EGYPT | MACROECONOMIC UPDATE | MONETARY POLICY | INSIGHTS

FUNDAMENTALS

EGYPT MPC UPDATE: IMF’s INVISIBLE HANDS

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IN BRIEF

- The Central Bank of Egypt unexpectedly raised the overnight deposit rate by 200bps to 21.25% in its February 2024 MPC meeting. Whereas disinflation has been on course throughout 4Q2023, negative spillover from the Middle East geopolitical tensions and ongoing trade disruptions have fueled upside risks to the inflation outlook.

- Against the backdrop of the MPC meeting was the conclusion of the delayed combined first and second reviews of the USD 3.0bn Extended Fund Facility (EFF) under the current IMF programme. In line with consensus, we believe that a devaluation is imminent; an event that will precede the formal approval of the combined reviews by the IMF Executive Board.

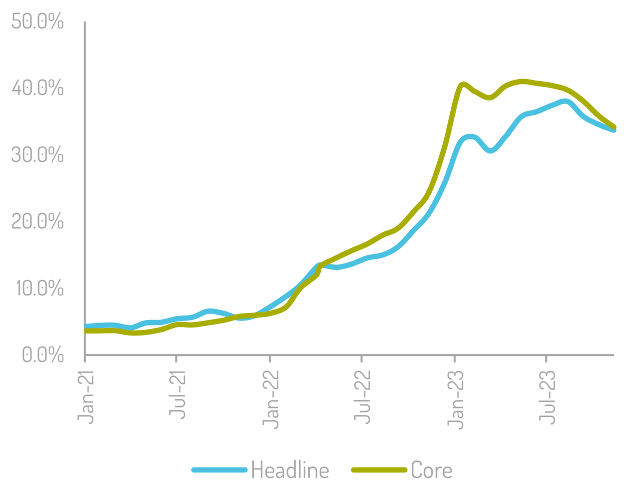
- As of Thursday's close, the market penciled in a 34.2% downward adjustment on the Egyptian pound based on the 1-month non-deliverable forwards. As was the case post November 2016 devaluation, and 2022-2023 devaluation episodes, it is becoming clearer that devaluation by itself is not the panacea. This point suggests that the imminent IMF deal will lay emphasis on greater Egyptian pound flexibility going forward to restore market confidence.

- From media reports, Egypt is to upsize the current IMF programme to USD 10.0bn. The IMF Managing Director was tight-lipped with details in her media roundtable late yesterday, but we think an IMF deal will be finalized in the coming week. In our view, we believe this will comprise an augmentation of the current EFF financing and some tapping of the Resilience and Sustainability Facility (RSF) which Egypt was equally eyeing.

Upward inflation surprise sways unexpected hawkish stance…

The Central Bank of Egypt unexpectedly raised the overnight deposit rate by 200bps to 21.25% in its February 2024 MPC meeting. Whereas disinflation has been on course throughout 4Q2023, negative spillover from the Middle East geopolitical tensions and ongoing trade disruptions have fueled upside risks to the inflation outlook. Against the backdrop of the MPC meeting was the conclusion of the delayed combined first and second reviews of the USD 3.0bn Extended Fund Facility (EFF) under the current IMF programme. In line with consensus, we believe that a devaluation is imminent; an event that will precede the formal approval of the combined reviews by the IMF Executive Board. In our view, the MPC was caught between a rock and a hard place as a devaluation will further de-anchor inflation outlook. Nevertheless, with inflation outturn elevated above the mid-point target of 7.0%, the triggering of the Monetary Policy Consultation Clause nudged the policymakers towards its unexpected hawkish decision.

INFLATION TREND

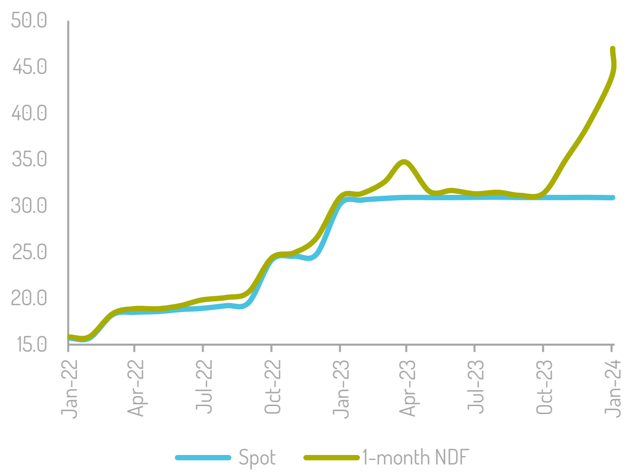


SOURCE: STATS SA, BLOOMBERG

…but is it really inflation-tackling, or largely to return the FX genie back to the bottle?

We believe the base effects will sustain the disinflation momentum despite the lingering geopolitical tensions and trade disruptions in the Red Sea. Although the MPC statement indicated that "elevated broad money growth running above its historical average further contributed to existing inflationary pressures", we note that M2 growth trended lower from 31.2% y/y in January 2023 to 19.9% y/y in December 2023. The December inflation print came in at 33.7%, pulled down by core inflation sub-index, and on cooling M2 growth. This notwithstanding, fruits and vegetables, and food excluding fruits and vegetables continued giving inflation legs with prints of 78.7% y/y and 62.2% y/y, respectively. We are of the view that the ongoing trade disruptions in the Red Sea, and the upcoming cyclical Ramadan period will tip the inflation cart to the upside in the near-term, more so through food sub-components. Furthermore, a devaluation, which is increasingly becoming a question of when and not if, will fuel inflationary pressures. As of Thursday's close, the market penciled in a 34.2% downward adjustment on the Egyptian pound based on the 1-month non-deliverable forwards. As was the case post November 2016 devaluation, and 2022-2023 devaluation episodes, it is becoming clearer that devaluation by itself is not the panacea. This point suggests that the imminent IMF deal will lay emphasis on greater Egyptian pound flexibility going forward to restore market confidence.

EGYPTIAN SPOT & 1-MONTH NDF



SOURCE: BLOOMBERG

Completion of the delayed reviews; a positive

Refreshingly, we liked the progress with the completion of the delayed combined first and second reviews that were initially targeted for March 2023 and June 2023, respectively. Notably, the targeted primary surplus, floor on tax revenue and social spending were all achieved as of March 2023 and June 2023. Recent comments from the fiscal authorities suggest that state entities will implement capex cuts of 15.0% for the remainder of the FY24 budget year, suggesting a contractionary Supplementary budget is in the works as part of the reforms. The targeted FY24 current account deficit at the start of the IMF programme of -3.0% of GDP was positively surpassed with an outturn of -1.2% of GDP. Notwithstanding the improved progression of the external sector at the end of 2023, the trade balance sector looks grim on expectations of lower Suez Canal receipts. Despite close to 15.0% of Suez transit fees implemented effected mid last month, the authorities have reported a preliminary dip of 44.0% y/y in Suez Canal revenue in January 2024.

Upsizing of the IMF programme to USD 10.0bn is possible, but with tapping of RSF

From media reports, Egypt is to upsize the current IMF programme to USD 10.0bn. As EFF-financed programmes usually run for a maximum of 48 months, we bake in the current sunset month of September 2026 for the upsized IMF programme. The IMF Managing Director was tight-lipped with details in her media roundtable late yesterday, but we think an IMF deal will be finalized in the coming week. In our view, we believe this will comprise an augmentation of the current EFF financing and some tapping of the Resilience and Sustainability Facility (RSF) which Egypt was equally eyeing. As the starting point for RSF determination is 75% quota, we estimate that Egypt can unlock USD 2.0bn under this facility. As for the current EFF facility, an augmentation of USD 4.8bn assuming full disbursement throughout this year will be within the 200.0% and 600.0% annual and cumulative limit access, respectively. With estimated USD 5.3bn and USD 4.7bn repayment obligations to the IMF over 2024 and 2025, respectively, we see scope of an augmentation with front-loaded disbursement features.

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