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Fitch Downgrades Egypt to 'B-'; Outlook Stable

Fitch Ratings - London - 03 Nov 2023: Fitch Ratings has downgraded Egypt's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'B-' from 'B'. The Outlook is Stable.

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

The downgrade of Egypt's IDRs reflects the following key rating drivers and their relative weights:

High

Rating Downgrade, Stable Outlook: The downgrade reflects increased risks to Egypt's external financing, macroeconomic stability and the trajectory of already-high government debt. The slow progress on reforms, including the delay on the transition to a more flexible exchange rate regime and on IMF programme reviews, have damaged the credibility of exchange rate policy, and exacerbated external financing constraints at a time of increasing external government debt repayments. Downward pressures on the currency have increased, and the path to policy adjustment has become more complicated, in our view.

The Stable Outlook reflects Fitch's baseline expectation that reforms - including privatisation, slowdown of megaprojects, and exchange rate adjustment - will accelerate after presidential elections in December, likely paving the way for a new and potentially larger IMF programme and additional support from the GCC.

Challenging Policy Adjustment: The stability of the official exchange rate since February contrasts with the Central Bank of Egypt's (CBE) stated commitment to a durably flexible exchange rate. Confidence in the currency arrangement appears weak, with foreign currency (FC) shortages at the official rate, the persistence of a widely different parallel market rate and the hoarding of FC by the private sector.

In our view, the CBE's ability to restore exchange rate and monetary credibility is uncertain. Floating the Egyptian pound, without rebuilding confidence and FX availability in the official market, may be associated with significant overshooting of interest rates and inflation (which was already 40% yoy in September), to the detriment of macroeconomic and social stability and public finances. Delays in adjustment aggravate these risks, in our view.

Higher External Debt Maturities: The general government (GG) will face a significant rise in external debt maturities to USD8.8 billion in the fiscal year ending June 2024 (FY24) and USD9.2 billion in FY25,

from USD4.3 billion in FY23. The government is at advanced stages to receive USD1.5 billion backed by guarantees from multilaterals, on top of about USD4 billion direct financing from official partners, including the IMF. Another sukuk issuance to GCC investors remains a possibility in FY24. We currently forecast negative net external GG borrowing of about USD2 billion in FY24, to be covered with proceeds to the treasury from state asset sales.

CAD Contraction Unlikely to Persist: The current account deficit (CAD) narrowed sharply to 1.2% of GDP (USD4.7 billion) in FY23 from 3.5% (USD16.5 billion) in FY22, helped by a surge in tourism and Suez Canal receipts. However, a large part of the improvement is due to a USD16 billion import contraction that we think is largely related to limited FC availability and will be increasingly difficult to sustain as it constrains economic growth and exports. As a result, we forecast the CAD to expand to 2.8% of GDP (USD10.6 billion) in FY24 and 2.2% of GDP (USD9 billion) in FY25.

We expect receipts from tourism, the Suez Canal and a recovery of remittances will help contain financing needs from larger imports. In Fitch's view, the Israel-Hamas war poses significant downside risks to tourism, although we build in some near-term hit.

Limited External Financing Options: Egypt is increasingly reliant on FDI to cover its CAD, as investor sentiment constrains prospects for portfolio investments and commercial borrowing. We forecast net FDI inflows to grow to USD12 billion in FY24 from USD9.7 billion in FY23, supported by the government's privatisation plan, which target USD5 billion in sales proceeds by end-FY24, advised by the IFC. This is subject to significant execution risk, in our view, as the success, timing, and scale of the privatisation plan remain uncertain, despite recent progress (USD1.9 billion sales in July), with limited alternative options except a further drain on external liquidity buffers (adding to the USD5.4 billion deterioration in banks' net foreign assets in FY23).

The risk of further portfolio outflows, after the USD3.7 billion drain in FY23, is still significant, as the foreign holdings of domestic government debt remains high, at USD16.5 billion at the end of August (50% of gross official reserves, at USD35 billion in September). However, these have stabilised since the beginning of 2023, highlighting substantial resilience to shocks.

Debt Trajectory at Risk: GG debt to GDP jumped to about 95% in FY23, from nearly 87% in FY22, mostly due to the weaker currency. We forecast it to decline to 90% in FY24 and 87% in FY25, supported by primary surpluses, negative real interest rates, and average GDP growth of 3.8%. This is considerably above Fitch's 2023 'B' median of 56%. A 10% currency depreciation above our forecast would increase debt by about 3pp of GDP, in our projections. We forecast interest-to-revenues will exceed 50% in FY25, one of the highest among the sovereigns we rate and pointing to marked solvency pressure.

Medium

Security and Social Stability Risks: Egypt's proximity to the Israel-Hamas conflict, and the potential influx of refugees, increases the security risk, especially in the Sinai region. We believe the impact of persistent high inflation (expected to average 33% in FY24) on living standards will be sizable and hard to reverse, despite the government's efforts to address it. Social tensions have remained contained so

far, but the risk of political instability lingers, given structural problems, including weaknesses in governance and high youth unemployment.

Egypt's 'B-' IDRs also reflect the following key rating drivers:

Fiscal Discipline, High Contingent Liabilities: The central government (CG) budget deficit was 6.0% of GDP in FY23 (5.7% GG deficit), in line with budget plans, despite the considerable additional pressures from higher interest rates, subsidies and social spending and repeated step devaluations. We expect the CG primary surplus to improve in FY24 and FY25 from 1.6% of GDP in FY23, supported by continued fiscal discipline, and revenue measures taken. However, higher interest costs will push up the overall CG deficit to 7.4% in FY24 and 8.4% in FY25 in our forecasts.

There is limited visibility on the extensive and complex broader public sector. This creates significant uncertainty on the potential contingent liabilities, and the overall fiscal risk, with recurrent below-the-line transfers.

ESG - Governance: Egypt has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGIs) have in our proprietary Sovereign Rating Model. Egypt has a low WBGIs ranking at 25, with a particularly low score for voice and accountability.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-External Finances: Greater external financing strains weakening international reserves and/or other liquidity buffers, for example, as a result of the inability of the authorities to restore confidence in the currency or to secure sufficient financing from multilateral, bilateral or market sources.

-Public Finances: Increased debt sustainability risks, for example, as a result of loosening of fiscal policy, and/or failure to reverse the recent deterioration in interest/revenue and government debt/GDP in the medium term.

-Structural: An escalation of the Israel-Hamas conflict increasing instability and security risk in Egypt, with substantial negative spill-over impact on tourism, investor sentiment, or increasing the domestic socio-political challenge to implementing reforms.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-External Finances: Reduction in external vulnerabilities, for example, through improved international market access, a sustained reduction of the current account deficit, and build-up of international reserves or other liquidity buffers.

-Macro and Public Finances: Policy adjustments that reduce economic distortions, improve access to

external financing and support a decline in government debt over the medium term and lower interest costs.

Sovereign Rating Model (SRM) and Qualitative Overlay (QO)

Fitch's proprietary SRM assigns Egypt a score equivalent to a rating of 'B-' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

Country Ceiling

The Country Ceiling for Egypt is 'B-', in line with the LT FC IDR. This reflects no material constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of 0 notch above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Egypt has an ESG Relevance Score of '5' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Egypt has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Egypt has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Egypt has a percentile rank below 50 for the respective Governance Indicators, this has a negative impact on the credit profile.

Egypt has an ESG Relevance Score of '4' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Egypt has a percentile rank below 50 for the respective Governance Indicator, this has a

negative impact on the credit profile.

Egypt has an ESG Relevance Score of '4+' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Egypt, as for all sovereigns. As Egypt has a track record of 20+ years without a restructuring of public debt and captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
Egypt	LT IDR	B- ●	Downgrade	B ●

ENTITY/DEBT	RATING		RECOVERY	PRIOR
	ST IDR	B	Affirmed	B
	LC LT IDR	B- 	Downgrade	B 
	LC ST IDR	B	Affirmed	B
	Country Ceiling	B-	Downgrade	B
• senior unsecured	LT	B-	Downgrade	B
• senior unsecured	ST	B	Affirmed	B

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Country Ceiling Criteria \(pub.24 Jul 2023\)](#)

[Sovereign Rating Criteria \(pub.06 Apr 2023\) \(including rating assumption sensitivity\)](#)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.0 [\(1\)](#)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.0 (1)

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Egypt UK Issued, EU Endorsed

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