



MULTIPLES GROUP
PRIVATE EQUITY & INVESTMENT BANKING

SNAPSHOT



Issue #8

**The IMF Loan to Egypt:
Reasons & Implications**

December 2016



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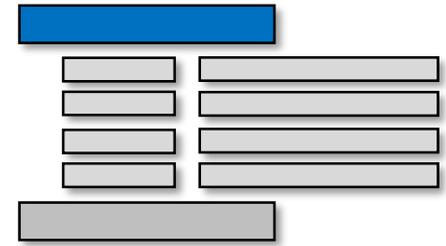
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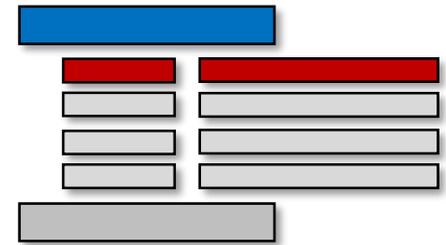
Introduction



Countries resort to debt to finance their expenditure and in most cases, to bail themselves out of an economic crisis. Recently Egypt has obtained a loan from the International Monetary Fund (IMF) to fund its economic reform program after negotiating several measures that have been applied to obtain the loan. This report aims to discuss the nature of the loan and its expected consequences in light of the country's economic reform program.



What is the Type of Loan that Egypt Has Obtained?



Type of loan

- In August 2016, Egypt has signed a staff-level agreement to get a three-year Extended Fund Facility (EFF).
- The main aims of the IMF's facility are to assist countries characterized by :
 - Serious payments imbalances caused by structural impediments.
 - Slow economic growth and an inherently weak balance of payments position.

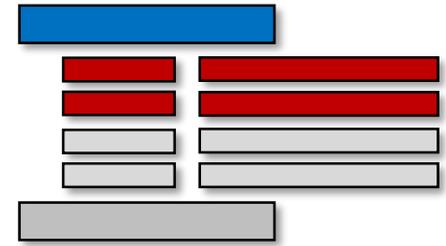
Structure

- Egypt has obtained a 12 BN USD facility in November 2016.
- Tranches of the loan will be received over 3 years.
- The first 2.75 BN USD tranche has been disbursed after the IMF's executive board approved it on the 11th of November.
- The loan will be repaid over a 10-year period.

Conditions

- There are no set conditions for the loan, yet the IMF required the Egyptian government to apply its economic reform measurements to obtain the loan including floating exchange rate and subsidies removal.

Why Did Egypt Request the IMF Loan?

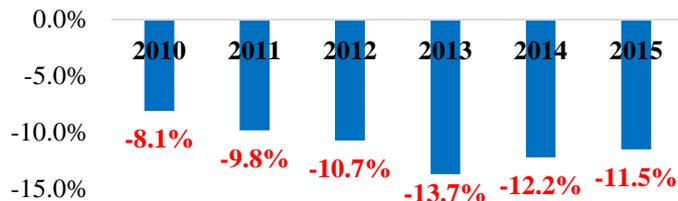


Egypt has requested the loan in order to finance its economic reform program which mainly aims to:

Control Budget Deficit

- Egypt has been facing a widening budget deficit since 2011 uprising.
- Despite reduction trials, the deficit amounted to 11.5% of the GDP in 2015 .
- This derives the need to get an external source to finance the country's expenditure transitionally until the budget gets under control.

Budget deficit as a % of GDP

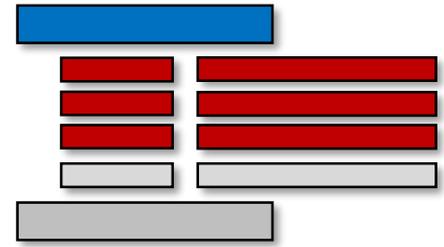


Increase Confidence in the EGP

- After a sharp wave of depreciation has hit the country's currency, the central bank has failed to defend the pound.
- Having two exchange rates systems has affected foreign direct investments and the functioning of the economy
- The Central Bank floated the pound, moving down from 8.8 officially, floated at 13 and reaching around 17-18 USD now.

Q3

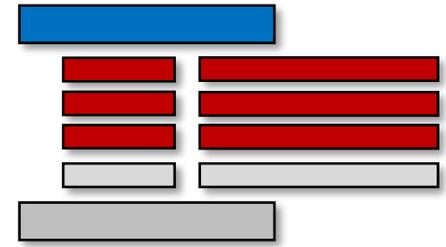
What is the Nature of Egypt's Economic Reform Program?



IMF DEAL



What is the Nature of Egypt's Economic Reform Program?



Egypt's Economic reform program comprises four main aspect including:

Subsidies Removal



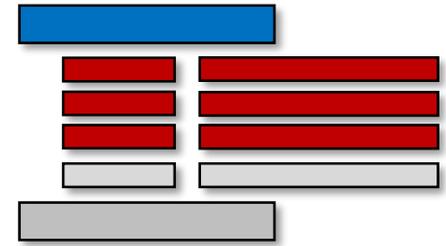
- This measure aims to reduce expenditure and hence reduce the strain on the country's financials.
- It is applied on energy prices as the government hiked the price of diesel and petrol at an average of 30.5% and 47% respectively.
- In addition, the government has raised the prices of essential public services including water and electricity at an average of 35%.
- A complete subsidy removal for the mentioned items is planned to be implemented within the next three years.

Taxation



- The country has adopted a 13% Value Added Tax (VAT) instead of general sales tax to widen its tax base and increase its income and hence minimize its deficit.
- Also, an increase in income tax is expected.
- Civil service law states that government employees' incentives will increase from 2.5% to 5%, however, only 10% of the employees will be eligible for the incentive based on their performance.

What is the Nature of Egypt's Economic Reform Program?



Floating Exchange Rate



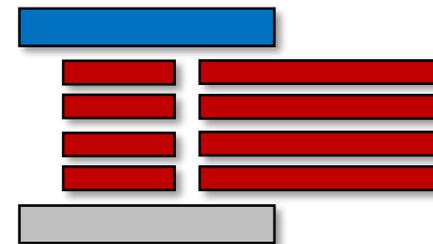
- Egypt's Central Bank has floated the pound currency, devaluing by 32.3% to an initial guidance level of 13 pounds to the USD.
- The pound is left to float, and the dollar is rate is currently 17-18.
- The bank has accompanied this decision by a contractionary monetary policy by increasing interest rates.
- The decision aims to limit black market and leave banks to determine exchange rates based on supply and demand.
- Also, public banks had issued bonds with 20% interest rates to attract investment substituting the investment in the dollar and hence supporting the pound.

Privatization



- The government is seeking to increase its income through the sale of some profitable, state-owned banks or companies to investors or publicly listing it in the stock market.

What are the Expected Consequences of the Loan?



As the economic reform measures include floating exchange rates and hence currency depreciation, the following advantages are assumed to result:

Advantages

Encourage FDI

- The government is expecting Foreign direct investment flow to the country amid currency depreciation.
- Yet, it is not expected to flow quickly as their concerns are not short of currency but also includes bureaucracy and political instability.

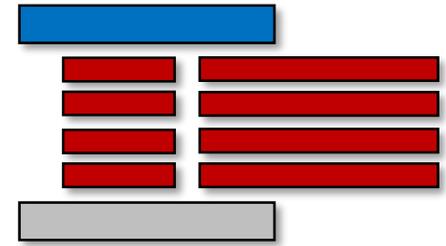
Increased Flow of Funds

- Increase flow of funds from portfolio investors who invest in government bonds which would be encouraged after the containment of the currency risk.

Increase Return on Tourism

- Yet, this is not expected to result quickly as it is not only reliant on the currency market but rather on political and security situations.

What are the Expected Consequences of the Loan?



However, the application of the mentioned measures will result in:

Risks

Inflationary Wave

- Amid the VAT application, currency devaluation and subsidy removals Egypt is expected to face a harsh inflationary wave.
- The IMF forecasts that the inflation rate will reach 17-18%, while real inflation might be even higher specially in the coming few months
- This is expected to last for the coming two years

Diminishing Purchasing Power

- As the price hikes are not outweighed by an increase in income
- This is expected to diminish the real purchase power of people and thus affect the demand on different goods and services in the economy, which is going to affect the GDP growth rate. This is expected to push the poverty rates.
- This will be the trend over the coming two years

Re-Pricing of Assets

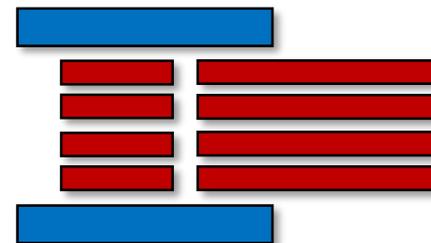
- As a result of currency depreciation, it is expected that different types of assets will be re-priced; including stocks in the market and real estate.
- This will take place throughout 2017

Labor Cost

- Employees will demand higher wages as inflation rates hike which will exert a severe pressure on firms. This is expected to be done over waves in the coming couple of years



Conclusion



Receiving the IMF loan has prevented the country from falling into a currency crisis and will achieve short-term economic stability which has started to be reflected through the stock market gains and foreign currency ease, in addition to increase in liquidity of foreign currency.

However, the social cost from the resulting inflationary wave might create a climate of social instability which will negatively affect the economy. In addition, the economic reforms are not sufficient to revive the economy.

The end result of the program will be quite positive on the currency; achieving currency stability in the short term, while it would be very tough on the inflation and growth. As a result, the economy is expected to witness stagflation – a mix between stagnation and inflation – over the coming couple of years.



Thanks ... End

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