

## Emirates MENA Top Companies Fund MENA Market Outlook & Positioning - Egypt

### Egypt

Egypt has made significant strides since the currency devaluation. The country's infrastructure and road network has improved leaps and bounds, increasing its coverage across the country. Moreover, there have been major developments well underway in the New Capital, with the new ministries complex on track for completion by the end of next year.

From a financial perspective, Egypt has managed to reduce its current account deficit from above 5% of GDP to around 2.5% (excluding grants). It has also managed to reduce its budget deficit from 16.5% in 2013 to 8.5% of GDP in 2018, while growing its economy by 5.5% (up from the 2.2% in 2013). Growth is expected around 5.5% to 6% over the coming 3 years supported by further gain in tourism, domestic consumption and oil and gas.

### The real opportunity

The real opportunity lies in the size of Egypt's unofficial cash economy. The gap between the official numbers and cash economy is estimated to be around 60-70% of official GDP (~USD250 billion). It was this cash economy that supported Egypt over the past 5 years (among the most challenging period since the 1930s) and it is this cash economy that is likely to support economic growth through increased private consumption heading into the future.

### Where do we head from here

The private sectors agree on 2 major challenges to unlocking economic activity: 1) another 300 basis points cut is needed to bring interest below < 13.0% and 2) reducing bureaucracy and red tape.

So far, interest rates have been reduced by 3% since post devaluation peak and the Ministry of Finance is budgeting a 3% decrease in interest expense for the next fiscal year (which starts in June 2019). On the monetary side, the Central Bank understands how crucial this issue is and closely monitors inflation and global dynamics (which are much more accommodative versus last year).

The Central Bank is likely to wait till after the last leg of the subsidy removals in July 2019 before cutting rates. We believe the impact of these subsidy removals will be within 2% increase to inflation, which is in line with the Central Bank's target. Most market participants are concerned about the impact of subsidy removal on inflation, however we do not share this view due to the 10% maximum volatility for indexation and current levels of oil prices. The Central Bank 2020 inflation target is 9% +/-3%.

Despite the significant improvements we have seen, we remain concerned about the country's debt levels. Debt consumes approximately 56% of the government's budget and limits its ability to invest in the economy and every 1% change in interest rate leads to EGP10.0 billion in additional expenses (0.1% of budget). However, a major consequence of this high debt, is less state's involvement in the economy and a larger role for the private sector. We have seen the private sector participation in new sectors, like electricity distribution as well as oil and gas for the first time.

It is worth highlighting that Egypt's external debt is approximately 32% of GDP, which is well below the emerging markets average of 42% and much more favorable than most of its emerging peers, such as Turkey (58 %), Malaysia (63 %), Chile (62 %), South Africa (48 %), Morocco (44 %), Vietnam (43 %), and Mexico (36 %).

The ministry has outlined a strategy to lower its total debt-to-GDP to below 90% by the end of this year from around 108% last year and to reach 80% by 2022. This will mainly be achieved through controlling and extending the maturity of current debt levels, while targeting 5% to 6% annual GDP growth.

### Reiterating our convictions

Egypt is among the most promising countries in Africa and the MENA region, which surprisingly went through one of the most successful IMF programs over the past 3 years. We expect 2019 to be a reflection point as trust and confidence builds into higher

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public and private investment.

In terms of our convictions, oil & gas, healthcare, education (healthcare and education require considerable investments over the coming years) and consumer finance are reaffirmed. One clear outcome is a slowdown in the real estate sector observed by lower margin and extended payment plans versus 5 years ago. The main disruptor to the sector is the government's New Urban Communities Authority (NUCA). NUCA has been aggressively selling land and entering into revenue sharing agreements due to the increased cash flows needs by the government. Also, many new players are now active in the market. We still believe that with a solid management and balance sheet Egypt Kuwait Holdings stands out as a multi-year growth story in the Energy Sector. Moreover, once interest rates are reduced by 3% we can see Commercial International Bank loan growth more than doubling to above 35%, although not before the second half of 2020.

### Fund positioning

The Emirates MENA Top Companies Fund currently maintains an overweight 13% exposure to Egypt (up from 7% in December 2018), versus 3% exposure in the funds benchmark.

	YTD	12 Months	36 Months	Dividend Yield	Active Share
Emirates MENA Top Companies Fund	11.36%	5.16%	33.08%	3.41%	77.5%
Benchmark*	9.26%	8.56%	29.74%	3.88%	n/a

Source: ENBDAM as at 30<sup>th</sup> June 2019. \*Benchmark 45% MSCI Saudi Arabia Domestic Index, 55% MSCI Arabian Markets Index ex Saudi Arabia.

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