

## Market Insights & Strategy

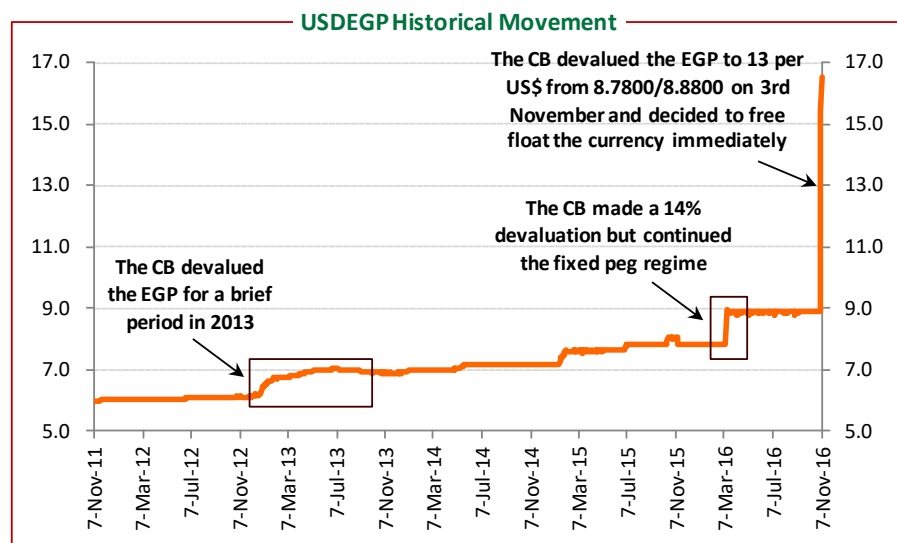
### Global Markets

## Egyptian Pound Is Finally Unshackled

As we suggested could happen in our special write up on Egypt which was published on the 1st of November 2016, the country's Central Bank Governor, Tarek Amer, announced just two days later that the local currency will indeed be allowed to float.

The switch from peg to float was undertaken via four stages;

- (1) An immediate devaluation of the official USD/EGP pegged exchange rate from 8.7800/8.8800 to 13.0000.
- (2) Local banks were then permitted to trade the pair within a +/- 10% band around 13.0000 ahead of a special auction that same day.
- (3) This specific auction offered US\$100 mio at 13.0000 to the banks which they could sell-on to their clients at a price the banks themselves deemed to be fair.
- (4) On Sunday the 6th of Nov the currency was then allowed to float freely within the interbank market, which would be open from 10am to 1pm (Cairo time) each trading day.



Source: Bloomberg; NBAD

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The Central Bank also hiked its benchmark deposit/lending rates by 300bp to 14.75 -15.75% respectively, in order to provide the market with some additional support following this major decision.

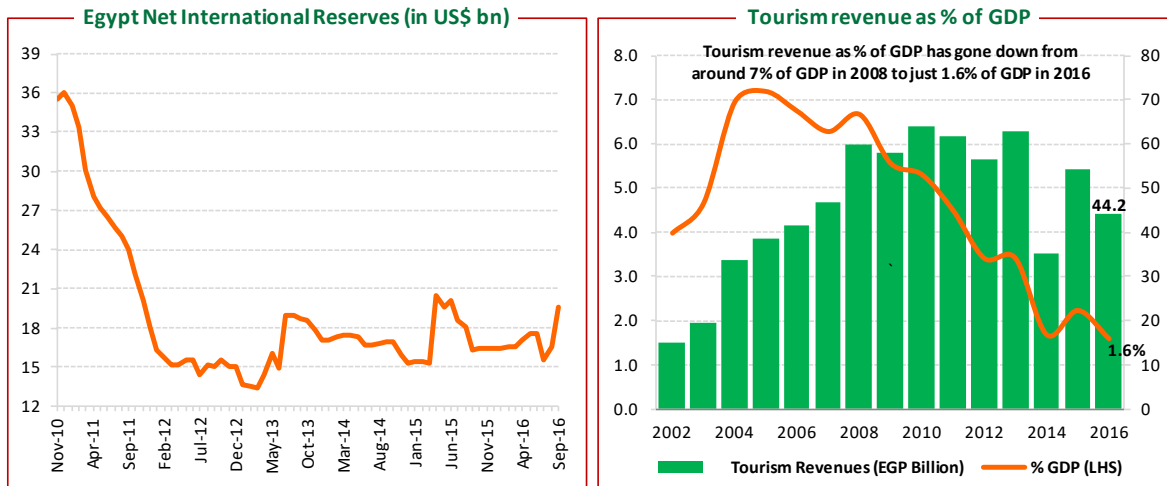
Together with their decision on the FX regime, the Egyptian authorities also acted on another sensitive issue by sharply reducing fuel subsidies, with the price of the lowest octane for example, rising by 46.8% to EGP 2.35 per litre. Until now this subsidy has been costing the government around US\$16 bio a year, and thus its partial removal will help ease pressure on the public purse.

### Why Now?

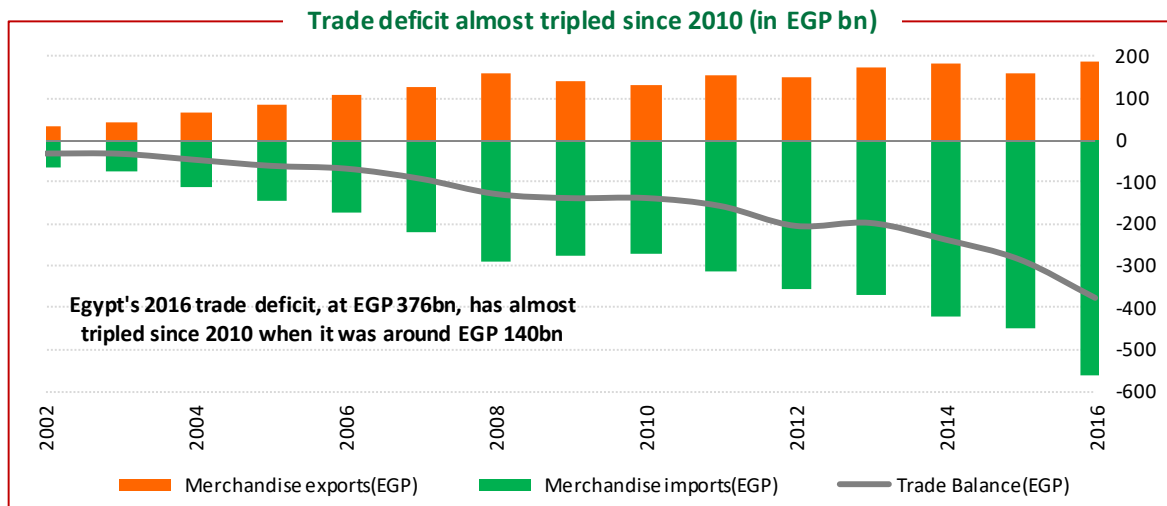
The bottom line is that they had very little choice, not only was the previous exchange rate regime unsustainable, it was constraining growth, increasing shortages, draining the country's limited FX reserves and encouraging corruption. Its replacement with a free-float was also a key step towards getting IMF sign-off on a US\$12 bio loan program.

## Benefits

Until now Egypt had been experiencing an acute shortage of hard currency due to an inflexible currency regime and various exchange controls, forcing many local businesses to shut down or purchase their FX requirements via the parallel market at an exchange rate, which at one stage reached a record low of eighteen pounds per one US dollar. The decision to float the pound, together with the lifting of a number of restrictions, and combined with the introduction of certain incentives such as a 3-year freeze on the implementation of a capital gains tax, should now make investing in Egypt less complicated and (after the obvious initial volatility), more attractive to potential offshore investors, which in turn could see the return of decent hard currency inflows. The devaluation should also provide some relief to the country's ailing but important tourism industry that is still trying to recover from the impact of last year's terror attacks.



Source: IIF; Bloomberg; NBAD



Source: IMF; NBAD

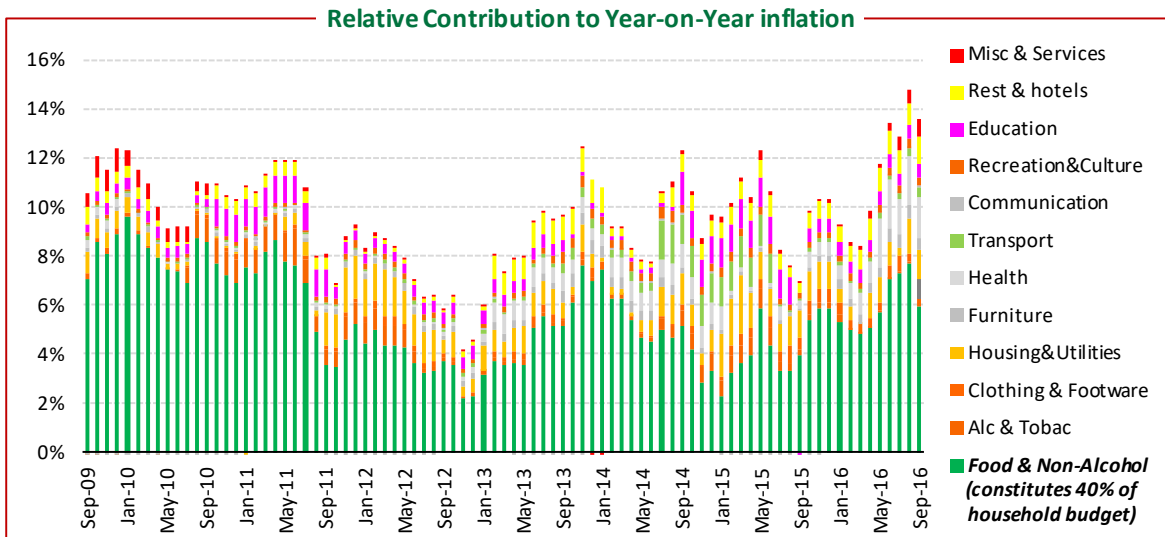
An overvalued currency also prevented the development of a proper domestic manufacturing sector, so exporters (both existing and potential) of course will be smiling, and while importers and consumers of foreign goods face hefty price rises, some of these increases had already taken place due to the limited availability of US dollars, and at least such goods will eventually be more freely available.

Most importantly of all, and as mentioned above, action on both the currency regime and fuel subsidies fulfils two more key conditions required by the IMF with regards to a US\$12 bio loan program, thus a final board sign-off by the international lender is virtually guaranteed to take place within the next 1-2 weeks.

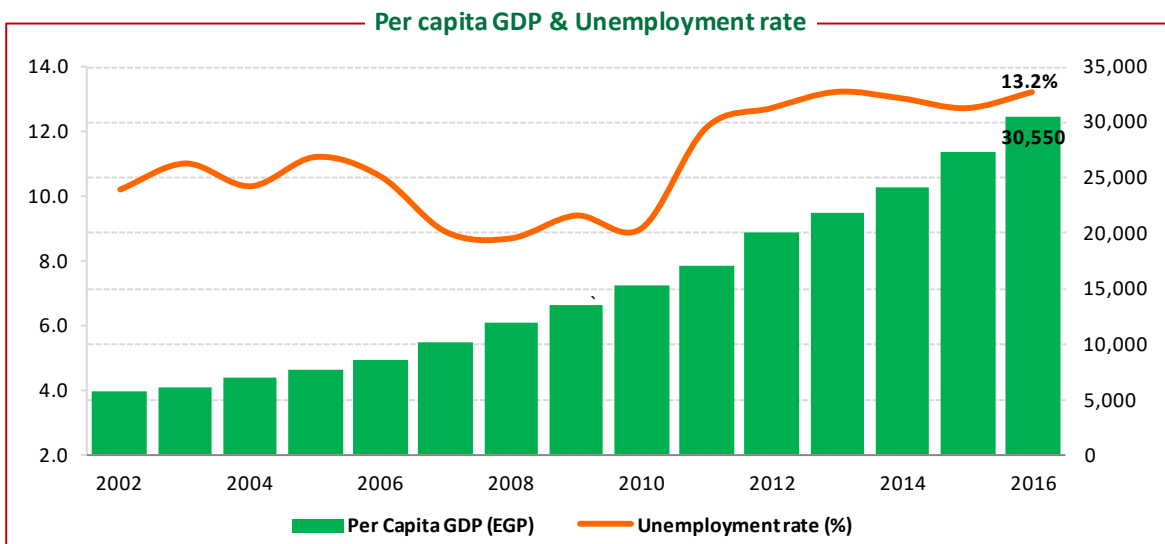
## Risks

Since coming to power, President Fattah El Sisi's government has managed to restore order and improve the country's security situation, however with the decision to float the currency and lift the fuel subsidies last week, inflation (already at 14.10%) will no doubt rise even further (perhaps as high as 20%) in the near term, this in turn raises the risk of major social upheaval.

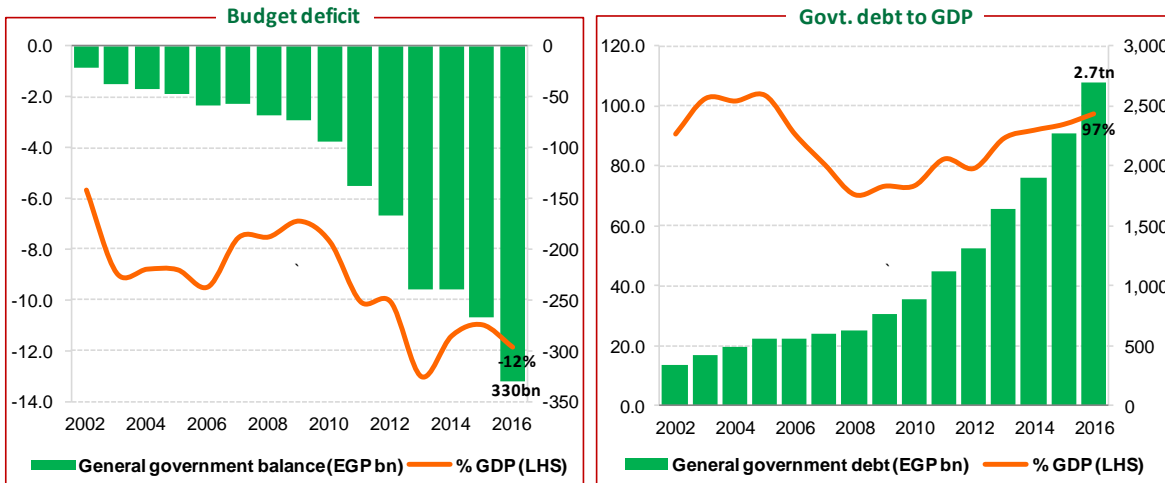
In an attempt to mitigate this (apart from the interest rate hike) the government has been storing away large reserves of essential goods in order to protect the poor from sharp price rises. Some subsidies are also expected to remain in place at least in the short-term, and will be combined with "smart" targeted welfare benefits. (The IMF has previously conceded that such support is required to avoid triggering major protests and civil unrest).



Of course a floating currency alone will never be the solution to cure Egypt's economic ills, so it's going to be extremely important that the authorities continue to implement measures aimed at improving the ease of doing business and encouraging the creation and expansion of local businesses, both small and large. Otherwise, the average Egyptian will not see any improvement in his/her life and consequently wide-scale anger could return to the streets sooner than later.



The government also needs to deal swiftly with another unrelated problem, and that is the recent disruption of its monthly supply of refined petroleum products from Saudi Arabia under a previously agreed aid program. The Egyptian Oil Minister, Tarek El Molla, confirmed yesterday that the shipments had been “halted until further notice,” which means the country will have to cover the shortfall by buying its requirements via the open market in cash, until either the reason for the suspension has been resolved or Egypt finds another benefactor.



Source: IIF; IMF; NBAD

### Market Reaction

Sunday and Monday were the first two tradable days for the local banks within this new free-float environment, and while volumes have been relatively small so far, it does appear that the pound is slowly finding its feet. USD/EGP touched 17.50 yesterday before recovering to close around 16.75. There has not been any official intervention in the market by the CB since last Thursday, and this will likely remain the case unless there are major US\$ demand pressures.

Of course banks will initially be working to reduce their back-log of client orders and this will take some time, thus the ability of offshore entities to go in and buy dollars directly onshore is still not practically possible. Meanwhile prices have re-appeared in the small offshore USD/EGP NDF market, and while the spot price is higher, the curve itself has flattened and we have begun to see some decent US\$ selling interest from offshore punters.

With the liberalization of the pound, full-convertibility should eventually mean the NDF market will be replaced by a deliverable one; however such a development will only take place once stability and confidence in the new regime has been established. Meanwhile NDF fixings are progressing as normal as the CB continues to publish a daily fixing rate.

### Conclusion

Overall while risks remain, we consider this to be a very positive move, and the only logical path for the authorities to follow considering the situation prior to this announcement.

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