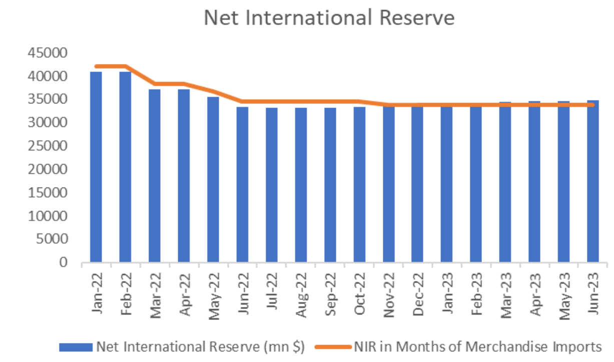
EGYPT'S ECONOMY: A TALE OF STRENGTHS AND CHALLENGES - JULY 2023

وزارة التخطيط والتنمية الاقتصادية
Ministry of Planning and Economic Development

Strengths:

1. **Net Foreign Reserves Growth:** Egypt has seen a significant increase in net foreign reserves for eleven consecutive months, reaching $34.8 billion by the end of June 2023. This growth provides the country with a buffer against external shocks and enhances confidence in its ability to meet foreign payment obligations.
2. **Purchasing Managers' Index (PMI) Improvement:** The PMI, a key indicator of economic activity in the manufacturing sector, reached its highest level in 22 months in June 2023. This improvement was driven by increased production and new orders, suggesting a potential recovery in local demand and economic activity.
3. **Relatively Low Business Activity Decline:** The report indicates that the decrease in business activity levels was the lowest since December 2021, indicating signs of a relative recovery in domestic demand.
4. **Government Response:** To alleviate the current FX shortages and reduce the pressure on external imbalances, the government announced that it will put on hold infrastructure projects worth a combined 247 billion EGP which will consequently lower imports related to the aforementioned projects .
5. **The Net Foreign Direct Investments (FDI) Growth:** FDI increased by 52%, reaching $2.4 billion in In Q2 FY 22/23, up from $1.6 billion in the corresponding quarter in the previous year. The increase is driven by a 10% increase in the total inflows in Egypt, which reached $ 5.8 billion in Q2 FY 22/23, compared to $ 5.3 billion in the same quarter in the previous year. Furthermore, total outflows declined by 9%, reaching $3.4 billion, compared to $3.7 billion in Q2 FY 21/22.
6. **Foreign Currency Deposits Growth:** Different monetary indicators revealed the tendency of market agents to save more in response to the tightening cycle taken by the Central Bank since March 2022. A tendency to favor foreign currency deposits to save value has been detected through that increase in the the share of foreign currency deposits to total deposits, which jumped from 14.78% in May 2022 to about 21.08% in may 2023 .its worth noting that the largest contributor to the aforementioned increase in the foreign deposits is time and saving deposits by the household sector .Further more we predict that foreign deposits will continue its upward trend after NBE and Banque Misr issue 3-year USD CDs with 7% and 9% annual yields .
7. **Improvement in The Trade Deficit:** The trade deficit contacted by US$ 10.0 billion to hit US$ 23.6 billion in July/March of FY 2022/2023; which was mostly due to the improvement in the non-oil trade deficit by US$ 12.4 billion recording US$ 25.2 billion down from US$ 37.7 billion in the same period in the previous FY , driven by the decline in the non-oil merchandise imports by 22 % recording $44.5 billion down from US$ 57.1 billion in the same period in the previous FY. The reduction was primarily observed in the imports of passenger vehicles, spare parts and accessories for cars and tractors, and telephones.



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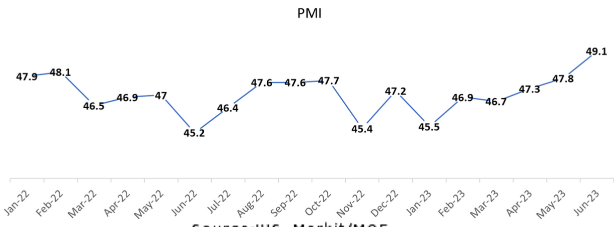

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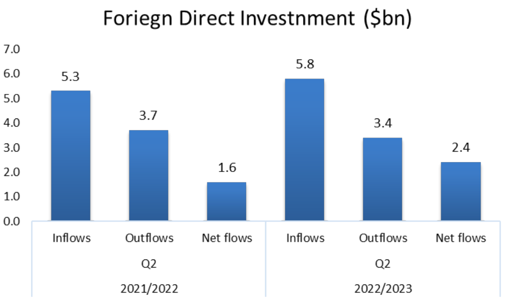

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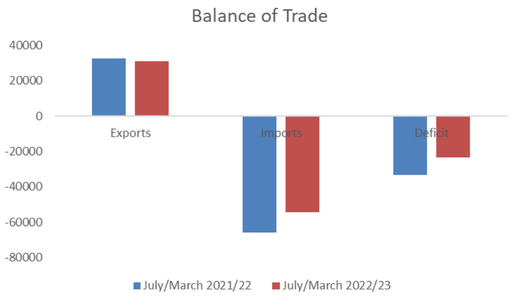

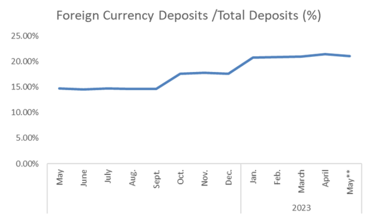

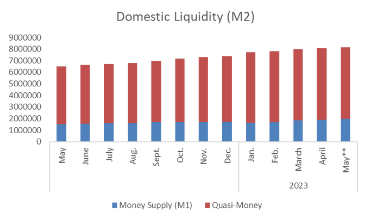

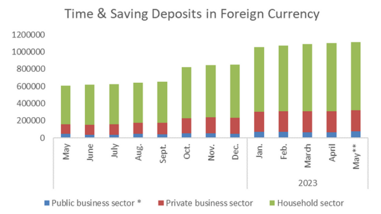

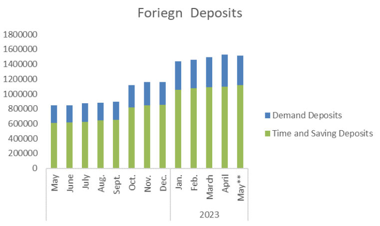

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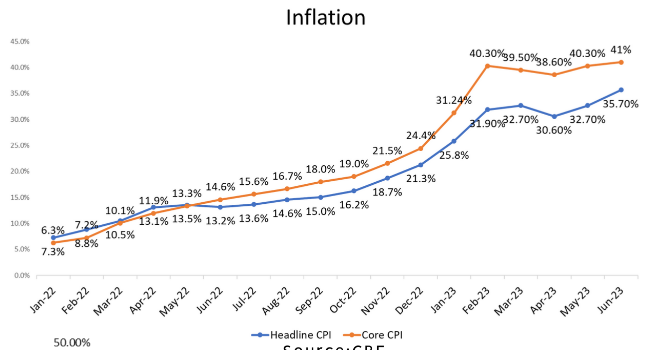
Challenges:

1. **High Inflation:** Egypt is experiencing a surge in inflation, with urban inflation reaching a record 35.7% in June 2023. The rise in food and beverage costs is a major contributor. The high inflation rates may erode purchasing power, impact consumer spending, and create challenges for businesses in managing costs.
2. **High Core Inflation:** Core inflation, which excludes food and energy prices, is also surging, reaching 41% in June 2023. This indicates that inflationary pressures are widespread beyond just temporary factors like seasonal food price hikes.
3. **Declining Export Orders:** The sharp decline in new export orders by -11% monthly and -12% annually in June 2023 indicates challenges in the global market for Egyptian goods and services. This could impact export revenues and the trade balance.
4. **Global Manufacturing Conditions Deterioration:** The weakening global manufacturing conditions could hamper Egypt's export-oriented industries and their competitiveness in international markets.
5. **High Reliance on Imports:** Egypt's net international reserves cover approximately 4.5 months of imported goods and 3.8 months of imported goods and services. This highlights the country's reliance on imports and potential vulnerability to external disruptions in trade.
6. **Reduced Purchasing Activity:** Non-oil private businesses cutting down their purchasing activity and decreasing input stocks suggest a cautious approach amid economic uncertainties. A slowdown in business investment could hamper growth prospects.
7. **Slower Output Price Increase:** The slower pace of output price increase compared to May indicates challenges in passing on higher input costs to consumers, which could squeeze profit margins for businesses.
8. **Domestic Credit Available for The Private Sector is Relatively Low:** the largest portion of the domestic credit is allocated to the government and public business sector representing around 60% of the domestic credit , on the other hand , net claims on private business sector accounts for only 22% of total domestic credit .
9. **The Inverted Yield Curve and Negative Bond Spreads in The Egyptian Government Bond Market:** Which suggest caution and heightened risk aversion among investors. The speculative credit rating, high CDS quotation, and implied probability of default add further concerns. As Egypt's economy faces challenges related to inflation, fiscal sustainability, and credit risk, investors are carefully assessing their bond investments and considering risk management strategies.
10. **Sharp Decline in Egypt's Natural Gas Exports by 75.6%:** The decline can be attributed to the the significant drop in European natural gas prices by 61.2%. Along with decline in the production and obvious hike in the domestic consumption of natural gas . Whereas, according to latest data published by CAPMAS, the production decreased from 4184.2 thousand tons in April 2022 to 3746 thousand tons in April 2023 .However, the domestic consumption increased from 3667 thousand tons to 3708 in the same period .Consequently surplus declined sharply from 517.4 thousand tons in April 2022 to 38 thousand tons in April 2023



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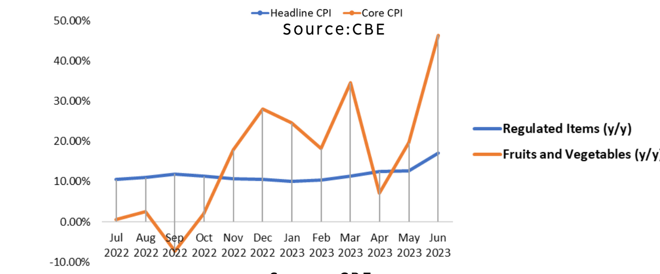

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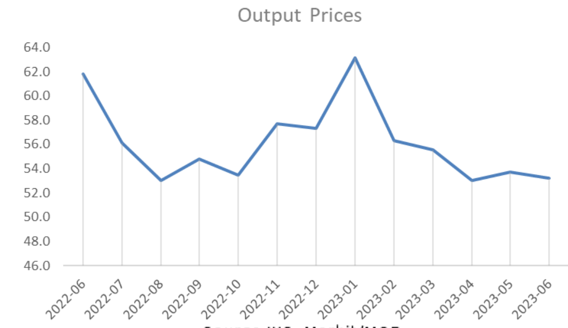

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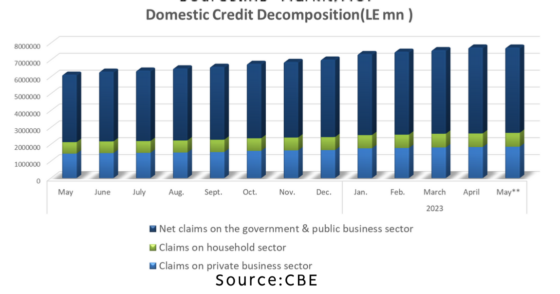

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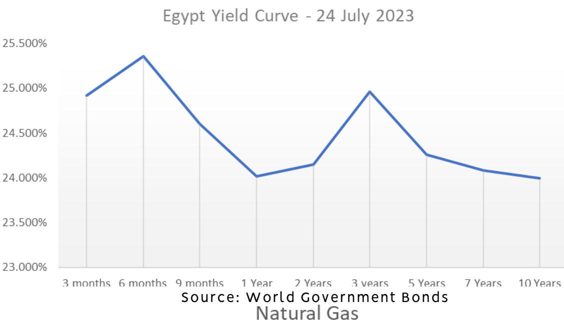
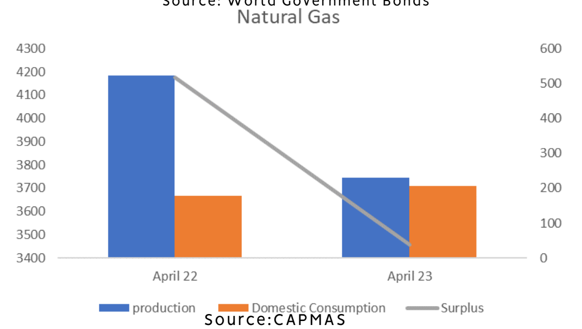


Source: World Government Bonds



Source:CAPMAS

Conclusion:

Egypt's economy exhibited some strengths in July 2023, particularly the growth in net foreign reserves, deposits in foreign currency and Foreign direct investments (FDI) , In addition to the improvement in the PMI, indicating a potential recovery in local demand. Along with The government's recent decisions to put on hold infrastructure projects worth 247 billion EGP is expected to help alleviate the current FX shortages and reduce the pressure on external imbalances. However, the economy faces significant challenges, primarily driven by soaring inflation rates along with the inverted yield curve and negative bond spreads in the Egyptian government bond market which highlight investors cautiousness amid economic uncertainties. The decline in export orders and weakening global manufacturing conditions, also pose risks to Egypt's external sector. This makes addressing inflationary pressures, diversifying export markets, and enhancing the country's resilience to external shocks key to foster sustainable economic growth and stability.