FLASH NOTE:
REASONS & RISKS OF EGYPT'S PUBLIC DEBT ...

PUBLIC DEBT IS DEFINED AS THE TOTAL FINANCIAL OBLIGATIONS IN LOCAL AND FOREIGN CURRENCIES (DOMESTIC AND EXTERNAL DEBT) INCURRED BY THE GOVERNMENTAL BODIES OF A NATION. THROUGHOUT ITS MODERN HISTORY, EGYPT HAS ALWAYS BORNE THE BURDEN OF RELATIVELY HIGH LEVELS OF PUBLIC DEBT THAT HAS RECENTLY REACHED UNPRECEDENTED LEVELS DUE TO THE INCREASE IN GOVERNMENT EXPENDITURES AND DETERIORATION OF KEY SOURCES OF NATIONAL INCOME.

THERE IS A DEBATE ABOUT THE OPTIMAL RATIO OF THE GOVERNMENT DEBT TO GDP ESPECIALLY THAT MOST DEVELOPED AND DEVELOPING COUNTRIES ARE FACING THE PROBLEM OF HAVING HIGH LEVELS OF DEBT, WITH THE EXCEPTION OF THE GULF COUNTRIES THAT BENEFITED FROM THE RISE IN INTERNATIONAL OIL PRICES DURING THE LAST FEW YEARS (PRIOR TO THE DECLINE IN PRICES WITNESSED IN 2014 AND 2015 WHEN AVERAGE PRICES REACHED ABOUT $ 38 PER BAREL IN DEC. 2015 COMPARED TO $ 98 IN DEC. 2013). HOWEVER, MOST INTERNATIONAL ORGANIZATIONS STILL CATEGORIZE EGYPT'S DEBT LEVELS AS BEING RISKY WITH THE ABSENCE OF A STRONG SUPPORT FROM ALLYING COUNTRIES (THE EU IN THE CASE OF GREECE) OR A RESILIENT ECONOMY THAT CAN BACK THE COUNTRY'S ABILITY TO MEET ITS DEBT OBLIGATIONS (THE CASE FOR THE US).

COMPARATIVE RATIOS OF PUBLIC DEBT TO GDP (2014)

LEBANON	USA	EURO ZONE	EGYPT	JORDAN	MOROCCO	TUNISIA	QATAR	UAE	ALGERIA	SAUDI ARABIA
133.4%	101.2%	90.9%	87.1%	86.7%	61.7%	44.4%	32.1%	15.9%	8.3%	2.2%

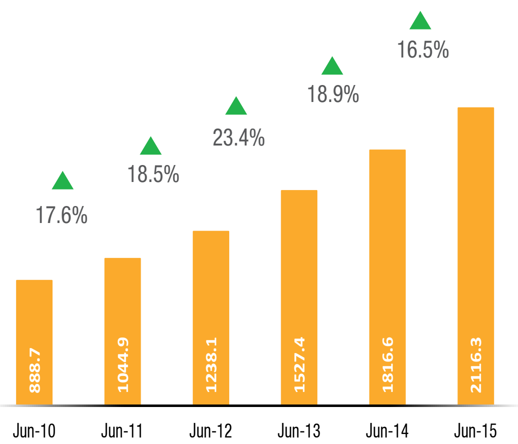
Source: Trading Economics

DOMESTIC DEBT

Domestic debt is concentrated in EGP government loans financed via individuals, banks and non-banking institutions. Egypt's domestic debt has kept increasing in the last 5 years, reaching unprecedented levels in June 2015, where it reached about EGP 2.1 trillion compared to EGP 888.7 billion in June 2010. Similarly, the domestic debt to GDP ratio increased to 88% in June 2015, compared to 73.6% in June 2010.

This increase is mainly attributed to the fact that government expenditures have been increasing at a faster pace than its revenues, leading to a rising budget deficit (The difference between the government's annual revenues and expenditures, that increased by about 158% during the period from 2009/10 to 2013/14) and a steady increase of indebtedness accordingly. On the expenditures side, different items like wages, interest payments, subsidies and public investments have significantly increased after the breakout of the 2011 Revolution, while state revenues, especially tax proceeds, were negatively affected by the witnessed political and economic instability.

EGYPT'S DOMESTIC DEBT (EGP BN.)



Source: Central Bank Of Egypt

GOVERNMENT'S ANNUAL REVENUES AND EXPENDITURES (EGP BN.)

	2010/11	2011/12	2012/13	2013/14	2014/15
Total Revenues	265.3	303.6	350.3	456.8	465.2
Tax Revenues	192.1	207.4	251.1	260.3	306
Grants	2.3	10.1	5.2	95.9	25.4
Other Revenues	70.9	86.1	94	100.6	133.8
Total Expenditures	401.9	470.9	588.2	701.6	733.5
Wages	96.3	122.8	143	178.6	198.5
Public Investments	39.9	35.9	39.5	52.9	61.8
Interest Payments	85.1	104.4	147	173.2	193
Subsidies & Social benefits	123.1	150.2	197.1	228.6	198.6
Other Expenditures	57.5	57.6	61.6	68.3	81.6

Source: Ministry Of Finance

81% of domestic debt is financed through the government issuance of T-Bills, with a maturity of 91, 182, 273 and 364 days respectively in addition to T-Bonds that have an average life of 3.39 years (As of June 2015).

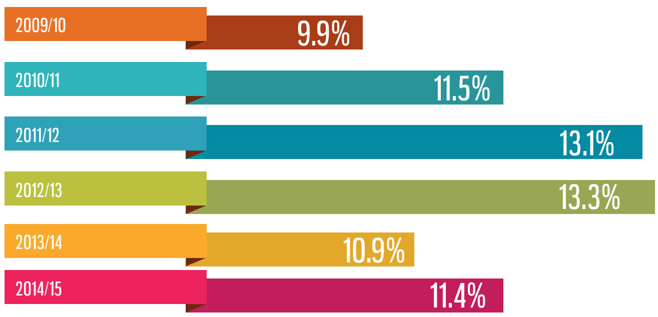
79% of issued Treasury Bills during June 2015 were held by Egyptian banks, making them the largest creditor to the government. Egypt's 3 state-owned banks hold about 50% of these bills, while the remaining percentage is held by private banks and foreign banks-branches.

37.4% of government expenditures in 2013/14 went towards the repayment of domestic debt service (inclusive of interest and principal payments, compared to 23.9% in 2009/10.

- Interest rates on T-Bills kept rising after 2011 due to increasing political and economic risks, then they started to decrease during 2013/14 after the inflow of Gulf aid to Egypt and the improvement of Egypt's credit rating. However, interest rates rose again in 2014/15, affected by increasing government's need for debt and the devaluation of the Egyptian Pound.

- Sovereign Credit Rating measures the country's ability to meet its financial obligations. Most international rating agencies upgraded both Egypt's sovereign credit rating and its outlook during 2014 and 2015 after receiving significant aid from Gulf countries and adopting economic and fiscal reform programs, which enhanced Egypt's ability to obtain finance at lower interest rates. However, S&P rating agency downgraded Egypt's outlook from "positive" to "stable", despite expecting a continued gradual economic recovery, due to expectd high fiscal imbalances and domestic debt ratios in the period from 2015 to 2018, with fiscal pressures in the Gulf that would lead to dwindling aid to Egypt.

INTEREST RATES ON 91-DAY T-BILLS



Source: Ministry Of Finance

EGYPT'S SOVEREIGN CREDIT RATING (2015)

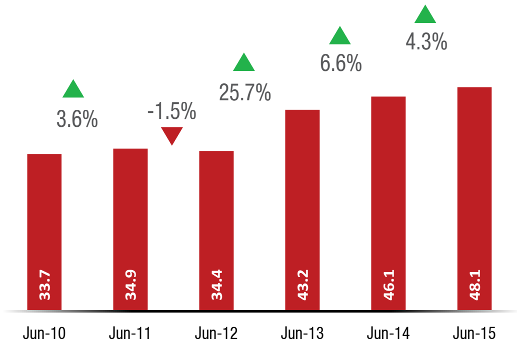
	FROM	TO	ACTION	OUTLOOK
MOODY'S	Caa1	B3	Upgraded	Stable
FITCH	B-	B	Upgraded	Stable
S&P*	B-	B-	Affirmed	Stable

*STANDARD & POOR'S

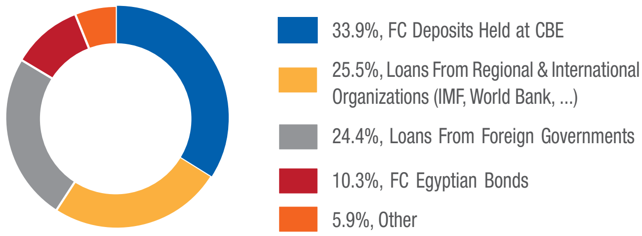
EXTERNAL DEBT

- External debt is defined as government loans attained in foreign currency from international creditors. In Egypt, it had an upward trend during the period from June 2010 to June 2015, representing 15% of GDP at the end of this period. This increase is mainly attributed to the decrease in key sources of foreign currency after 2011, including tourism revenues, exports and FDIs.
- Egypt's external debt mainly consists of loans from foreign governments[1] and regional & international monetary agencies like the World Bank and the IMF. It also includes bonds offered in international markets and deposits held by the Central Bank of Egypt. Egypt issued $ 1.5 billion of bonds in international markets last June as a part of its plan to diversify the sources of its external debt. It also plans to issue a new debt instrument called "Sukuk", which are Sharia compliant bonds that aim at attracting investments from Gulf nations.

EGYPT'S EXTERNAL DEBT ($ BN.)



BREAKDOWN OF EGYPT'S EXTERNAL DEBT COMPOSITION



Source: Central Bank Of Egypt

RISKS OF RISING DEBT

- Crowding-out bank loans to the private sector, preferring safe lending to the government at high interest rates which leads to a decline in the loans to deposits ratio in the banking sector. Depriving corporates and SMEs from potential funds could negatively impact economic activity and GDP growth rate, leading to a further rise in the debt to GDP ratio accordingly.
- The alternative opportunity cost of reallocating such resources (Debt service cost) to social expenditures on education, health and welfare programs that can target low-income groups. In addition, it decreases public investments in infrastructure projects that are essential for attracting foreign and domestic investments.
- Increasing the cost of borrowing and limiting access to more funds because of the decreasing confidence in the Egyptian economy.
- It's unlikely for Egypt to fail in meeting its external debt obligations because of the favorable structure of Egypt's external debt (95% of it is represented by medium and long term debt) which mitigates the burden of periodical payments; however, escalating debts increase the chances of such risk that may lead to severe negotiations with creditors to restructure owed debts and seeking help from neighboring countries.

GOVERNMENTAL EFFORTS TO CONTAIN THE INCREASING DEBT

- The Egyptian government aims to reduce the public debt to GDP ratio through tackling reasons behind the increase in both domestic and external debt. For domestic debt, authorities are trying to decrease the annual budget deficit to 8% of GDP from the current level of 11.5% by 2018/19 through:
    - Gradually cutting energy subsidies that have always represented a high share of government expenditures. The first stage of that plan was already implemented by raising energy prices by 40–80% in July 2014.

[1] Mainly Paris Club which is an group of creditor nations whose objective is to find workable solutions to payment problems faced by debtor nations. The Paris Club has 20 permanent members, including most of the western European and Scandinavian nations, the United States of America, the United Kingdom and Japan. The Paris Club activity is organized around monthly sessions prepared by a Secretariat General. The Chair and the General Secretariat of the Paris Club are run by senior officials from the French Treasury.

- Planning to raise tax revenue through applying the VAT system.

- For external debt, the government is trying fix the balance of payments' imbalances in order to be able to meet its constant need of foreign currency and lessen the dependence on external debts through:
  - Attempting to lower imports and encourage exports by offering cash incentives to exporters and devaluate the Egyptian Pound to raise the competitiveness of Egyptian goods in international markets.
  - Encouraging FDIs to reach pre-2011 levels through enhancing the local investment climate and organizing an international conference to offer major investment opportunities in Egypt.

SOURCES

- Ministry Of Finance, The Financial Monthly, September 2015
- Central Bank Of Egypt, Monthly Statistical Bulletin, October 2015
- Investing.com, Crude Oil Historical Data

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