Egypt
Investors Required

Overview

Beset with a worsening hard currency shortage which has seen the country's FX reserves plunge from US$36 bio in early 2011 to US$16.53 bio (Feb 2016) and the black market USD/EGP exchange rate hit a high of 9.8000 earlier this year, the Egyptian authorities finally took the step many analysts (including ourselves) had been predicting for months and devalued their domestic currency by 14.4% from 7.7301 to 8.8500 against the US dollar, at a special auction yesterday during which the Central Bank also sold US$198 mio to the local banks.

Tough Times

Egypt's economy has suffered a severe downturn since the 2011 revolution as foreign investors and tourists deserted the country due to the subsequent social instability. Financial support from the GCC and the election of President Sisi last year has somewhat steadied the political environment for now, but there is a desperate need for job creation, and to re-attract both investment inflows and tourism receipts in order for this stability to be maintained and expanded. Yesterday's aggressive downward adjustment in the value of the pound, combined with a promise to implement a new exchange rate regime, is a step in the right direction, as it removes the "not if but when ?" concern investors had over devaluation, makes Egypt's exports more attractive, gives a boost to its stagnant but extremely important tourism industry (despite ongoing security concerns), and could also be a precursor to the resumption of loan talks with the IMF who have been calling on Egypt to introduce a series of economic reforms, including a more flexible FX policy. The domestic equity market was the first to display a positive reaction to yesterday's move with the main EGX 30 index jumping to its highest level this year immediately following the announcement, while local banks were reportedly showing a reasonably tight bid/offer spot price of 8.9000/8.9500 in the interbank market. Interestingly we are also hearing that some onshore banks will be allowed to offer investors looking to purchase local T-bills the ability to hedge their currency risk via options.

What Next ?

While we still await details on when a new FX regime will be implemented and how it will be structured, a further decline in the value of the pound is likely, although this would probably be managed and limited, especially as the currency is now much closer to what is considered to be "fair value." In the meantime the weaker exchange rate will hopefully ease pressure on Egypt's FX reserves but will also feed into inflation, and while most consumer goods have been priced at the higher black market rate for some time, we expect the Central Bank will try to pre-empt the effect of this by hiking its benchmark rate by 100-150bp at the next MPC meeting which is due to take place on the 17th of March.

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Conclusion

While Egypt will continue to face major headwinds on both the economic and political fronts, we believe this latest development is a positive one. The government has also promised to move forward with other key structural reforms especially in the area of taxation and subsidies, such as the expansion of the Takafol and Karama programs (which would help the very poor and at the same time reduce the overall subsidy bill) as well as the introduction of a flat VAT rate of 10%. If genuine progress is made in all these areas then foreign investors will feel more comfortable looking again at this country which still offers plenty of opportunities, not just in its equity and fixed income markets but also in longer-term direct investment.

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