الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & FINANCIAL SECTOR OVERVIEW

Arab Republic of Egypt

December, 2020

FINANCIAL SECTOR OVERVIEW: Egypt

A population of 99.2mn in 2018 and an expected GDP of USD 302.3b in 2019[1], makesEgypt the 3rd largest African economy. Macroeconomic environment has improved significantly during the last few years as Egypt completed a three year arrangement under the IMF Extended Fund Facility that commenced in November 2016. The country posted a higher growth rate of 5.3% during 2017-18 and is expected to have grownat a steady 5.1% during 2018/19. Egypt was expected to continue its growth trajectory with 5.9% growth during 2019/20, though interrupted by the on-going COVID-19 pandemic driving the global economy intoarecession.

As the impact of change in exchange rate regime in 2016 and in turn devaluation diluted, both core and headline inflation have come to single digit, with a gradual decline in both since May 2019. Headline inflation has trended down to 5.3% as of February 2020 from a high of 14.4% in February 2019. In line with declining inflation and global interest rate cuts, Central Bank of Egypt has also cut its discount rate successively to 9.75% in March 2020, supplemented by a further 50bps cut last month. Egyptian Pound has been strengthening against USD with 10.4% appreciation during 2019 and further 1.8% during 2020 to date, currently stood at USG/ EGP parity of 15.76.

Table 1: Economic Indicators

	2017/18	2018/19	2019/20	2012/21
Population (million)	97	99.2	101.5	103.8
Real GDP growth	5.3	5.6	2	2.8
Fiscal Balance (% of GDP)	-9.7	-8.1	-8.3	-7.8
Inflation Rate (CPI, annual variation in %)	20.9	13.9	5.8	8.2
Current Account (% of GDP)	-2.4	-3.6	-4.3	-4.6
International Reserves (USD)	43.5	43.9	35	31.9
External Debt (% of GDP)	37.4	34.1	33.2	35.4
Source: IMF Consultation Report – September 2020				

The current account deficithas also declined to -2.5% of GDP during 2018/19 from a high of -5.6% of GDP during 2016/17. The current account position has posted a continually improving position during the first quarter of 2019/20 at -0.4% of GDP. However, we expect disruptionsin 2020 due to COVID-19. A significant portion of current account receipts include tourism inflows and Suez Canal receipts which will be adversely affected due to travel restrictions and lower trade between countries amid the COVID-19 pandemic. However, this may be offset in part by reduced import bill with record low oil prices.

As part of the fiscal consolidation efforts, the government adopted a Medium Term Revenue Strategy to alleviate fiscal pressures and has since posted a declining deficit of -8.0% of GDP during 2018/19 (2017/18:-9.7% of GDP). More significantly, Egypt posted a positive primary balance of 1.6% of GDP during 2018/19 from -4.3% of GDP during 2014/15. As an economic slowdown is imminent due to the pandemic, fiscal account is expected to be impacted with higher government expenditures,given the economic package introduced and lower tax revenues reflecting decline in economic activity. Fiscal reforms in the form of widening taxes and enhanced fee structures may be expected in the medium-term.

After the constitutional changes, the sitting president may remain in power till 2030. The newly formed cabinet in 2018 has demonstrated policy continuity and investor sentiment has remained positive. The on-going COVID-19 pandemic is likely to impactthe economy adversely in short to medium term,with pressure on fiscal and external accounts.

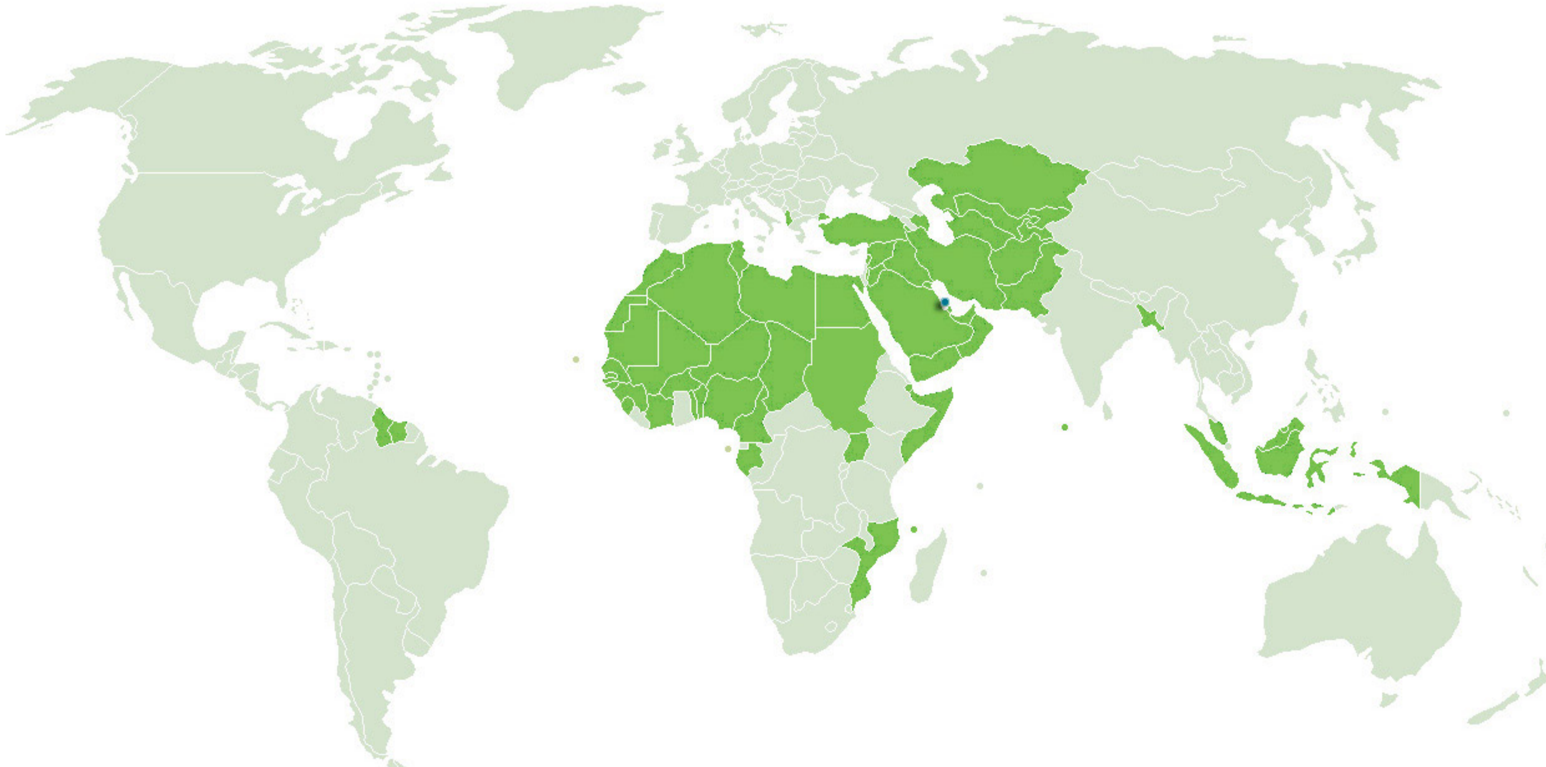
[1] *Source:IMF*

Banking Sector Review

The Banking Sector of Egypt has been growing with strong profitability indicators and supported by proactive regulation. The industry is viewed to be facing challenges with Capital Adequacy Ratio having declined to 14.0% in 2016. The Central Bank of Egypt has taken various steps including increasing minimum capital required to LE 5b to be implemented by 2020. These initiatives have led to increasing the industry's CAR to 20.1% as of June2020. The banking sector in Egypt has shown resilience with strong profitability, high liquidity and improving capitalization buffers. A low non-performing loan ratio of 3.9% as of June2020 supported by higher loan provisioning to NPL ratio of 97.2% bespeaks strong asset quality.

Egypt is also getting closer to issue its maiden Sukuk as the Ministry of Finance completed the Sukuk Act. The Banking sector has remained heavily invested in government treasuries with a financing to deposit ratio of 47.1% as of June2020, which has been decreasing over time. While high investment in securities in an elevated interest rate environment has facilitated margins while being capital light, it has crowded out private sector financing. CBE has lately emphasized on increasing SME financing and requires banks to extend at least 20% financings to SMEs until 2019. Morever, the sector has shifted its focus on corporate financing in the current order to protect banks' balance sheets from the expected economic fallout of COVID-19.A loosened monetary policy will likely reduce investment returns and hence marginsfor the sector during 2020.

No separate law for Islamic Banks has been issued and there are limited liquidity placement avenues in the Islamic Banking domain. More specifically, the country has not initiated issuing Sukuk while Islamic Banks have been permitted to invest in conventional securities to maintain liquidity. In April 2020, Egypt's financial regulatory authority approved the first issuance of a corporate Sukuk. Issuance of Sukuk at government level wouldexpand the universe of Shari'a compliant options available for liquidity management.



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