptian banks, though it has also crowded out lending to the private sector. Between December 2010 and March 2014, banks' asset portfolios have changed markedly. In particular, loans to customers as a percentage of total assets declined from 35.7% to 31.7%, while the share of securities and investments to the government increased from 34.4% to 44.1%. Clearly, therefore, banks' exposure to government risk has increased, which would become a concern if Arab aid to Egypt were to stop.

## Macroeconomic data and forecasts

| Key annual economic data | 2009 | 2010 | 2011 | 2012 | 2013E | 2014F | 2015F |
|---|---|---|---|---|---|---|---|
| Real GDP (% change) | 4.67 | 5.15 | 1.78 | 2.23 | 2.10 | 1.65 | 2.77 |
| Nominal GDP (US$bn, calendar years) | 202.67 | 232.57 | 243.70 | 269.04 | 270.12 | 289.71 | 307.92 |
| Consumer price inflation (average, %) | 11.76 | 11.27 | 10.05 | 7.12 | 9.47 | 10.90 | 10.26 |
| Budget balance, incl grants (% of GDP) | -6.62 | -8.11 | -9.96 | -10.62 | -13.57 | -13.90 | -13.19 |
| - Revenue (% of GDP) | 27.11 | 22.22 | 19.35 | 19.27 | 19.98 | 21.20 | 20.24 |
| - Expenditure (% of GDP) | 33.73 | 30.33 | 29.31 | 29.89 | 33.55 | 35.10 | 33.43 |
| Government debt (% of GDP) | 80.99 | 79.39 | 82.34 | 83.17 | 93.87 | 99.77 | 103.18 |
| Current account balance (% of GDP) | -1.65 | -2.41 | -3.24 | -3.64 | -1.60 | -2.81 | -3.10 |
| Trade balance (% of GDP) | -11.09 | -11.90 | -11.71 | -13.36 | -11.65 | -11.48 | -11.19 |
| EGP/US$ | 5.54 | 5.62 | 5.93 | 6.07 | 6.87 | 7.10 | 7.53 |
| Short-term interest rate (%) | 11.98 | 11.01 | 11.03 | 12.00 | 12.29 | 11.73 | 12.00 |
| Foreign reserves (US$bn) | 32.25 | 33.61 | 14.92 | 11.63 | 13.61 | 13.21 | 13.14 |
| Months of import cover | 7.78 | 7.28 | 3.40 | 2.61 | 3.12 | 3.02 | 2.99 |

Source: NKC Research

| Key monthly indicators | End-10 | End-11 | End-12 | End-13 | Mar-14 | Apr-14 | May-14 |
|---|---|---|---|---|---|---|---|
| Consumer price inflation (%, y-o-y) | 10.28 | 9.55 | 4.66 | 11.66 | 9.81 | 8.87 | 8.24 |
| Monetary policy rate (discount rate, %) | 8.50 | 9.50 | 9.50 | 8.75 | 8.75 | 8.75 | 8.75 |
| Foreign reserves (US$bn) | 36.00 | 18.12 | 15.01 | 17.03 | 17.41 | 17.49 | 17.28 |
| 91-day treasury bill rate (%, eop) | 9.50 | 12.90 | 13.35 | 10.30 | 10.35 | 10.20 | 10.22 |
| EGP/US$ (eop) | 5.80 | 6.03 | 6.35 | 6.95 | 6.97 | 7.01 | 7.15 |
| Brent crude (US$/barrel, eop) | 80.29 | 109.2 | 111.6 | 110.5 | 106.4 | 109.0 | 110.0 |

Sources: NKC Research, CBE, Reuters

**Note:** In the table above, E and F are the abbreviations for estimate and forecast respectively.