Arab Republic of Egypt
Rating Report

B

NEGATIVE OUTLOOK

Credit strengths

- Diversified and resilient economy
- Robust relations with international partners
- Recent record of structural reforms

Credit challenges

- Large and sustained external imbalances
- Elevated interest burden and public debt
- Weak governance

Rating rationale:

Strong growth momentum supported by a diversified economy: Real GDP growth has been resilient to external shocks thanks to the dynamism of the service and manufacturing sectors. Higher energy exports and private-sector-led activities could support higher growth potential.

Robust relations with multilateral and bilateral partners: Proactive negotiations and robust relations with international partners, including the IMF and the Gulf Cooperation Council (GCC), constitute buffers to ease pressure on public and external accounts.

Recent track record of structural reforms amid IMF asssitance: Egypt has a track record of reforms under the IMF assistance initiated in 2016, which is expected to be deepened in the context of the Extended Fund Facility (EFF) approved in December 2022.

Rating challenges include: i) elevated external financing requirements amid challenging funding conditions on debt capital markets; ii) large fiscal deficits resulting from elevated interest burden and public expenditures; iii) high public debt relative to emerging market standards and peers; and iv) weak governance indicators.

Egypt's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	bb+	EGP [+0]	1/3	B
Public Finance Risk		20%	bb-		-3/3	
External Economic Risk		10%	ccc		-2/3	
Financial Stability Risk		10%	aaa		-2/3	
ESG Risk	Environmental Factors	5%	aa		0	
	Social Factors	7.5%	a		-1/3	
	Governance Factors	12.5%	c		-1/3	
Indicative outcome		**bb**			**-3**	
Additional considerations					**0**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Negative Outlook reflects Scope's view that risks to the ratings are skewed to the downside over the next 12 to 18 months.

Positive rating-change drivers

- Sustained reduction in external risks leads to a faster-than-expected shore-up of international reserves
- Sustained fiscal consolidation and/or higher-than-expected GDP growth lowers interest burden and/or places the debt-to-GDP ratio on a firm downward trajectory

Negative rating-change drivers

- A significant deterioration of external risks reduces international reserves and/or threatens macroeconomic stability
- A firm upward trajectory of the interest burden and/or the public-debt-to-GDP ratio undermines the debt service capacity

Ratings and Outlook

Foreign currency

Long-term issuer rating	B/Negative
Senior unsecured debt	B/Negative
Short-term issuer rating	S-4/Stable

Local currency

Long-term issuer rating	B/Negative
Senior unsecured debt	B/Negative
Short-term issuer rating	S-4/Stable

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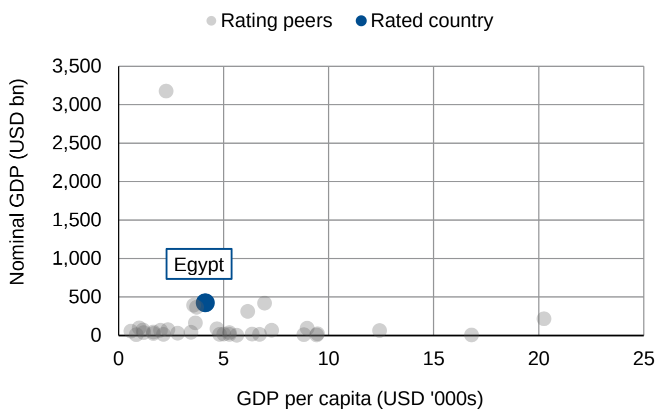
Domestic Economic Risks

- **Growth outlook:** The real GDP growth rate is expected to decelerate from 6.6% in 2022 to 4.0% in 2023 and pick up at 5.2% in 2024 based on IMF financial assistance supporting higher confidence. Domestic consumption is also expected to benefit from the gradual decline in inflation, although GDP growth prospects are hampered by monetary policy tightening and foreign currency liquidity constraints. In the long run, GDP growth potential (estimated above 5%) could benefit from a more dynamic private sector based on a level playing field between public and private investors. The economy could also benefit in the medium- to long-term from higher oil and gas exports towards Europe, which is Egypt's largest trading partner, based on large natural resources and existing infrastructures (LNG plants, Suez Canal, Sumed pipeline).
- **Inflation and monetary policy:** Egypt is highly exposed to the fluctuations of energy and food prices accounting for about 38% of the consumer price index. The headline inflation rate exceeds by large margins (31.9% YoY in February 2023) the Central Bank of Egypt's (CBE) pre-announced target of 7% (±2 percentage points) in Q4 2024 and 5% (±2%) in 4Q 2026. After rate hikes totalling 1000 basis points since January 2022, bringing the discount rate to 18.75%, the CBE is likely to further rise its monetary policy rates as inflation is expected to peak above 15% in 2023 on average in the wake of the Ukraine conflict, the devaluation of the Pound, and the recent rise in fuel prices.
- **Labour markets:** Egypt's fast-growing population (up to 140 million by 2040 against 104 million currently) is expected to put further strain on unemployment, which is moderately high (7.4% as of Q3 2022). Still, low labour force participation as well as high informal employment (50%) and youth unemployment (25%) impede higher GDP growth rates. A sustained rise in employment and inclusive growth is unlikely pending upon the development of economic activities led by the private sector.

Overview of Scope's qualitative assessments for Egypt's *Domestic Economic Risks*

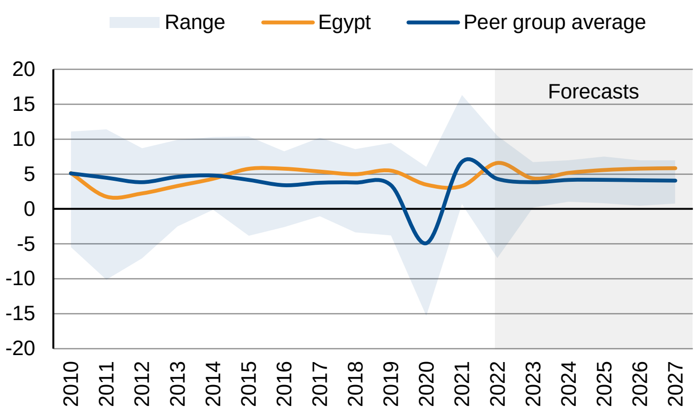
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Growth potential of the economy	Strong	+1/3	Solid growth prospects underpinned by well-diversified economy, large labour force, and investment in the energy sector
	Monetary policy framework	Neutral	0	Long history of double-digit inflation rates exceeding CBE's target, although IMF cooperation help to anchor inflation expectations
	Macro-economic stability and sustainability	Neutral	0	Strong growth momentum and resilience to external shocks, although low domestic saving increase reliance on external funding

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

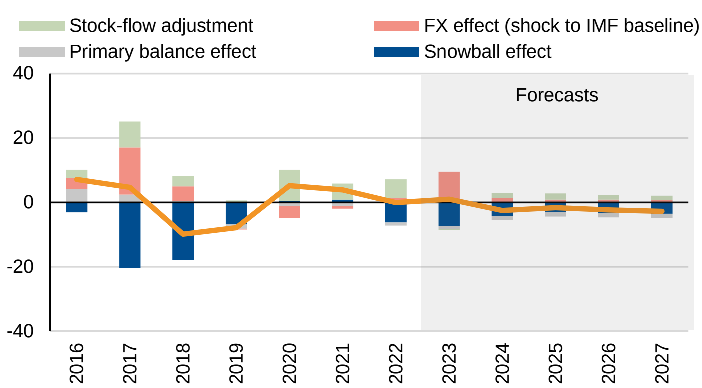
Public Finance Risks

- **Fiscal outlook:** The government is expected to maintain a primary fiscal surplus of 1.2% of GDP on average over 2023-2027, which is lower than the target set in the IMF programme (more than 2% over the period). The general government deficit is set to reach 7.5% on average by 2027 because of elevated net interest payments (more than 40% of revenue, or 8% of GDP per year on average) and of challenges ahead to deliver sustained and material fiscal consolidation. The durably flexible exchange rate is expected to increase the cost of servicing foreign currency debt, while pressuring social spending (subsidies, transfers) to mitigate the adverse consequences of an elevated import bill. Despite reforms implemented since 2016, interest payments (32% of expenditures in 2021-22), wages (20%) and subsidies-grants-social benefits (17%) account for about 70% of public expenditures.
- **Debt trajectory:** General government debt is set to decline from 89.2% of GDP in 2022 (or about 445% of fiscal revenue) to 80% of GDP by 2027 thanks to modest but continued primary surplus and robust GDP growth (more than 5% on average). Still, the uncertainty on the government's ability to maintain high primary surplus compared to past performance (deficit of 4% of GDP on average between 2010 and 2015, against a surplus of 1% between 2016 and 2019) constitutes a downside risk. In an adverse scenario, assuming a primary surplus of 0.9% of GDP, a GDP growth rate of 3.4%, public debt would rise above 100% of GDP by 2027, which is high relative to emerging market standards and peers.
- **Debt profile and market access:** Large public gross financing needs, underpinned by elevated fiscal deficits and moderate average maturity (around 3 years), weigh on market access with 10-year yields trading around 22% for Treasury bills and 15% for international bonds. Medium- and long-term public and publicly guaranteed (PPG) external debt service amounts to USD 16bn in 2023 and 2024 (or about 47% of gross international reserves). Although close to 40% of PPG external debt service in 2023 is due to the IMF, Egypt's ability to meet financing needs is contingent on reform implementation and net foreign capital inflows.

Overview of Scope's qualitative assessments for Egypt's *Public Finance Risks*

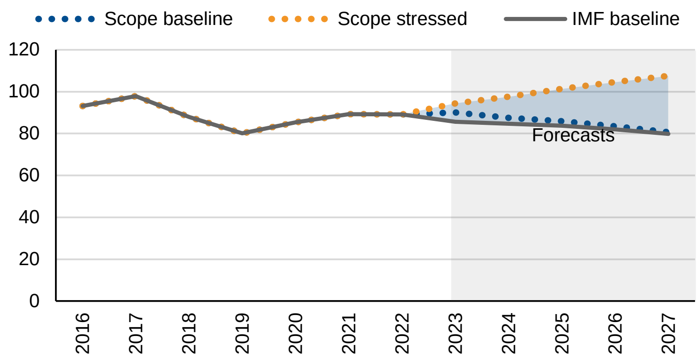
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Fiscal policy framework	Weak	-1/3	Rigid expenditures and large investment needs limit the prospects for fiscal consolidation
	Debt sustainability	Weak	-1/3	Elevated public debt, high interest burden, and exchange rate adjustment weigh on debt dynamics
	Debt profile and market access	Weak	-1/3	Low debt maturity and large debt service amid challenging funding conditions; vulnerability to a shift in market sentiment

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

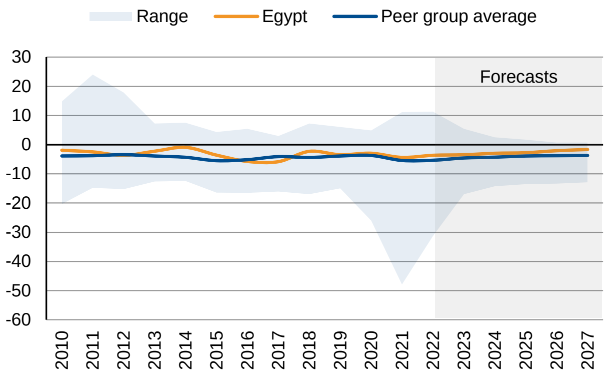
External Economic Risks

- **Current account:** Egypt's current account deficit is expected to remain sizeable in 2023 and 2024 (2.7% of GDP on average) because of higher commodity prices, and to narrow down to about 2.0% of GDP in the medium term amid growing hydrocarbon exports and a weaker exchange rate supporting the non-oil trade balance. Still, current account deficits weigh on external financing requirements, estimated at around USD 23bn per year on average between 2023 and 2024, around 5% of GDP or 66% of gross international reserves. Egypt is dependent on net foreign capital inflows, including reliable sources such as remittances (USD 32bn in FY 2021/2022) and Suez Canal shipping fees (USD 7bn), but also export (USD 44bn) and tourism receipts (USD 11bn).
- **External position:** Gross external debt (USD 155bn as of end-September 2022, or 33% of GDP) is moderate and mostly long term (83% of total). External debt structure is favourable as it is mainly due to multilateral institutions (33% of total; against 19% for bonds held by non-residents), among which the IMF (43%), and GCC countries (26%). External debt is mostly denominated in US dollar (67% of total) and issued by the government and the CBE (38% of total). Short-term debt structure is favourable as new deposits from GCC countries (USD 13bn) account for about half of the debt stock. This ratio rises to almost 60% when including the currency swap with the People's Bank of China. Egypt's Net International Investment Position (NIIP) is largely negative (USD 236bn as of Q3 2022, or 49% of GDP) and mainly composed of foreign direct investment.
- **Resilience to shocks:** An IMF financing envelope (USD 3.1bn) materially below initial expectations (USD 10-15bn) and upfront disbursements representing about 12% of the total (compared with about 23% in 2016) are expected to maintain pressure on international reserves (USD 34.4bn as of February 2023, about 4 months of imports). Policy conditionality attached to IMF disbursements is more stringent, which increase the risk of the programme being renegotiated over the implementation period ending September 2026. Greater exchange rate flexibility is expected to remain controversial, while GCC partners that have already provided a significant amount of grants and deposits are likely to condition additional financial assistance to more productive investment. Resilience to short-term external shocks depends primarily on the ability to deliver on structural reforms, among which the privatisation plans.

Overview of Scope's qualitative assessments for Egypt's *External Economic Risks*

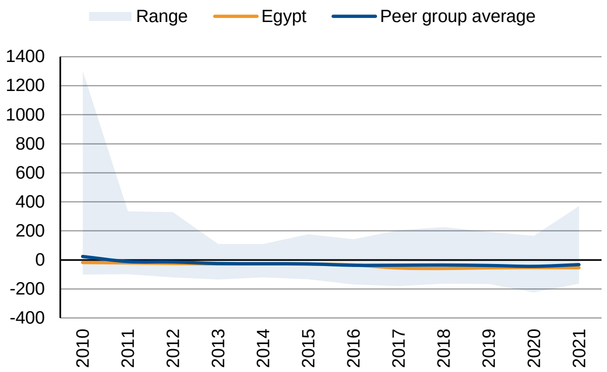
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Current account resilience	Weak	-1/3	Large gross financing needs partially covered by volatile capital inflows; heavy reliance on external funding
	External debt structure	Neutral	0	Moderate and long-term gross external debt, but relatively large short-term liabilities in comparison to international reserves
	Resilience to short-term external shocks	Weak	-1/3	Limited international reserves compared to external financing needs; external financial support conditional upon challenging reforms

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

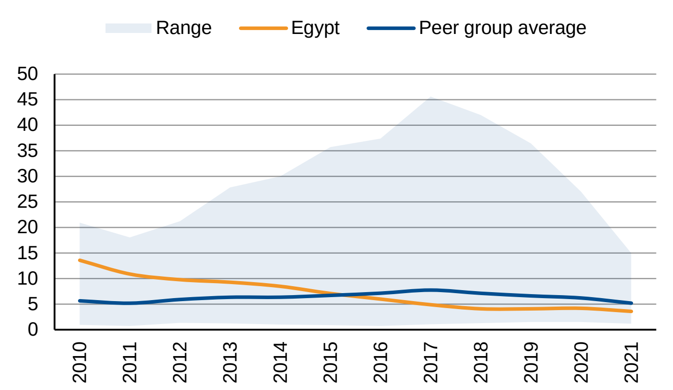
Financial Stability Risks

- **Banking sector:** Egyptian banks are resilient based on robust capitalisation (Tier 1 capital/risk weighted asset of 17.1% as of end-June 2022) and profitability (aggregate return on equity ratio of 16.1%). Exposure to worsening economic and financial conditions is limited, with low NPL ratio (3.2%), but net claims on the government account for about 66% of domestic credit and 44% of assets. The foreign currency liquidity of the banking system has deteriorated so that its net foreign position is negative (USD 22bn in January 2023), although liquidity risks are mitigated by banks' foreign liabilities that are mostly long-term (65%). Deposits denominated in foreign currency (11.8% as of September 2022, including government's deposits; 23.1% in June 2017) remain a source of vulnerability amid large devaluation of the exchange rate.
- **Private debt:** Household and private business sector represent about 32% of domestic credit as of end-2022. Private indebtedness is structurally constrained by Egyptian banks' exposure to the government and public related entities. This constrains private sector investment but limits the exposure of household and corporates to rising interest rates. Still, credit growth to the private business sector is structurally higher, around 25% YoY on average in 2022 (10% in 2019), following initiatives taken to support micro, small and medium-sized enterprises.
- **Financial imbalances:** Elevated sovereign-bank nexus amid rising risks on government's debt and public sector entities is the main risk lingering on financial stability, as it creates distortion around bank's lending and asset prices. Listed government bonds account for 98% of total listed bonds as of September 2022. The heavy reliance of local financial markets on foreign portfolio investments is also a risk amid monetary policy tightening and large devaluation of the Pound. Equity indexes (EGX30 Index, EGX70 EWI Index) are high compared to historical performance.

Overview of Scope's qualitative assessments for Egypt's *Financial Stability Risks*

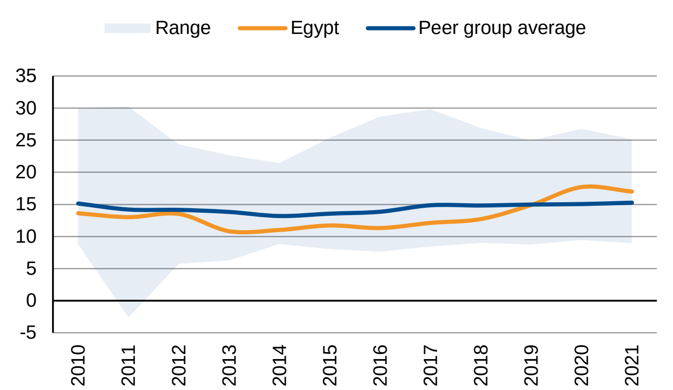
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Weak	-1/3	Resilient banking system, but increasingly challenging operating environment and significant pressure on foreign currency liquidity
	Banking sector oversight	Neutral	0	Structural shortcomings partly addressed by the strengthening of the supervision framework
	Financial imbalances	Weak	-1/3	Strong sovereign-bank nexus; local asset prices exposed to foreign capital outflows and exchange rate volatility

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG Risks

- **Environment:** Egypt is highly vulnerable to climate change given coastal urban areas and dependence on the Nile Delta. Even so, the authorities are expected to ramp up green transition policies and projects, supported by green bond issuance, given vulnerability to commodity price volatility and climate related events. The authorities updated the Green Financing Framework following the COP27 and launched the National Climate Change Strategy 2050 for which the country can count on financial support from multilateral partners such as the EIB and the EBRD. The latter's country strategy for the period 2022-2027 aims at accelerating Egypt's pace towards a green economy as a strategic priority.

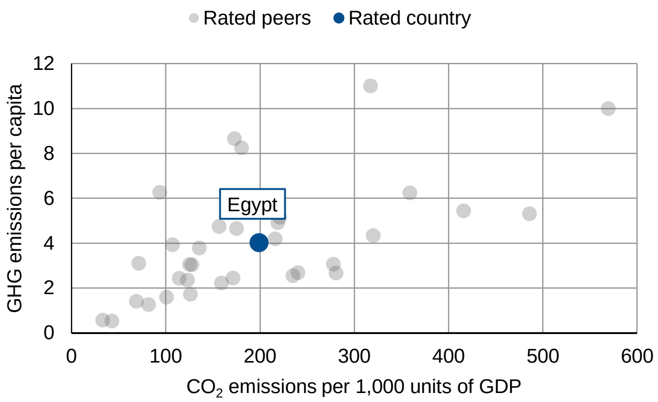
- **Social:** The old-age dependency ratio (people aged 65 years or over as a percentage of those aged 15-64) is expected to remain relatively low at 10% by 2035. However, a rapidly growing population represents a challenge in terms of labour market integration, in view of low participation and elevated youth unemployment rates, as well as public transfers and poverty mitigation measures. Effective form April, the authorities have decided to increase the wages of State workers and pensions, as well as the allowance to the beneficiaries of the Takaful and Karama programmes (about 5 million or 5% of population) to ease the adverse consequences of external shocks and structural reforms.

- **Governance:** Institutional stability has strengthened since 2011, including through the launch of the 'National Youth Conference' in 2016, the decision to halt the extension of the state of emergency declared in 2017, the constitutional referendum held in 2019, and the introduction of a 'National Dialogue' in 2022. Nonetheless, structural weaknesses persist, at a time where a deteriorating macroeconomic environment amid high poverty rate (about 30%) and extra policy adjustments exacerbate socio-political risks, especially if the reform agenda fails to generate economic dividends ahead of elections. The constitutional reform approved in 2019 extended President Abdel-Fattah El-Sisi's second four-year term to six years and allowed him to run for another six-year term in 2024. Pressure from international partners has risen against the State's intervention in the economy, which exacerbate institutional challenges.

Overview of Scope's qualitative assessments for Egypt's *ESG Risks*

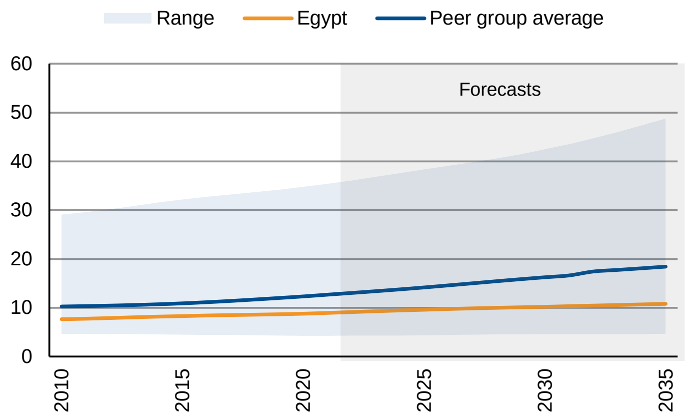
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Environmental factors	Neutral	0	High vulnerability to climate change, mitigated by proactive policies and the support of international partners
	Social factors	Weak	-1/3	Pre-existing social vulnerabilities aggravated by rising inflation amid high poverty rates
	Institutional and political factors	Weak	-1/3	State intervention in the economy challenged by structural reform agenda; record of institutional instability and constitutional changes

Emissions per GDP and per capita, $mtCO_2e$



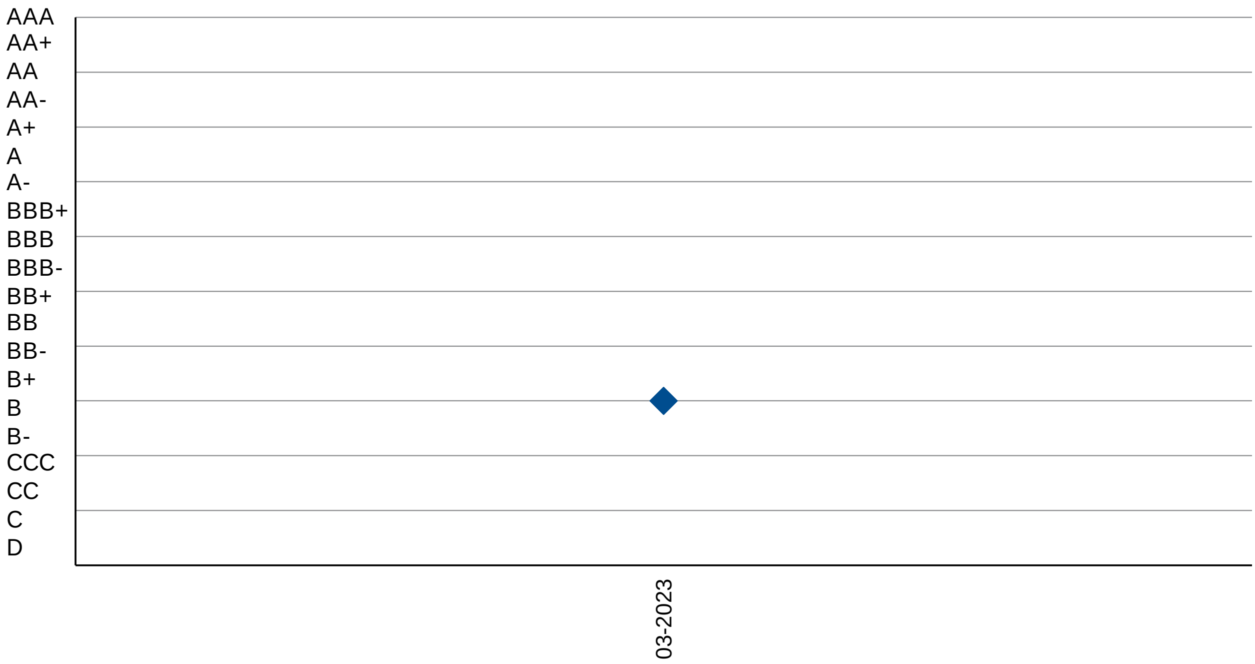
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Georgia
Greece
South Africa

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2017	2018	2019	2020	2021
Domestic Economic	GDP per capita, USD '000s	IMF	2,593	2,710	3,214	3,802	4,144
	Nominal GDP, USD bn	IMF	246.8	263.2	317.9	382.5	423.1
	Real growth, %	IMF	5.4	5.0	5.5	3.5	3.3
	CPI inflation, %	IMF	23.5	20.9	13.9	5.7	4.5
	Unemployment rate, %	WB	11.7	9.8	7.8	9.2	9.3
Public Finance	Public debt, % of GDP	IMF	97.8	88.0	80.1	85.3	89.2
	Interest payment, % of revenue	IMF	36.4	43.6	46.0	47.5	42.8
	Primary balance, % of GDP	IMF	-2.4	-0.4	1.3	1.2	1.2
External Economic	Current account balance, % of GDP	IMF	-5.8	-2.3	-3.4	-2.9	-4.4
	Total reserves, months of imports	IMF	5.7	5.9	5.8	5.6	-
	NIIP, % of GDP	IMF	-56.6	-59.6	-55.4	-53.0	-54.9
Financial Stability	NPL ratio, % of total loans	IMF	4.9	4.1	4.1	4.2	3.6
	Tier 1 ratio, % of RWA	IMF	11.9	12.5	13.5	16.1	-
	Credit to private sector, % of GDP	WB	28.5	25.5	24.0	27.1	-
ESG	CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	252.8	251.0	227.2	198.9	205.2
	Income share of bottom 50%, %	WID	14.6	14.6	14.6	14.6	14.6
	Labour-force participation rate, %	WB	49.4	47.9	47.9	-	-
	Old-age dependency ratio, %	UN	8.5	8.6	8.7	8.8	8.9
	Composite governance indicators*	WB	-0.9	-0.8	-0.8	-0.9	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Developing Economies
5y USD CDS spread (bps) as of 24 March 2023	1403.0

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