EGYPT | MACROECONOMIC UPDATE | BUDGET ANALYSIS | INSIGHTS

FUNDAMENTALS

EGYPT: FY24 DRAFT BUDGET
LESSENING THE INFLATION PAIN

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IN BRIEF

- The draft FY24 budget documents presented in the House of Representatives showed a much lower fiscal deficit target of 7.0% (revised FY23: 7.4%) and on course to meet the FY27 target of 5.6%.
- The higher inflationary environment, although boosting the nominal GDP has resulted in a downward revision of FY23 real GDP growth estimate by 130bps to 4.2%. For FY24, the authorities have penciled in a real GDP growth rate of 4.1%.
- The primary surplus target of 2.5% of GDP in FY24 is impressive, compared to the average 1.4% of GDP achieved in FY20 – FY22, and 70bps higher than the authorities' projections at the start of the current IMF programme. We see some downside risks on this ambitious target if FY23 in-year revision from 1.6% to 0.5% is anything to go by.
- A revised lower tax revenue-to-GDP base (from 12.1% to 11.9%) has resulted in the metric growing by 1.0pp in FY24 to 12.9%, and higher than the target 0.5% annual growth rate as per the Medium-Term Revenue Strategy. The authorities have employed both tax administrative measures and newer tax proposals to prop up tax revenue.
- The budgetary allocation to subsidies, grants and social benefits has been enhanced to EGP 529.7bn (24.3% y/y). Although food subsidy has been maintained at EGP 127.7bn, the authorities have hinted widening the target households which suggests reduced rations to the beneficiary card holders.
- The draft budget assumed an average price of brent crude at USD 80.0 per barrel (-14.9% y/y) in FY24. Nevertheless, the authorities have enhanced the fuel subsidy with a more than doubling in budgetary allocation to EGP 119.4bn, which is to cushion the most vulnerable as the government implements the retail fuel price indexation mechanism that has an upside bias.

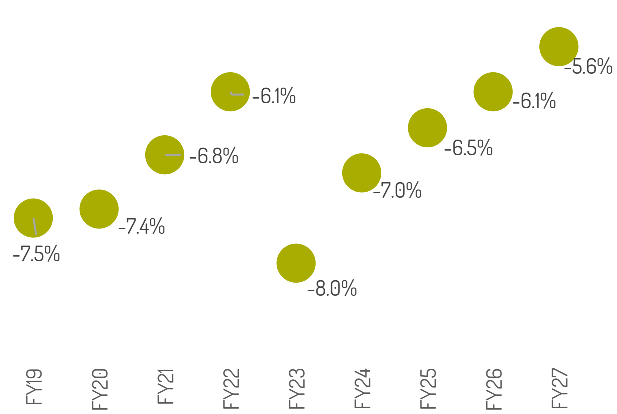
Fiscal consolidation on track; inflation cutting both ways

The draft FY24 budget documents presented in the House of Representatives by Finance Minister, Dr Mohamed Maait, on 9 May 2023 showed a much lower fiscal deficit target of 7.0% (revised FY23: 7.4%) and on course to meet the FY27 target of 5.6%. In-year budget adjustments lowered revenue estimates and increased spending lifted FY23 fiscal deficit target by 90bps from the initial 6.5%. The authorities are bullish about a much-improved primary surplus target (2.5% of GDP) in FY24, albeit driven by a sharp increase in interest payment costs.

The higher inflationary environment, although boosting the nominal GDP has seen a downward revision of FY23 real GDP growth estimate by 130bps to 4.2%. For FY24, the authorities have penciled in a growth rate of 4.1%. In absolute numbers, the authorities expect a revised nominal GDP of EGP 9.8tn in FY23 (from an initial EGP 9.1tn) and EGP 11.8tn in FY24, narrowing the fiscal deficit-to-GDP. Tax revenue-to-GDP has increased by 1.0pp to 12.9% with the projected FY24 tax revenue rising by EGP 361.2bn (30.9% y/y). Specifically, taxes subjected to sales of goods and services are expected to rise 22.9% y/y to EGP 664.7bn, with VAT on services within the hospital sector jumping 66.4% y/y, although from a low base.

Amidst the runaway inflationary environment, the FY24 budget has enhanced its social assistance, although some of the target proposals have been in effect from April 2023. A monthly increase of 15.0% and 25.0% has been implemented on payouts of pension and "Takaful and Karama" cash transfer programmes, respectively. The minimum monthly wage of public sector workers was increased to EGP 3,500, that partly explains the 14.6% jump in the wage bill to EGP 470bn. Additionally, the income tax threshold on annual income was raised from EGP 24,000 to EGP 30,000.

FISCAL DEFICIT-TO-GDP



SOURCE: MINISTRY OF FINANCE

An improved primary surplus

The primary surplus target of 2.5% of GDP in FY24 is impressive, compared to the average 1.4% of GDP achieved in FY20 – FY22, and 70bps higher than the authorities' projections at the start of the current IMF programme. We see some downside risks on this ambitious target if FY23 in-year revision from 1.6% to 0.5% is anything to go by. Although the first IMF review has been delayed, the authorities have surpassed the IMF programme's indicative target of the primary surplus with the December 2022 outturn at EGP 25.5bn against a target of EGP 0.0bn.

That said, the sharp rise in interest payments has partly improved the primary surplus outlook. Interest payments in FY24 are projected to increase by 44.5% y/y to EGP 1.1tn, cementing it as the single largest budgetary item. The impact of the cumulative 1,000bps rate hikes by the central bank to address inflation has increased interest rates on local currency bonds with the authorities baking in an average of 18.5% interest rate on T-Bills and T-Bonds. Furthermore, the devaluation of the Egyptian Pound, EGP, in FY23 has also increased the servicing of external debt in local currency terms. Currency weakness exacerbated debt unsustainability with the debt-to-GDP ratio widening to 94.4% in FY23 from 85.3% in FY22. With expectations of further EGP weakness in FY24, this may compound the authorities target of 79.4% in FY27.

From our assessment of the draft FY24 budget documents, proceeds from privatization have been partly penciled in. Previously, the authorities had signaled privatization proceeds of USD 9.7bn and USD 12.0bn in FY23 and FY24, respectively, with 70:30 split between IPO exits and FDI. We believe the IMF would want to see some progress around privatization as a precursor to its first review of its programme's implementation. Amidst a constrained global financing environment, Egypt may face difficulties with the commercial component of the upcoming USD 7.2bn debt amortizations in FY24. Nevertheless, the authorities are bullish about raising USD 6.8bn in the next fiscal year, mainly from concessional sources.

Widening the tax bracket

A revised lower tax revenue-to-GDP base from 12.1% to 11.9% has resulted in the metric growing by 1.0pp in FY24 to 12.9%, and higher than the target 0.5% annual growth rate as per the Medium-Term Revenue Strategy. The authorities have employed both tax administrative measures and newer tax proposals to prop up tax revenue. Continued registration of free professions and forays into the digital economy are expected to widen the tax bracket. The authorities are also implementing reforms to automate tax administration to improve efficiency. The 15.0% hike in toll fee, effected on 1 January 2023, for transit across the Suez Canal is expected to improve its revenue, generating a projected 1.6x increase in corporate tax payments to EGP 103.7bn in FY24.

The FY24 budget has a rather bullish economic outlook, penciling in a 38.6% increase in taxes on income, profits, and capital gains. Taxes on employment income are expected to jump by 21.7% y/y as the authorities intend to introduce a new upper personal income tax of 27.5% on income above EGP 800k per year. Amidst a higher interest rate environment, the withholding tax on T-Bills and T-bonds are expected to be higher by 64.4% to EGP 153.5bn. The authorities have singled out restructuring economic bodies and SOEs to increase their surpluses that accrue to the public treasury.

BUDGET, EGP BN's

	Revised FY23 budget	Draft FY24 budget
Revenue [A]	**1,517.9**	**2,142.1**
Taxes	1,168.8	1,530.0
Grants	0.9	1.9
Other revenues	348.1	610.2
Expenses [B]	**2,235.9**	**2,990.9**
Wages	410.0	470.0
Purchase of goods and services	125.6	139.4
Interest payments	775.1	1,120.1
Subsidies, grants, and social benefits	426.0	529.7
Other expenses	122.7	145.1
Purchase of non-financial assets (Investments)	376.4	586.7
Cash Deficit [C] = [A] - [B]	**(718.0)**	**(848.8)**
Net possession of financial assets [D]	(5.1)	24.4
Total Deficit [E] = [C] + [D]	**(723.2)**	**(824.4)**
Net Borrowing	723.2	824.4
Net Proceeds of privatization	-	-
Primary Surplus	52.0	295.6
NOMINAL GDP	**9,092.1**	**11,841.1**
Revenue-to-GDP	16.7%	18.1%
Tax-to-GDP	12.9%	12.9%
Total Deficit-to-GDP	-8.0%	-7.0%
Primary Surplus -to-GDP	0.6%	2.5%

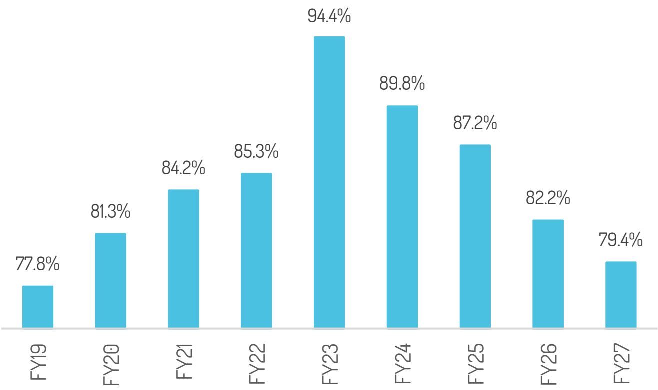
SOURCE: MINISTRY OF FINANCE

Continued targeted support to select sectors

The budgetary allocation to subsidies, grants and social benefits has been enhanced to EGP 529.7bn (24.3% y/y). Although food subsidy has been maintained at EGP 127.7bn, the authorities have hinted widening the target households which suggests reduced rations to the beneficiary card holders. The draft budget has assumed average price of wheat and brent crude at USD 340.0 (-19.8% y/y) and USD 80.0 (-14.9% y/y) in FY24. Nevertheless, the authorities have enhanced the fuel subsidy with a more than doubling in budgetary allocation to EGP 119.4bn which is to cushion the most vulnerable as the government implements the retail fuel price indexation mechanism that has an upside bias. Social housing subsidy, whether cash or utility, has also more than doubled to EGP 10.2bn.

To improve liquidity, the government has enhanced a subsidy program for exporters from EGP 6.0bn to EGP 28.5bn. Since October 2019, the government settled arrears to exporters in five instances, and the pivot towards support for export development is in line with the overarching aim of achieving annual export of USD 100bn by 2030. The government intends to ramp up investments by 55.9% to EGP 586.7bn, to boost the construction sector. Going forward, the budget sector will bear the burden of subsidizing lending to the "industrial, agricultural and construction" sectors following the commitment by the central bank to halt this programme to enhance monetary policy transmission under the IMF programme. The budgetary allocation in FY24 is EGP 12.0bn for provision of subsidized interest rate of 11.0% (825bps lower than the benchmark lending rate).

PUBLIC DEBT-TO-GDP



SOURCE: MINISTRY OF FINANCE

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