

Egypt's Precarious Economic Stabilization

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In September 2023, a Bloomberg analysis placed Egypt only second to Ukraine on a list of countries most at risk from debt.¹ Soon after, Moody's, Fitch and S&P² unanimously downgraded the country's credit rating deeper into or closer to junk territory. Indeed, since the second quarter of 2022, Egypt has witnessed severe foreign currency shortages, a general economic slowdown and historically high inflation rates,³ induced by the real depreciation of the Egyptian pound vis-à-vis the US dollar. Come March 2024, things suddenly took a dramatic turn. The watershed moment was the announcement of the Ras El Hekma deal struck between Egypt and the United Arab Emirates: a \$35-billion partnership agreement to develop the 40,600 acre area, located 350 km northwest of Cairo.⁴ The investment partnership secured a massive inflow of dollars for the Egyptian government in the immediate run, deemed necessary to bridge the country's financing gap and enable it to meet its huge external commitments. Egypt has received a total of \$24 billion over the past two months, in addition to a credit swap of \$11 billion in existing debt.

This was soon followed by the IMF's approval of an augmentation of the original programme by \$5 billion "allowing the authorities to draw the equivalent of about \$8.2 billion."⁵ In the meantime, European Union leaders allocated an additional 7.4 billion euros,⁶ including one billion in immediate aid. A few days earlier, the World Bank had issued a statement⁷ declaring the allocation of \$3 billion for financial support to government programmes over the next three years.

Unsurprisingly, this sudden and immediate inflow of dollars to Egypt has drastically changed the future prospects for the country. After having forecast a \$17 billion financing gap in the years 2023-2026, Goldman Sachs has now projected a \$26 billion⁸ external funding surplus for Egypt in the following four years. By a similar token, the three leading global credit rating agencies have upgraded the country's future outlook.⁹

Unprecedented Exposure to the Vagaries of Global Finance

Following the revolution of January 2011, the Egyptian economy went through a downward economic spiral. Growth rates declined, unemployment skyrocketed, investment rates collapsed and the country's foreign currency reserves were all but depleted

¹ www.bloomberg.com/news/articles/2023-09-27/egypt-transfixes-market-as-jpmorgan-imf-moody-s-wait-and-worry.

² www.moody.com/credit-ratings/Egypt-Government-of-credit-rating-258330?lang=en&cy=can; www.fitchratings.com/entity/egypt-80442214#ratings; <https://disclosure.spglobal.com/ratings/>.

³ <https://english.ahram.org.eg/News/504423.aspx>.

⁴ <https://timep.org/2024/03/12/understanding-egypts-ras-al-hekma-land-deal-no-panacea/>.

⁵ www.imf.org/en/News/Articles/2024/03/29/pr24101-egypt-imf-executive-board-completes-first-second-reviews-eff-approves-augmentation.

⁶ <https://english.ahram.org.eg/News/519534.aspx>.

⁷ www.worldbank.org/en/news/statement/2024/03/18/world-bank-group-statement-of-support-to-egypt-s-development-and-reform-efforts.

⁸ www.businesstodayegypt.com/Article/1/4253/Goldman-Sachs-expects-26-5B-external-funding-surplus-for-Egypt.

⁹ <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/type/HTML/id/3140215>.

by 2013. Two additional years of turmoil exacerbated many of the country's economic and financial structural weaknesses.

In November 2016, the newly-stabilized regime reached a deal with the IMF.¹⁰ In return for a sharp devaluation of the Egyptian pound and committing to severe austerity measures, the Egyptian government received a \$12-billion loan from the IMF. This was just a part of a bigger package of \$21 billion, which depended on the IMF deal facilitating Egypt's borrowing an additional \$9 billion from international markets.

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The large inflows of capital did allow the government to rebuild its foreign reserves, stabilize many of its macroeconomic indicators including exchange, interest and inflation rates and hence relaunch the economy's growth. The economic recovery had admittedly come at a very high social cost, with "official" national poverty rates¹¹ increasing by 5% in four years (2015-2019). This was justified, however, as part of the bitter pill Egypt had to swallow: a necessary price to pay for longer-term growth and stability. However, the same process also put Egypt on a path of debt-driven and -dependent economic recovery. The Egyptian economy showed a sustained need for fresh credit injections in order to meet its external financial needs, which started with financing a huge import bill and devolved to looking for sources to roll over the mounting foreign debt.

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starts, relying on access to fresh loans from International Financial Institutions, namely the IMF, the private creditors investing in government Eurobonds, as well as domestic debt-for-currency swaps.

Immediately after the expiration of the IMF deal in late 2019, Egypt started facing foreign financing problems. Between March¹² and May¹³ 2020, Egypt received an additional \$7.9 billion in assistance from the IMF.

The increasing weight of IFIs in Egypt's foreign debt stock proved to be complicit and complementary to private creditors, mainly investment banks and private equity funds. Between 2016 and 2022, the share of private creditors jumped from eight to 28 percent, an almost fourfold increase, according to the Central Bank of Egypt.

It is an understatement to hold that Egypt's post-2016 recovery has been largely debt-driven. Indeed, Egypt's external debt stock increased by almost 307 percent between 2012 and 2022. In the same vein, external debt stocks as a percentage of GDP more than doubled during the same period, jumping from 14.35 to 34.21 percent

Admittedly, these figures only capture the evolution of the medium-and long-term foreign debt stock. Slightly less visible are the huge inflows of private foreign credit to finance domestic treasury bills through currency swaps with the Egyptian Central Bank. The 2016 IMF deal was key to raising domestic interest rates, rendering them the highest¹⁴ in the world. With the Federal Reserve keeping interest rates on the dollar close to zero, many global investment banks and funds found it appealing to buy domestic debt instruments from the Egyptian government. This was short-term debt that was primarily used by the Central Bank in order to replenish its foreign reserves. Naturally, such short-term capital flows, also known as hot money, were particularly susceptible to external shocks.

Subsequently, the Egyptian economy became exposed to the vagaries of global finance in an unprecedented manner. In the first quarter of 2022,

¹⁰ www.imf.org/en/News/Articles/2016/11/11/PR16501-Egypt-Executive-Board-Approves-12-billion-Extended-Arrangement.

¹¹ <https://egyptindependent.com/poverty-impedes-achievement-of-sustainable-development-in-arab-countries/>.

¹² www.imf.org/en/News/Articles/2020/05/11/pr20215-egypt-imf-executive-board-approves-us-2-772b-in-emergency-support-to-address-the-covid19.

¹³ www.imf.org/en/News/Articles/2020/06/26/pr20248-egypt-imf-executive-board-approves-12-month-us-5-2billion-stand-by-arrangement.

¹⁴ www.bloomberg.com/news/articles/2021-03-18/egypt-sticks-with-world-s-highest-real-interest-rate.

more than \$20 billion¹⁵ flowed out of the country, partly in the wake of the Ukraine war, but also in response to the Federal Reserve's continuous interest rate hikes. It soon became clear that Egypt, along with scores of other low- and middle-income countries,¹⁶ was to be virtually cut off from global financial markets. This would have come at a very bad moment for Egypt on multiple fronts. As a net food and fuel importer, higher primary commodity prices put more pressure on the country's foreign position. It also came hand in hand with record-high forecasts for foreign debt service for 2024, 2025 and 2026 estimated at 34.9, 19.4 and 25.2 billion, according to Central Bank figures.¹⁷

Left in Limbo (2022-2024)

In the face of such a dire situation, the Egyptian government fell back on its regional safety net: its friends and allies in the Gulf Cooperation Council (GCC). Initially, it was a good bet. The Saudis, Emiratis and even the then recently reconciled Qataris poured in billions of dollars, which enabled the rebuilding of the country's foreign reserves. It is estimated that in the first quarter of 2022, Egypt received an amount of dollars equivalent to its outflows (\$22 billion) in Central Bank deposits.¹⁸ These money inflows have been critical for filling the country's huge and ever-widening external financing gap, supporting its national currency versus the US dollar and overall stabilizing its macroeconomic indicators. This would put the share of short- and long-term GCC deposits in the Egyptian Central Bank as high as 82% of total foreign reserves in March 2023.¹⁹

However, the zeal with which the GCC averted what could have become a disaster (i.e. Egypt running out

of dollars to finance its imports and meet its external commitments), did not translate into a similar willingness to finance an economic recovery.

Instead of effecting a massive transfer of capital to Egypt as happened in the interval between 2013 and 2015,²⁰ the GCC governments started talking about the need for economic reforms, especially regarding the country's foreign exchange regime and the extent of state involvement in the economy. This set the framework for another deal with the IMF and a, not-so-frequent, alignment between IFIs and GCC countries. In the past, Egypt had been somewhat successful in using IFIs and GCC countries as substitutes.

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In 2022, Egypt concluded eight long months of negotiations with the IMF. They reached a deal securing a meagre \$3 billion of financing, which fell well short of the country's needs. In the meantime, the IMF stated that its programme would depend on attracting capital in the form of investment and credit from the GCC countries.²¹ This was an interesting instance of alignment between the IMF and the GCC. In the past, they had mainly acted as substitutes for each other. This was the case with the Paris Club debt forgiveness in the early 1990s and the IMF deal in 2016. Conversely, the GCC countries were interested in tightening the IMF's conditionality on Egypt in the areas of the foreign exchange regime and state ownership of assets, before they injected badly needed dollars into Egypt's economy.²²

¹⁵ www.reuters.com/markets/europe/egypt-can-no-longer-depend-hot-money-budget-finance-minister-2022-06-27/.

¹⁶ www.reuters.com/markets/europe/big-default-dozen-countries-danger-zone-2022-07-15/.

¹⁷ CENTRAL BANK OF EGYPT, *External Position of the Egyptian Economy*, July/September 2023/2024; Volume No. (83): p. 38.

¹⁸ ESPAÑOL, Marc, "Gulf states give Egypt \$22 billion to mitigate fallout from Ukraine war." *Al-Monitor* 11 April 2022, www.al-monitor.com/originals/2022/04/gulf-states-give-egypt-22-billion-mitigate-fallout-ukraine-war.

¹⁹ CENTRAL BANK OF EGYPT, International reserves: www.cbe.org.eg/en/markets/international-reserves (accessed 5 June 2023).

²⁰ Between 2013 and 2015, Egypt received around \$23 billion in aid and subsidized credit from Saudi Arabia, the United Arab Emirates and Kuwait. A year earlier (2012-2013), the country had received support from Qatar in the vicinity of \$8 billion, primarily in the form of Central Bank deposits.

²¹ INTERNATIONAL MONETARY FUND, "IMF executive board approves 46-month USD 3 billion extended arrangement." 16 December 2022: www.imf.org/en/News/Articles/2022/12/16/pr22441-egypt-imf-executive-board-approves-46-month-usd3b-extended-arrangement.

²² SAYIGH, Yezid. "Assessing Egypt's state ownership policy: challenges and requirements." 8 May 2023: <https://carnegie-mec.org/2023/05/08/assessing-egypt-s-state-ownership-policy-challenges-and-requirements-pub-89637>.

From Market Exposure to Geopolitical Dependency

Egypt was left for two long years, proving to be too big to fail, but also too big to bail.²³ However, as the economy hobbled on, the situation in the region deteriorated considerably with the breakout of the civil war in Sudan, the Israeli war on Gaza and the subsequent flaring of tensions with Iran and its proxies in Lebanon, Syria, Iraq and Yemen, including the sustained disruption of trade movement in the Red Sea.

Quickly enough, Egypt looked like a bastion of political and security stability in a very unstable and critical part of the world. This must have sent clear signals to the sponsors-cum-donors/investors/creditors to start moving in order to ease the country's departure from its financial distress. Hence, came the "seemingly" – albeit informally – coordinated inflows of capital in multiple forms of credit and foreign direct investment, in the first half of 2024, from the UAE, IFIs and the EU.

This could be interpreted in many ways. On the one hand, it vindicates the Egyptian government's assumption that the country was indeed too big to fail. On the other, it highlights a continuity in Egypt's rising dependency on foreign funding in order to keep its economy going and to evade default. The mechanism of such a dependency has simply shifted from being exposed to global financial markets, where debts were raised between 2017 and 2022, to more openly politically-inspired bailouts. Since the 2016 deal with the IMF, Egypt has demonstrated an ever-growing need for foreign financing rounds, which have involved bigger amounts and at more regular inter-

vals. Thus, Egypt's precarious stabilization has continued, and has perhaps even worsened.

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The one potential difference is the form that this recent bailout took, especially with regard to the UAE's deal in Ras El Hekma. The very fact that the inflows were neither credit nor aid, but rather foreign direct investment, is indeed noteworthy. Not only does it promise the delivery of Egypt from its crushing foreign debt burden in the coming years, but it might also pave the way for shifting the financial dependency from debt to FDIs. This could be an upgrade, albeit remaining firmly within a relationship of dependency. However, for this to take place in the relatively near future, significant institutional and regulatory changes are needed in order to create an environment conducive to foreign investment. Whether the ruling coalition would be politically capable of delivering such sweeping changes to its modus operandi is uncertain, if not doubtful.

²³ SPRINGBORG, Robert. "Is Egypt Too Big to Fail or Too Big to Bail?" 8 May 2023: <https://carnegieendowment.org/2023/05/08/is-egypt-too-big-to-fail-or-too-big-to-bail-pub-89639>.