

Egypt Macroeconomics

Rate cuts around the corner

- Inflation numbers continue to improve down to 17.1% y/y, well below the peak of 33.0% in July 2017, with two consecutive months of negative price growth.
- We pencil in a 200bps rate cut in March 2018, as we expect the MPC to wait for inflation to get back into its target 10-16% range, but do not completely exclude a 100bps cut in February following the improvement so far. On our numbers, inflation should hit 10.8% by YE 18e and 8.5% by YE 19e, with average inflation of 12.2% and 9.4% respectively.
- The fiscal deficit should improve sharply over the coming two years on lower interest rates and energy subsidy cuts with the primary balance on track to recording a small surplus in 17/18, in-line with IMF targets, but total deficit should exceed targets.

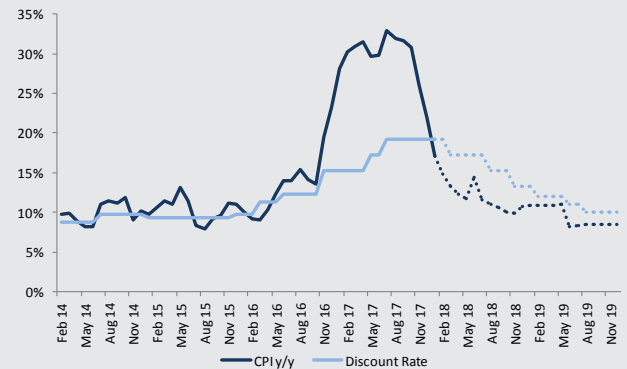
January inflation numbers show a drastic improvement. Inflation is now down to 17.1% y/y in January with two consecutive m/m inflation rates (-0.2% in December and -0.1% in January). The MPC's 10-16% target range YE 18 implies an average m/m inflation of 0.8-1.25%. The improvement in January mostly came from a continued decline in F&B prices, the third consecutive month, while most other items remained stable, barring a 26bps m/m increase in housing and energy costs, as well as a 2.49% increase in miscellaneous items.

200bps rate cut in March or 100bps in February. We expect the Egyptian MPC to cut its discount rate by 200bps (our forecasts in Exhibit 1) in March as inflation should continue to improve as we forecast declining y/y inflation at 14.8% in February, bringing inflation within the MPC's 10-16% target range and pushing real interest rates into positive territory. A 200bps cut would bring the lending, deposit, and discount rates to 17.75%, 16.75%, and 17.25% respectively. However, we also do not exclude the possibility of a 100bps rate cut in February, following the significant improvement seen so far. We expect the electricity subsidy removals, as well as the potential fuel subsidy cuts in the summer to cause inflation to increase again, potentially rising by 3.3% m/m, but we pencil in a 14.4% y/y increase in June, still within the target range. On our numbers, inflation should hit 10.8% by YE 18e and 8.5% by YE 19e, with average inflation of 12.2% and 9.4% respectively.

Primary fiscal balance on track to meeting the IMF target in 2017/18, but likely to miss in 2018/19. We estimate a primary fiscal surplus of 0.19% in 2017/18, in-line with the IMF target, but improving to 0.95% in 2018/19, below the 2.1% target. The overall fiscal deficit should also improve significantly going forward, from 10.84% expected in 2017/18, going down to 8.79% in 2018/19, and 6.91% in 2019/20 with most of the improvement coming from lower domestic debt costs and energy subsidies though partly offset by higher subsidies to food and other commodities, enhancing the overall efficiency of spending. We expect debt/GDP to peak at 103.3% FY 16/17 and to improve to 92.3% 17/18, 87.0% 18/19 and 82.4% 19/20e.

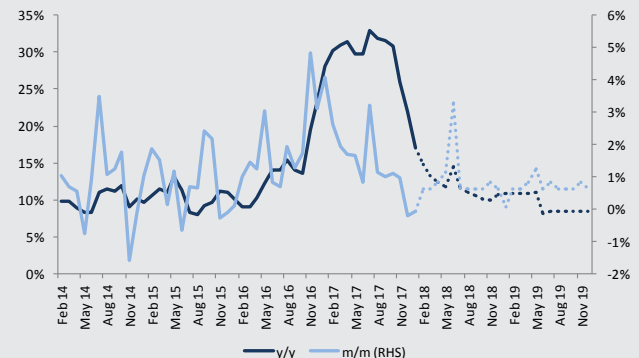
Key Charts

Inflation y/y vs. discount rate



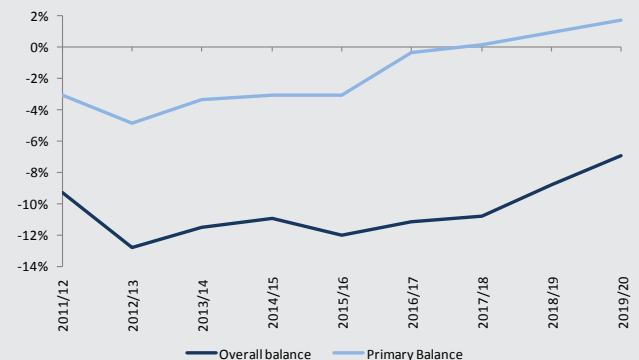
Source: CBE, Arqaam Capital Research

Inflation - y/y vs. m/m



Source: CBE, Arqaam Capital Research

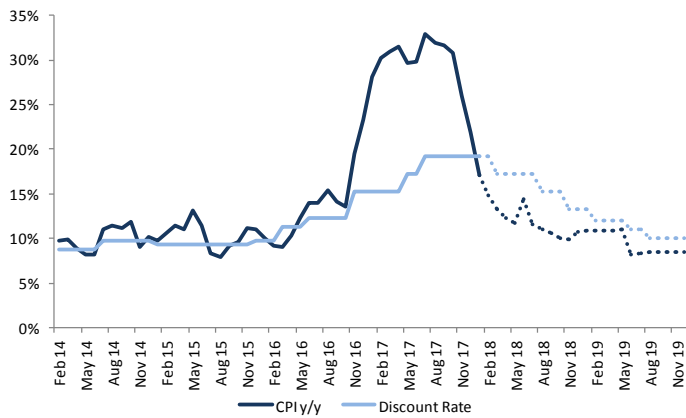
Fiscal balance as % of GDP



Source: Ministry of Finance, Arqaam Capital Research

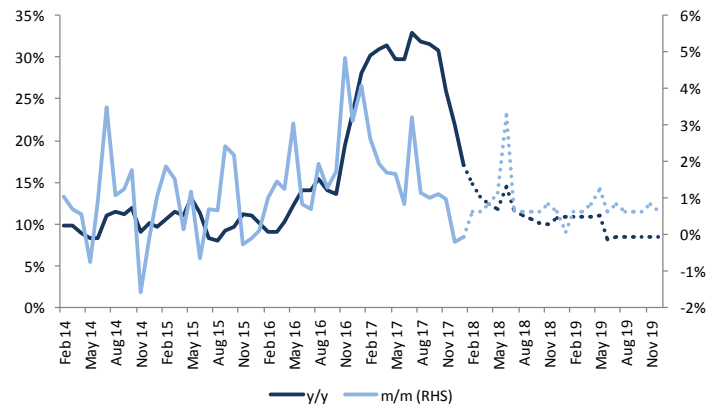
Upcoming MPC meetings: Feb 15; Mar 29; May 17; June 28; Aug 16; Sept 27; Nov 15; Dec 27

Exhibit 1: CPI y/y vs. discount rate



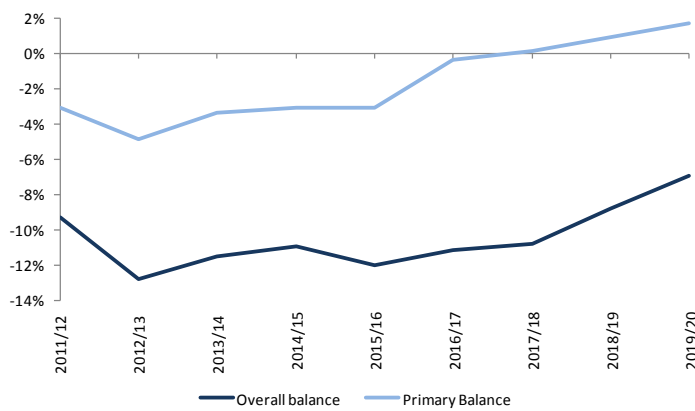
Source: CBE, Arqaam Capital Research

Exhibit 2: CPI – y/y vs. m/m



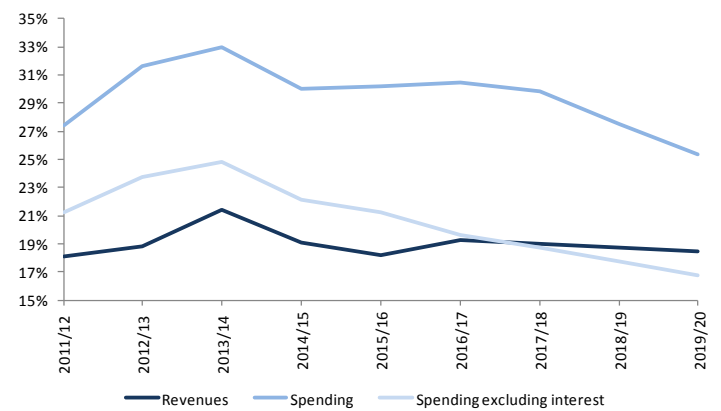
Source: CBE, Arqaam Capital Research

Exhibit 3: Fiscal balance as % of GDP



Source: Ministry of Finance, Arqaam Capital Research

Exhibit 4: Revenue vs. spending as % of GDP



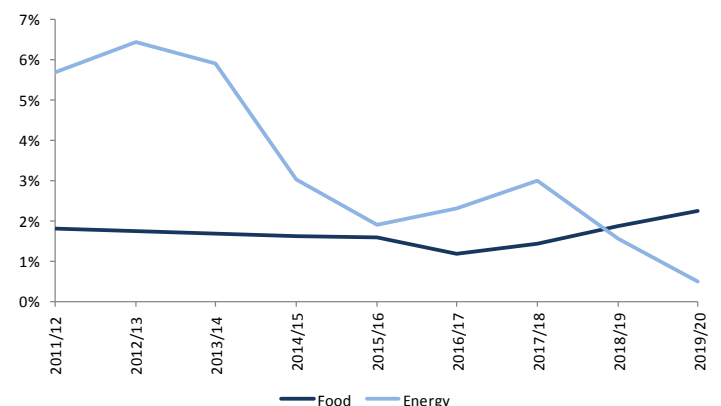
Source: Ministry of Finance, Arqaam Capital Research

Exhibit 5: Spending breakdown as % of GDP



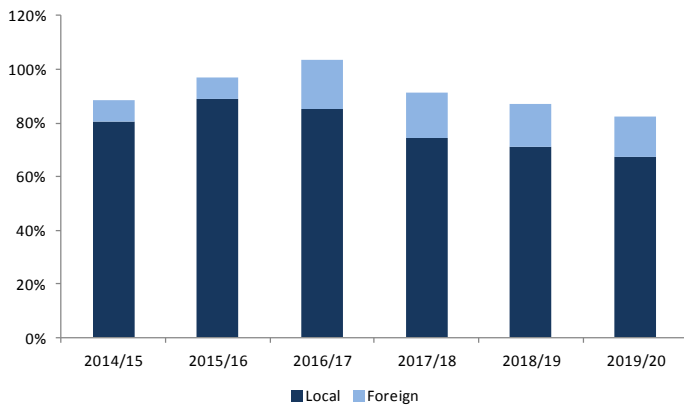
Source: Ministry of Finance, Arqaam Capital Research

Exhibit 6: Subsidies as % of GDP



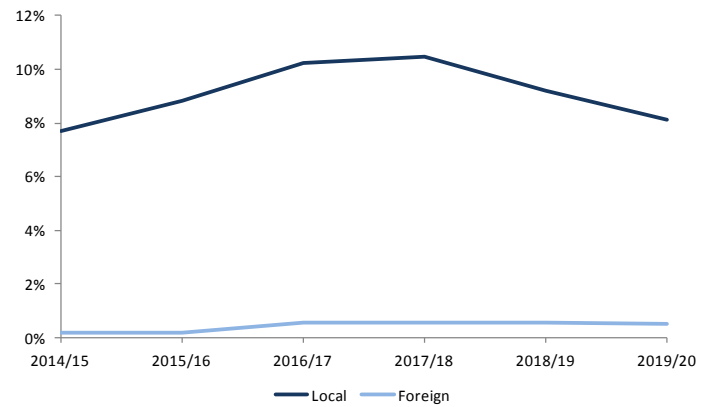
Source: Ministry of Finance, Arqaam Capital Research

Exhibit 7: Gross debt as % of GDP



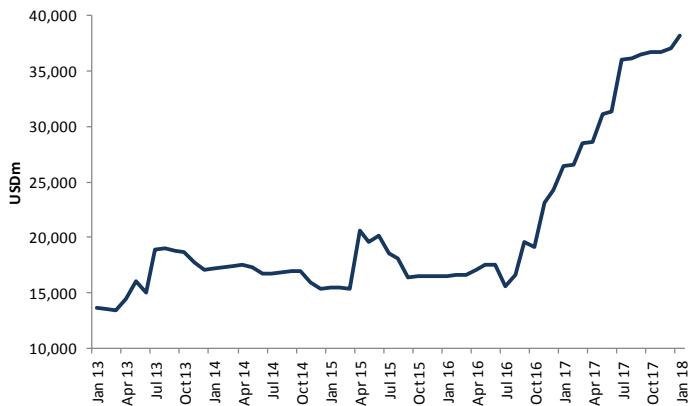
Source: Ministry of Finance, Arqaam Capital Research

Exhibit 8: Debt cost as % of GDP



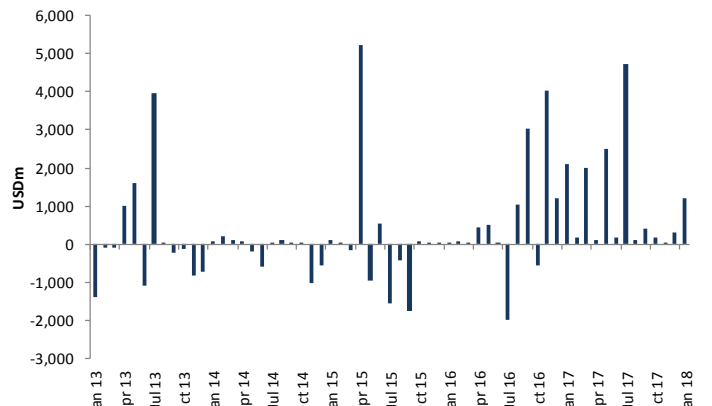
Source: Ministry of Finance, Arqaam Capital Research

Exhibit 9: FX reserves



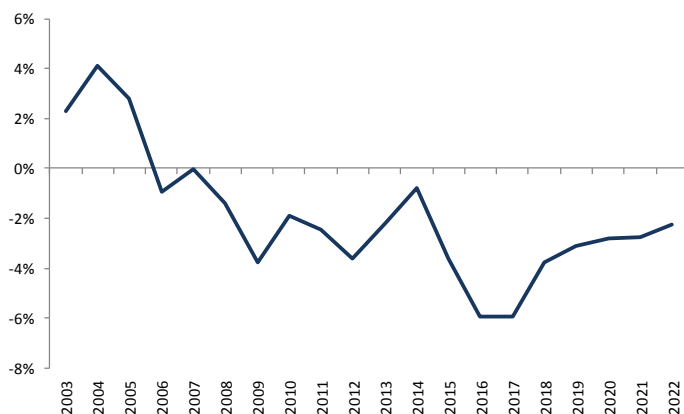
Source: Thomson Reuters Datastream, Arqaam Capital Research

Exhibit 10: FX reserves change m/m



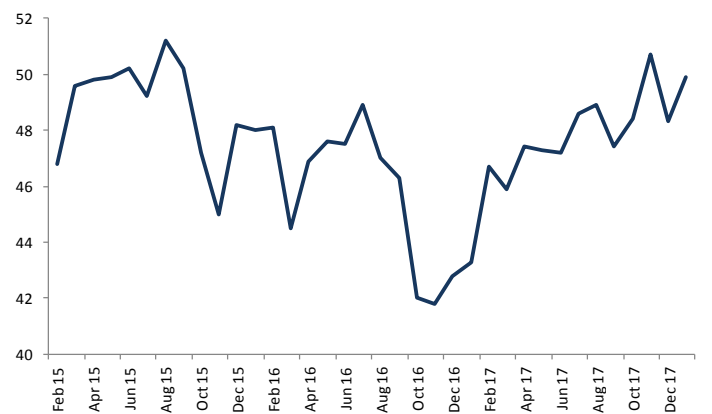
Source: Thomson Reuters Datastream, Arqaam Capital Research

Exhibit 11: Current account as % of GDP



Source: Thomson Reuters Datastream, Arqaam Capital Research

Exhibit 12: PMI



Source: Bloomberg, Arqaam Capital Research

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