Invesco Fixed Income Investment Insights

Country Spotlight: Egypt

Resilient macroeconomics and stable external support create constructive outlook

Q2 2021

Invesco

Contributors
Invesco Global Debt Team

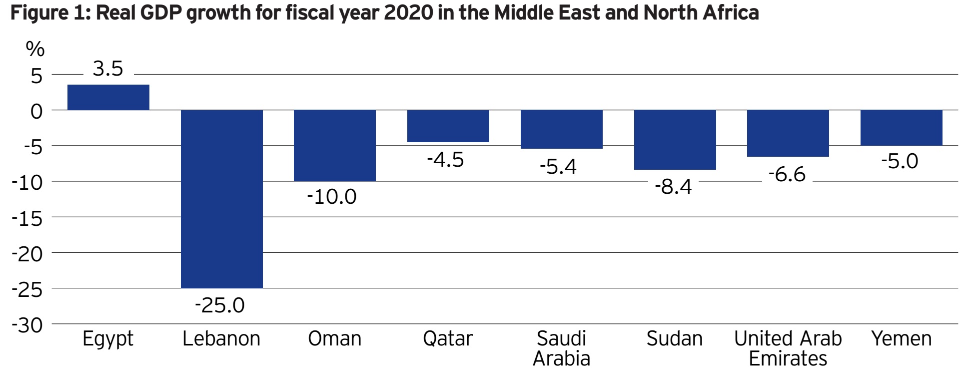
Highlights

+ We maintain a constructive outlook on Egypt's economy due to its solid economic management, stable political environment, and access to reliable external funding.
+ Egypt's diversified economic base has helped it weather the COVID-19 pandemic, including external sector weakness, making it one of the only Middle Eastern and North African countries to avoid a contraction in fiscal year 2020.
+ We expect improvement in Egypt's fiscal and balance of payments positions based on its commitment to reduce spending and implement structural reforms on the fiscal side and the availability of funding from supranational organizations and access to international capital markets on the external side.
+ We believe the three to five-year part of the government yield curve presents the most attractive carry and roll opportunities. We also maintain a constructive view on the Egyptian pound, as it is a relatively stable currency in the current US dollar environment and is not highly correlated to the US dollar.

Egypt has emerged as a bright spot in emerging markets investing in recent years. Solid economic management and a stable political environment have offered fixed income investors an improving economic outlook. After successfully completing a three-year International Monetary Fund (IMF) program, the COVID-19 pandemic threatened to derail Egypt's economic recovery in 2020. The Sisi government loosened restrictions to manage the impact of the pandemic, but economic activity was significantly hurt, especially in certain COVID-19-related sectors, such as tourism. Weakened demand from Egypt's key European trading partners also damaged its export volumes. However, Egypt's relatively diversified economy, its commitment to fiscal reform, and stable external funding support make it well-positioned to weather the current challenging conditions brought on by the pandemic, in our view. We maintain a constructive outlook on Egypt's economy.

Diversified economic base generates economic resilience
Egypt's domestic economy is robust, driven by domestic investment, primarily in infrastructure, and agriculture, which was not significantly affected by the COVID-19 pandemic. Public investment, led by the government and military, was briefly halted in the initial months of the pandemic, but quickly resumed in April 2020, helping to offset some of the weakness in Egypt's external sectors, including tourism, keeping growth on track. Due to the diversified nature of Egypt's economy, real gross domestic product (GDP) grew 3.5% in fiscal year 2020, making Egypt the only country in the Middle East and North Africa to avoid a contraction (Figure 1). While the growth outlook remains challenged in the near-term, we believe Egypt's relatively diversified economic base will support its economic resilience.

Figure 1: Real GDP growth for fiscal year 2020 in the Middle East and North Africa



Source: International Monetary Fund, World Economic Outlook Database. Data as of October 31, 2020.

Fiscal position likely to improve

Despite headwinds caused by the pandemic, Egypt has made significant improvements in managing its fiscal position and remains committed to fiscal reform. Because government revenues in Egypt are heavily weighted toward interest payments, wages, and social spending, there is limited flexibility to adjust fiscal spending. In particular, the debt stock has risen recently, and the Central Bank of Egypt (CBE) has kept real interest rates elevated, so debt service costs have dominated fiscal spending. A high interest bill could make reducing Egypt's debt burden challenging in the near term.

Despite these challenges, Egypt made significant progress in reducing fiscal spending under the recently concluded IMF agreement. The government's fiscal deficit was 7.9% of GDP in the most recent fiscal year, higher than its target of 7.2% but less than the previous year's deficit of 8.2% of GDP.[1] The finance ministry has signaled its commitment to further fiscal consolidation and has announced energy price increases for the summer. While fiscal consolidation plans have been partly delayed by the pandemic, we believe Egypt's budget deficit will continue to shrink and that its debt-to-GDP ratio will continue to decline, improving its overall fiscal position.

Weakness in Egypt's balance of payments supported by external funding prospects

Egypt's balance of payments position, while negative in the near term, is manageable over the longer term, in our view, due to the availability of external support. The pandemic had an immediate impact on Egypt's balance of payments: Egypt experienced reserve drawdowns and foreign currency outflows of over USD25 billion in the first three months of the COVID-19 crisis.[2] Because Egypt's external sector relies heavily on tourism and worker remittance receipts from abroad (which together comprise 50% of its current account receipts), it is vulnerable to a worsening global environment.[3] When tourism collapsed due to travel restrictions, Egypt's current account receipts fell sharply. Remittances remained resilient, maintaining a 10% year-over-year growth rate in the fiscal year ending June 2020, but the outlook is challenged due to potentially weaker employment growth in the Middle East.[4]

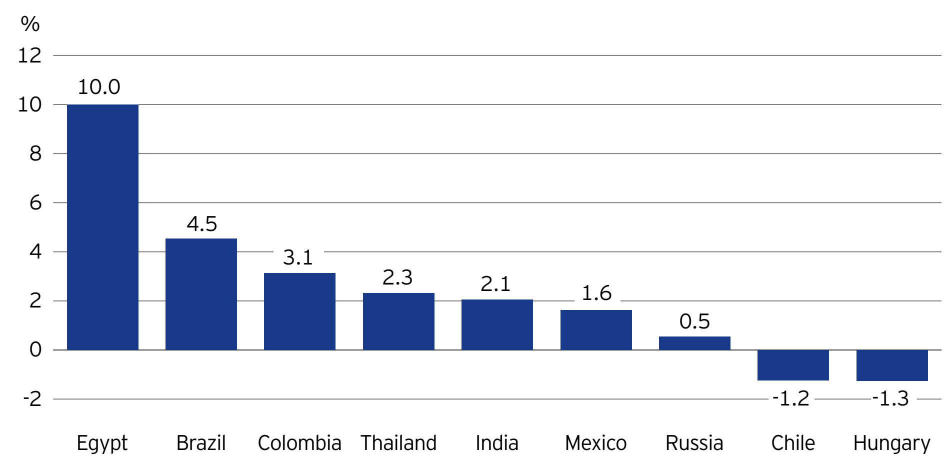
We believe Egypt's current account will recover due to the likely availability of funding from supranational organizations and access to international capital markets. Foreign investors have already returned, and portfolio inflows have recovered from early 2020. Since the beginning of the pandemic, the Sisi administration has secured external funding through the issuance of USD9.5 billion in eurobonds, demonstrating investor confidence.[5] It has also secured USD2.8 billion from the IMF Rapid Financing Instrument and USD5.2 billion from the new IMF 12-month Stand-By Agreement.[6] Given its stable funding prospects and relatively high level of foreign exchange reserves (USD40 billion), Egypt's balance of payments position remains manageable, in our view, despite recent headwinds.[7]

Potential opportunities in interest rates and currency

The CBE has managed monetary policy prudently throughout the pandemic, in our view, including reducing its policy rate by 300 basis points.[8] Inflation dynamics are relatively benign, with inflation expected to remain below the CBE's target band of 5% to 9%. In terms of market accessibility, the Sisi administration has made efforts toward inclusion in major emerging market fixed income indices and Euroclearability. It has also sought to further develop the local currency bond market by issuing longer maturity bonds and engaging with foreign investors to help build investor confidence in Egypt's longer duration bonds.

Due to these developments, Egypt has some of the highest real interest rates in the emerging markets (Figure 2). We believe the three to five-year part of the government yield curve presents the most attractive carry and roll opportunities. We also maintain a constructive view on the Egyptian pound, as it is a relatively stable currency in the current US dollar environment and is not highly correlated to the US dollar.

Figure 2: Real interest rates in selected emerging market countries



Source: Bloomberg L.P. Data as of February 28, 2021. Real rates defined as 5-year government bond yields minus consumer price inflation.

1 Source: Egypt's Finance Ministry, as of November 30, 2020.
2 Source: Bloomberg L.P., as of March 1, 2021.
3 Source: Macrobond, Central Bank of Egypt, as of July 31, 2020.
4 Source: Central Bank of Egypt, as of October 30, 2020.
5 Source: Bloomberg L.P., as of March 1, 2021.
6 Source: International Monetary Fund, as of June 30, 2020.
7 Source: Central Bank of Egypt, as of January 31, 2021.
8 Source: Central Bank of Egypt, as of January 31, 2021.

Conclusion

In addition to Egypt's supportive policy management – before and during the COVID-19 pandemic – the country has made significant progress in restructuring its economy for the longer term, including improvements in governance standards, the business environment, and income per capita. Many of these improvements have bolstered investor confidence in Egypt as an investment opportunity. While there is still room for improvement in terms of Egypt's macro-social factors, such as public safety, government accountability, and political freedoms, we believe political and geopolitical risks are broadly contained. In our opinion, the Sisi administration will continue to make progress in addressing domestic discontent by improving social safety nets and implementing structural reforms to improve Egypt's business and economic environment.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

When investing in less developed countries, you should be prepared to accept significantly large fluctuations in value.

Important information

This document is for Professional Clients only in Dubai, Jersey, Guernsey, Isle of Man, Ireland, Continental Europe (as defined below) and the UK; for Institutional Investors only in the United States, for Sophisticated and Professional Investors in Australia; in New Zealand for wholesale investors (as defined in the Financial Markets Conduct Act); for Professional Investors in Hong Kong; for Qualified Institutional Investors in Japan; in Taiwan for Qualified Institutions/Sophisticated Investors; in Singapore for Institutional/Accredited Investors; for Qualified Institutional Investors and/or certain specific institutional investors in Thailand; in Canada, this document is restricted to Accredited Investors as defined under National Instrument 45-106. It is not intended for and should not be distributed to, or relied upon by, the public or retail investors. Please do not redistribute this document.

For the distribution of this document, Continental Europe is defined as, Austria, Belgium, Bulgaria, Czech Republic, Croatia, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Kosovo, Liechtenstein, Luxembourg, Netherlands, North Macedonia, Norway, Portugal, Romania, Spain, Switzerland and Sweden.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

This overview contains general information only and does not take into account individual objectives, taxation position or financial needs. Nor does this constitute a recommendation of the suitability of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions. It is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or instrument or to participate in any trading strategy to any person in any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it would be unlawful to market such an offer or solicitation. It does not form part of any prospectus. While great care has been taken to ensure that the information contained herein is accurate, no responsibility can be accepted for any errors, mistakes or omissions or for any action taken in reliance thereon.

The opinions expressed are that of Invesco Fixed Income and may differ from the opinions of other Invesco investment professionals. Opinions are based upon current market conditions, and are subject to change without notice.

As with all investments, there are associated inherent risks. Please obtain and review all financial material carefully before investing. Asset management services are provided by Invesco in accordance with appropriate local legislation and regulations.

This material may contain statements that are not purely historical in nature but are "forward-looking statements." These include, among other things, projections, forecasts, estimates of income, yield or return or future performance targets. These forward-looking statements are based upon certain assumptions, some of which are described herein. Actual events are difficult to predict and may substantially differ from those assumed. All forward-looking statements included herein are based on information available on the date hereof and Invesco assumes no duty to update any forward-looking statement. Accordingly, there can be no assurance that estimated returns or projections can be realized, that forward-looking statements will materialize or that actual returns or results will not be materially lower than those presented.

By accepting this document, you consent to communicate with us in English, unless you inform us otherwise. All information is sourced from Invesco, unless otherwise stated.

All data as of March 31, 2021, unless otherwise stated. All data is USD, unless otherwise stated.

Restrictions on distribution

Australia

This document has been prepared only for those persons to whom Invesco has provided it. It should not be relied upon by anyone else. Information contained in this document may not have been prepared or tailored for an Australian audience and does not constitute an offer of a financial product in Australia. You may only reproduce, circulate and use this document (or any part of it) with the consent of Invesco.

The information in this document has been prepared without taking into account any investor's investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs.

You should note that this information:

– may contain references to dollar amounts which are not Australian dollars;
– may contain financial information which is not prepared in accordance with Australian law or practices;
– may not address risks associated with investment in foreign currency denominated investments; and
– does not address Australian tax issues

Issued in **Australia** by Invesco Australia Limited (ABN 48 001 693 232), Level 26, 333 Collins Street, Melbourne, Victoria, 3000, Australia which holds an Australian Financial Services License number 239916.

Canada
This document is restricted to accredited investors as defined under National Instrument 45-106. All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. This is not to be construed as an offer to buy or sell any financial instruments and should not be relied upon as the sole factor in an investment making decision. As with all investments there are associated inherent risks. Please obtain and review all financial material carefully before investing. Issued in **Canada** by Invesco Canada Ltd., 5140 Yonge Street, Suite 800, Toronto, Ontario, M2N 6X7.

Further information is available using the contact details shown:
- Issued in **Belgium, Denmark, Finland, France, Greece, Italy, Netherlands, Spain, Sweden, Luxembourg, Norway and Portugal** by Invesco Management S.A., President Building, 37A Avenue JF Kennedy, L-1855 Luxembourg, regulated by the Commission de Surveillance du Secteur Financier, Luxembourg. .
- Issued in **Dubai** by Invesco Asset Management Limited. PO Box 506599, DIFC Precinct Building No 4, Level 3, Office 305, Dubai, UAE. Regulated by the Dubai Financial Services Authority.
- Issued in **Austria** and **Germany** by Invesco Asset Management Deutschland GmbH, An der Welle 5, 60322 Frankfurt am Main, Germany.
- Issued in **Switzerland** by Invesco Asset Management (Schweiz) AG, Talacker 34, 8001 Zurich, Switzerland.
- Issued in **Ireland, the Isle of Man, Jersey, Guernsey** and the **United Kingdom** by Invesco Asset Management Limited which is authorised and regulated by the Financial Conduct Authority. Invesco Asset Management Ltd, Perpetual Park, Perpetual Park Drive, Henley-on-Thames, RG9 1HH, UK.

Hong Kong
This document is provided to professional investors (as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules) only in Hong Kong. It is not intended for and should not be distributed to or relied upon by the members of public or the retail investors. Issued in Hong Kong by Invesco Hong Kong Limited 景順投資管理有限公司, 41/F, Champion Tower, Three Garden Road, Central, Hong Kong.

Japan
This document is only intended for use with Qualified Institutional Investors in Japan. It is not intended for and should not be distributed to, or relied upon, by members of the public or retail investors. Issued in Japan by Invesco Asset Management (Japan) Limited, Roppongi Hills Mori Tower 14F, 6-10-1 Roppongi, Minato-ku, Tokyo 106-6114; Registration Number: The Director-General of Kanto Local Finance Bureau (Kin-sho) 306; Member of the Investment Trusts Association, Japan and the Japan Investment Advisers Association.

New Zealand
This document is issued in New Zealand only to wholesale investors (as defined in the Financial Markets Conduct Act). This document has been prepared only for those persons to whom it has been provided by Invesco. Information contained in this document may not have been prepared or tailored for a New Zealand audience. This document does not constitute and should not be construed as an offer of, invitation or proposal to make an offer for, recommendation to apply for, an opinion or guidance on Interests to members of the public in New Zealand. Any requests for information from persons who are members of the public in New Zealand will not be accepted. Issued in New Zealand by Invesco Australia Limited (ABN 48 001 693 232), Level 26, 333 Collins Street, Melbourne, Victoria, 3000, Australia, which holds an Australian Financial Services Licence number 239916.

Singapore
This document may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 304 of the Securities and Futures Act (the "SFA"), (ii) to a relevant person pursuant to Section 305(1), or any person pursuant to Section 305(2), and in accordance with the conditions specified in Section 305 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. This document is for the sole use of the recipient on an institutional offer basis and/ or accredited investors and cannot be distributed within Singapore by way of a public offer, public advertisement or in any other means of public marketing. Issued in Singapore by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.

Taiwan
This material is distributed to you in your capacity as Qualified Institutions/Sophisticated Investors. It is not intended for and should not be distributed to, or relied upon, by members of the public or retail investors. Issued in Taiwan by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800- 045-066). **Invesco Taiwan Limited is operated and managed independently.**

United States
Issued in the United States by Invesco Advisers, Inc., Two Peachtree Pointe, 1555 Peachtree Street, N.E., Suite 1800, Atlanta, Georgia, 30309.