

AFRICA RISK CONSULTING

Egypt Monthly Briefing February 2017

Egypt Summary 14 February 2017

The government successfully issues a \$4 billion Eurobond, Africa's largest bond issuance. The order book exceeds \$13.5 billion, with high investor demand likely to encourage a return to the international markets in the next financial year. The International Monetary Fund (IMF) publishes targets and conditions of the \$12 billion extended fund facility (EFF). President Abdel Fattah Al-Sisi (2014-present) confirms that a cabinet reshuffle is imminent, though unlikely to affect core economic ministers.

Egypt launches Africa's largest Eurobond issuance

The finance ministry issued a \$4 billion **Eurobond**, Africa's largest bond issuance, on 25 January.¹ Strong foreign investor appetite during the preceding international marketing campaign will encourage future issues during the current financial year. The finance ministry had earlier indicated that its target was \$2 – 2.5 billion.² The government subsequently increased the total to \$4 billion as the order book for the bonds exceeded \$13.5 billion.³ The government has said that this is sufficient to bridge the 2016/2017 financing gap and a portion of the 2017/2018 deficit.⁴ The international bond issuance was Africa's first triple tranche bond issuance. The bonds had different maturities and yields: \$1.75 billion at 6.125% for five-year notes; \$1 billion at 7.5% for 10-year notes; and \$1.25 billion at 8.5% for 30-year securities.⁵ **Egypt** had planned to launch the issue in the third quarter 2016 but was concerned about market liquidity in the region as **Saudi Arabia** launched \$17.5 billion bonds in October.

*"It took us by surprise, the appetite, given there were other options. The recent issuing of Saudi bonds – was one of the most successful issuances. It was oversubscribed seven to eight times and was the first time the Saudi government has tapped the international market. But people are worried what will happen to Saudi Arabia in five years. On the other hand, Egypt is strengthening – and partly because carry traders are anticipating that the Egyptian pound is not going to devalue more than 20 Egyptian pounds to the greenback. So they are now investing in government debt. That being said, I would go for the 5-year bond not the 30-year. I'm fascinated to know who took these up."*⁶

Analysts have cited several factors for the strong demand by portfolio investors: the relatively attractive pricing, the **International Monetary Fund's (IMF)** positive assessment of the economic reform programme under the extended fund facility (EFF) (see below), and relative global market liquidity.⁷

"The terms of the offering were good compared to what the market was offering, after the devaluation and taking the IMF loan and the structural changes they committed to including eliminating and or reducing subsidies; it's shown the economy is on the right track to improving over the long term, which has given investors renewed confidence. If you're spending more than

¹ Daily News Egypt, 27 Jan 2017.

² Daily News Egypt, 27 Jan 2017.

³ Daily News Egypt, 27 Jan 2017.

⁴ www.almasryalyoum.com

⁵ Daily News Egypt, 27 Jan 2017.

⁶ Source, investment banker, Cairo

⁷ Enterprise, 27 Jan 2017.

you're making then you have to bridge the gap, you try to decrease costs, to bring in more dollars. The fact they held the sale and that it was so oversubscribed says investors are interested in Egypt.”⁸

Banks and investment companies acquired 92% of the issuance, with hedge and pension funds acquiring the remainder.⁹ Investor distribution was balanced between investors in **North America** (50%), **Europe** (40%), and **Middle East** and **Asian** investors (10%).¹⁰ The issue was arranged by lead manager **France**-based **BNP Paribas** and **Natixis SA**, and **United States (US)**-based **JPMorgan Chase & Co** and **Citigroup Inc**, and the bonds will be listed on the **Luxembourg Stock Exchange (LSE)**.¹¹ At the time of writing, the bonds are hovering around \$100, close to the offering price.¹²

“Generally, it shows that investors are betting on the recovery of Egypt and that's why it got oversubscribed.”¹³

Due to the level of investor demand, finance minister **Amr el-Garhy** said the government is considering issuing **Japanese** yen-denominated samurai bonds and **Chinese** yuan-denominated panda bonds.¹⁴ Local media quoted anonymous finance ministry officials as saying that the ministry had approached the **Japanese Bank for International Cooperation (JBIC)** to guarantee yen-denominated bonds.¹⁵

*“Overall, tapping into international markets is good, and the appetite is encouraging. More issuance is the way to go, because until now Egypt is not leveraged: it's only around 20% of gross domestic product. This combined with oil and gas deregulating is a good move. Relying on bilateral support hasn't worked, they simply can't do it anymore. Talking about returning to the market, I would say in the form of **Islamic** bonds – based on assets, so as to comply with sharia laws that ban interest. With sovereign local funds, you have a huge potential market. This would be the smart thing for government to do. But if I was a betting man I wouldn't bet on the ministry of finance to do the smart thing.”¹⁶*

Garhy said it is too early to determine when Egypt might next access the external debt market, or how much it would seek to borrow.¹⁷ Deputy finance minister **Ahmed Kouchouk** subsequently said on 30 January that the government will not issue another international bond this financial year.¹⁸

“In terms of returning to the market they might not again soon, it's going to be on a need basis when they need to raise funds they'll resort to market, there aren't any definite plans to my knowledge so far.”¹⁹

However, domestic and regional political considerations mean the government's macroeconomic policy remains hard to predict.

“The government needs to bridge the deficit and that will probably be done through more debt if they can't attract dollars into the economy. If inflow of foreign investments don't pick up as well as tourism and remittances from Egyptians living abroad we are in trouble. It's hard to say what the government will do going forward. Especially with Saudi Arabia out of the picture and the IMF reforms are not easy, especially the subsidies reform.”²⁰

⁸ Source, second investment banker, Cairo

⁹ www.alborsanews.com

¹⁰ Enterprise, 27 Jan 2017.

¹¹ Daily News Egypt, 27 Jan 2017.

¹² Enterprise, 31 Jan 2017.

¹³ Source, merger and acquisition specialist, Cairo

¹⁴ Mubasher, 29 Jan 2017.

¹⁵ Al Borsa, 29 Jan 2017.

¹⁶ Source, investment banker, Cairo

¹⁷ Mubasher, 29 Jan 2017.

¹⁸ Al Borsa, 31 Jan 2017.

¹⁹ Source, second investment banker, Cairo

²⁰ Source, merger and acquisition specialist, Cairo

Garhy additionally noted increased foreign investor appetite for government treasury bills following the November currency devaluation which increased yields on domestic securities.²¹ Inflows into the capital and financial account will increase Egypt's net international reserves. Egypt faces debt repayments of approximately \$11 billion in 2018, but its external debt to gross domestic product (GDP) ratio of 18% remains relatively low.²² **Central Bank of Egypt (CBE)** governor **Tarek Amer**, on 31 January, said that the CBE completed the \$720m payment to the **Paris Club** of debtors due that morning.²³ Egypt still owes the Paris Club approximately \$3.5 billion, with the next scheduled payment in July.

Investors and the banking sector are divided about the risk that the government may not maximise the Eurobond funds by using them to bolster foreign reserves rather than capital investment.

*"I am a sceptic when it comes to what this government does – when you lend someone you want to know why they are lending, so you need to know what they are doing. Eurobonds make sense if you are intending to invest in infrastructure and or repay the oil and gas companies their dues. But I was surprised that they took the money and put it in the reserves of the CBE where it could definitely get wasted. Essentially so they could trumpet 'we reached \$20 billion'. They might have something else in mind though, I want to be optimistic."*²⁴

According to a second source,

*"I don't think they'll squander this money... but I would hope that they are by now aware that the stakes are very high if the economic crunch continues for too long."*²⁵

The Eurobond issue – especially the demand for 30 year-notes – shows that investors have a long-term positive view of Egypt. Much, however, will depend on the government's continued political will and capacity to deliver on sensitive economic restructuring (see below).

IMF publishes details of \$12 billion EFF

The IMF published full details of its three-year \$12 billion EFF on 18 January.²⁶ The programme's policy adjustments will test the government's fiscal discipline and the public's tolerance. In publishing the full documents relating to the programme, the IMF praised the measures that the government has implemented since the board approved the EFF in November.²⁷ Head of Egypt IMF mission **Chris Jarvis** described progress as *"so far, so good"*.²⁸ Jarvis, in particular, praised the CBE currency flotation the week after IMF board approval.²⁹ Jarvis said exchange rate liberalisations *"are always difficult"*³⁰, and that the Egyptian pound had depreciated more than the IMF had originally projected.³¹ According to Jarvis, inflation is *"slightly"*³² higher than forecast. Inflation increased from 13.6% in October to 23.3% in December. The IMF had forecast that inflation would reach 18% at the end of 2016.³³ However, the IMF said the currency was not as volatile as feared and has subsequently stabilised, and noted that the CBE had not needed to intervene in the exchange market since the flotation.³⁴ The IMF forecasts that inflation will decrease during the second quarter of 2017, though this depends on demand for dollars moderating.

²¹ Mubasher, 29 Jan 2017.

²² Reuters, 27 Jan 2017.

²³ Al Borsa, 31 Jan 2017.

²⁴ Source, investment banker, Cairo

²⁵ Source, second investment banker, Cairo

²⁶ www.imf.org

²⁷ www.imf.org

²⁸ www.imf.org

²⁹ www.imf.org

³⁰ www.imf.org

³¹ www.imf.org

³² www.imf.org

³³ www.imf.org

³⁴ www.imf.org

Access to the EFF is distributed evenly over three years. The programme is fully-financed for 2016/2017, but additional financing – from multilateral sources, rollovers of maturing liabilities, and “little”³⁵ fresh financing – is required to bridge a \$35 billion financing gap for 2017/2018 and 2018/2019. The first biannual review will take place on 15 March, and the second on 11 November.

The IMF notes that implementation risks are “significant”³⁶ but mitigated by “backing at the highest political level”.³⁷ The IMF programme commits the CBE and government to a series of core policies and targets:³⁸

- Growth: the programme targets an increase in GDP growth, from 5% to 6% in the medium term, but the IMF notes that 2016/2017 growth will remain “well below”³⁹ its potential due to fiscal consolidation and monetary tightening. The EFF aims to reduce the current account deficit to 3% of GDP by 2018/2019;
- Reserves: the programme wants the CBE to accumulate \$4.9 billion in reserves between June 2016 and June 2017, \$7 billion in 2017/2018 and \$4 billion in 2018/2019. Reserves should reach \$33 billion – approximately five months’ worth of import cover – by the end of the EFF. The CBE is to develop new investment guidelines for reserve management, including capping allocation of investments to foreign subsidiaries and branches of Egyptian banks’ stock at \$5.6 billion.
- Monetary policy: the programme wants the CBE to embark on “money targeting”⁴⁰ through deposit auctions. The IMF targets inflation in mid-single digits over the medium term, compared to 23.3% in December. The CBE should “maintain short-term interest rates at levels that ensure tight liquidity conditions.”⁴¹ Inflation will start to decline in 2017/2018, with the CBE lowering interest rates accordingly to permit credit recovery. The programme will aim for direct CBE financing of the budget to decrease to below 75 billion Egyptian pounds (EGP) (\$3.9 billion) in 2016/2017. From March, the CBE will publish quarterly monetary policy and inflation reports.
- Exchange rate: the programme requires the government to lift its limit on \$100,000 transfers abroad and a \$50,000 cap on cash deposits on import of non-priority goods by 30 June. The IMF is to undertake full analysis of the exchange system prior to the first loan review.
- Debt and deficit: the programme requires government debt to decrease from 94.6% of GDP in 2015/2016 to 85.8% by 2018/2019, and 78.2% by 2020/2021. The overall deficit is expected to decrease from 12.1% of GDP to 4.7%. The government is expected to turn a 3.4% deficit in primary balance in 2015/2016 to a 2.1% surplus in 2018/2019.
- Tax and revenue: the programme wants tax revenue to increase by 2.5% of GDP by the end of the programme. The programme includes deficit-saving measures amounting to 3.9% of GDP, including revenues from value added tax (VAT) and subsidy cuts. Before April 2017, the government should introduce a simplified tax framework for small and medium enterprises. The government should reinstate capital gains tax from May 2017, effective no later than 2017/2018. The sale of government licences and land to increase revenue by 0.3% of GDP in 2016/2017 and 0.5% in 2018/2019. The first sale of stakes in state-owned enterprises should take place in first quarter of 2017.

³⁵ www.imf.org

³⁶ www.imf.org

³⁷ www.imf.org

³⁸ Unless otherwise noted - www.imf.org

³⁹ www.imf.org

⁴⁰ www.imf.org

⁴¹ www.imf.org

- Spending: the programme caps the increase in wage bill at the projected level of inflation to generate savings of 0.9% of GDP. The programme calls for government to increase the level of fuel costs recovered to 100% by 2018/2019, and to develop a pension reform roadmap by June 2017. The programme allows for additional 1% of GDP spending to mitigate the impact of economic adjustment;
- Oil and gas: the programme wants gas production to increase current production of 3.8 billion cubic feet (bcf) per day to 4.9 bcf by June, and to 7.7 bcf per day within three years. The government will contract an international consultant to prepare an energy sector reform strategy, which it will then implement. The state-owned **Egyptian General Petroleum Corp** will agree a schedule with creditors to repay arrears before June 2019, and ensure it does not accumulate new arrears.

The terms of the EFF show that the IMF is broadly positive about Egypt. Whether the targets are achievable will depend on the continued engagement of the government and the CBE. Inflationary pressures on household spending (see below) mean popular and political pressure will increase on the government to maintain its high levels of spending regardless of the budget deficit. The CBE will have to resist the temptation to intervene in the exchange rate market.

Cabinet reshuffle looming

President **Abdel Fattah Al-Sisi** (2014-present) confirmed on 16 January that a cabinet reshuffle is imminent.⁴² It is unlikely that the reshuffle will be sufficiently large to negatively impact policy stability. Sisi confirmed that the shuffle will take place *“very soon”*⁴³ but did not provide any additional details about the timing. The process of appointing the new cabinet appeared to have *“stalled”*⁴⁴ before prime minister **Sherif Ismail** confirmed on 8 February that it would take place on 12 February.⁴⁵ However, at the time of writing, the cabinet reshuffle has not taken place. The reason for the delay is unclear, but there is local speculation that Sisi has rejected Ismail’s choices.⁴⁶ When originally announcing the shuffle, Sisi said Ismail retains *“his full trust”*⁴⁷ in an indication that he will remain head of the government. Sisi also defended the government’s economic reform, criticising approval ratings as *“a very unfair way to assess the government”*.⁴⁸ Observers have suggested that this indicates Sisi’s continued backing for his core economic ministers, including Garhy and investment minister **Dalia Khorshid**, and that the reshuffle will not impact them.⁴⁹

Sisi referred to the cabinet reshuffle in an extended interview with the state-owned media. In the interview, Sisi committed the government to providing subsidised goods to eligible households, and to monitoring prices.⁵⁰ Sisi additionally blamed Egypt’s problems on unbridled capitalism and profit seeking. Sisi, however, stressed that he does not want a return to a fully state-controlled economy. Sisi praised the government’s progress towards the *“crucial”*⁵¹ reforms required to fix the *“stunted”*⁵² economy. Sisi praised the floatation of the Egyptian pound and the draft **Investment Act** (see *ARC Briefing Egypt January 2017*), saying they will increase foreign investment.⁵³ Sisi defended the central role that large-scale national projects play in the government’s economic growth strategy, and the

⁴² Al Ahram, 16 Jan 2017.

⁴³ Al Ahram, 16 Jan 2017.

⁴⁴ Source, journalist, Cairo

⁴⁵ Al Ahram, 8 Feb 2017.

⁴⁶ Source, journalist, Cairo

⁴⁷ Al Ahram, 16 Jan 2017.

⁴⁸ Al Ahram, 16 Jan 2017.

⁴⁹ Enterprise, 17 Jan 2017.

⁵⁰ Enterprise, 17 Jan 2017.

⁵¹ Al Ahram, 16 Jan 2017.

⁵² Al Ahram, 16 Jan 2017.

⁵³ Enterprise, 17 Jan 2017.

economic role and commercial interests of the military.⁵⁴ Sisi also announced that he is forming a political advisory council on both domestic and foreign affairs.⁵⁵

The cabinet reshuffle is unlikely to mark a significant change in political, economic or security policy, with Sisi – rather than his ministers – dominating government decision-making.

About Africa Risk Consulting:

Africa Risk Consulting (ARC) is a pan-African consulting company that provides timely, relevant information and advice that enables its clients to take informed investment decisions and to safeguard their reputations.

ARC's core consulting services include integrity due diligence and corporate investigations, political advisory and country assessments, opportunity monitoring and reputation risk management. Most relevant to private equity firms is ARC's integrity due diligence and corporate investigations capability. Specifically, ARC offers pre-deal integrity checks to highlight red flags before negotiations start; full detailed multi-jurisdictional reputation due diligence; and supplier and senior hire vetting and repeat due diligence for compliance programmes. ARC is unique in that it offers a 10-day delivery for a routine integrity due diligence. ARC also offers a suite of corporate investigations services from immediate investigation, evidence gathering, e-discovery, forensic accounting and whistleblower support on one end to crisis media management and regular monitoring on the other.

www.africariskconsulting.com

About ARC Briefing:

ARC Briefing is ARC's essential online business information service.

Companies at any stage in their Africa expansion, whether building or communicating an Africa strategy, investing directly, expanding current operations, financing other investors, doing the legal leg-work or researching the Africa growth trend, need ARC Briefing.

ARC Briefing is an online information service keeping you:

- Up to date with Country Chronologies of business-critical events
- In the know via Country Briefings on political, economic, business and operating trends. Written in-country, ARC experts analyse and comment
- Ahead with Country Planner which details future elections, budgets, regulatory changes etc.

www.briefing.africariskconsulting.com

Getting in touch

Please contact us by email info@africariskconsulting.com or call + 44 (0) 20 7078 4080

Follow us on Twitter: [@ARCBriefing](https://twitter.com/ARCBriefing)

⁵⁴ Enterprise, 17 Jan 2017.

⁵⁵ Enterprise, 17 Jan 2017.