

Tales from the Emerging World

Egypt: The Best Reform Story in Emerging Markets?

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One visible sign of the best reform story in the Middle East, perhaps in any emerging market, is the billboards in Cairo advertising the government's new digital payments system. Designed to raise revenue, reduce corruption, and bring poor citizens out of the financial wilderness, the "Meeza" program distributes benefits on a debit card and collects payments electronically. To this end, the government of retired Gen. Abdel Fattah el-Sisi has installed some 7,000 terminals in government, universities, and other public spaces.

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On a recent visit to Cairo we met with tech start-ups, venture capitalists, and corporate executives, and heard time again that the government has "taken all the right steps" to create a more business friendly environment and rein in the swelling deficits. They added that "the guys running the country are brave and making tough decisions" and "the worst seems to be over." The belt-tightening has largely achieved its objectives, setting the economy up for a strong run. At a time when a secular slowdown in the global economy is lowering the definition of rapid growth (see *Tales—Investing in a Four D World*, July 2019), any country at Egypt's stage of development, with an average income under \$5,000¹, is doing well if it is growing faster than 5 percent. And we think Egypt is on track to grow as fast as 6 percent in coming years.

Facing a collapsing currency and runaway inflation after the coup that brought it to power, the el-Sisi government entered a loan agreement with the International Monetary Fund (IMF) in 2016 and has since moved aggressively to meet its conditions. It cut subsidies from 11 percent to 5 percent of gross domestic product

¹ Source: MSIM EM Research, World Bank as of December 2017. Expectations correspond to consensus forecasts from Bloomberg as of June 2019.



(GDP)², and made deep cuts to civil servant salaries. As a result, the primary balance has improved from a 4 percent deficit to a 1 percent surplus, and public debt has come down from 108 percent of GDP to 88 percent². The big fiscal reforms are largely done, but to keep investor confidence up, the government plans to extend the IMF program.

Cairo was buzzing about government investment in large power and infrastructure projects, including 14 new cities, six tunnels connecting Sinai to the Egypt mainland and 7,000 kilometers of new road, some linking the Suez Canal to Cairo. A new capital is rising 30 miles east of Cairo, on a spit of land between the Suez and the Nile, with a new presidential palace. While some critics describe these projects as “Ramses building the pyramids,” many of them serve a purpose larger than ego inflation.

Energy investments have helped Egypt, the largest oil and gas consumer in the Middle East, reduce its dependence on fossil-fuel imports. The current account deficit is down to 2 percent of GDP from a 2017 peak of 6 percent³. And by 2022, Egypt expects to generate 20 percent of its electricity from local renewable sources⁴, which should further stabilize its external balances.

Beyond mega projects, officials of the finance ministry told us that much of the 40 percent increase in public investment since the early 2010s has gone into healthcare and education. The government aims to screen all 100 million citizens for Hepatitis C and other diseases, and to digitize all schools.

As part of its deal with the IMF, the el-Sisi government floated the battered Egyptian pound, which subsequently fell by more than 50 percent to nearly 20 to the US

dollar. Though it has since recovered (to 16 to the dollar) the pound still feels cheap, a perception that is drawing in a flood of tourists, and has spurred double-digit growth in exports over the last two years.

Egypt’s longer term aim is to become a low-cost manufacturing hub, a task that will be difficult in the age of deglobalization. Still, the cheap currency and the large domestic market have drawn foreign direct investment from regional players like a Turkish food company that is investing \$200 million to expand its biscuit plant, and strong interest from well known Western firms. Big US tech firms are expanding in Egypt, and some are said to be in talks about opening data warehouses. Nonetheless, three CEOs volunteered independently that foreigners were not likely to invest more heavily until private Egyptian companies do, and that has yet to happen in a big way.

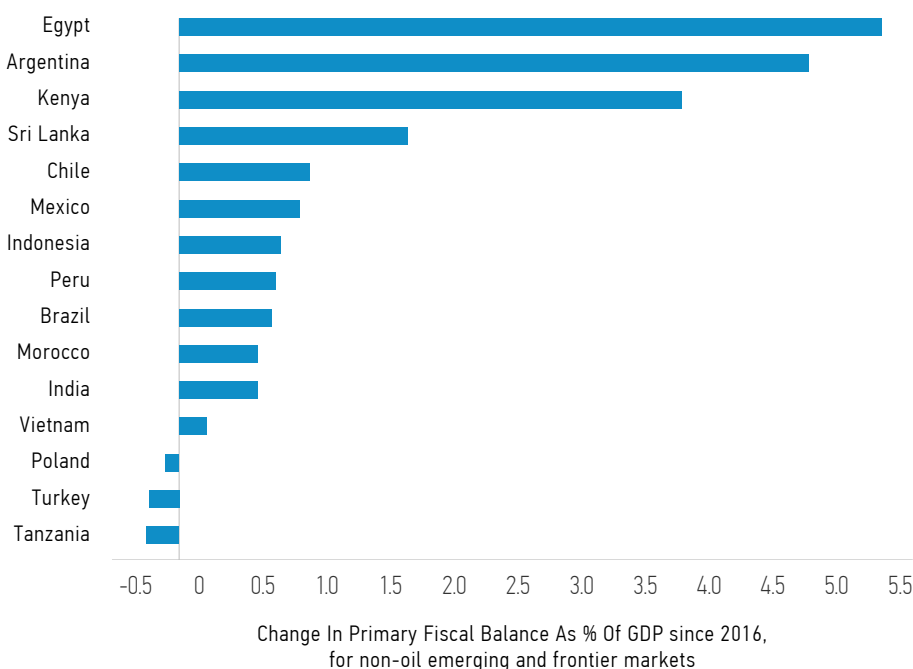
We spent a day visiting tech companies, which say Egypt is just starting to move beyond entertainment to wider mobile services. US and other foreign rideshare firms invested heavily in Egypt, introducing millions to mobile apps, and now many of their former employees are moving to local start-ups. Nearly 9 in 10 Egyptians don’t use a bank², and fintech firms are starting to sell them hard on mobile banking. E-commerce has also yet to take off, stymied by the cash economy and the logistical nightmare of delivering in Cairo traffic. But the opportunities are so wide that tech execs say that, so long as Egypt is growing faster than 3 percent, they can grow at 100 percent—from a very low base.

It’s not just e-tailers who have had a slow go of it in recent years either. Consumption was boosting GDP growth by 4 to 5 percent a year as recently as 2015⁵. Then the big devaluation and

DISPLAY 1

Belt-Tightening

Since 2016 no developing market has pushed tougher fiscal reforms than Egypt



Source: IMF.

² Source: Egyptian Ministry Of Finance. Data as of June 2019.

⁴ Source: World Bank. As of April 2018.

³ Source: Haver. Data as of Dec 2018.

⁵ Source: Haver. Data as of 2015.

subsidy cuts began to hit consumption, and its contribution fell to just one percent a year⁶. At the bottom, a bank exec told us that one beverage distributor marveled that he couldn't make money selling "the most popular drink in the world, in an incredibly hot country."

There are signs, however, of a rebound. The final fuel subsidy cut (and price hike) was implemented late last month, so consumers face no further jolt on that front. Some are already trading up to luxury goods, and consumer companies told us their sales volumes have only recently recovered to levels of 2016, before the devaluation. They expect stronger growth from here.

Though the subsidy cuts have fueled headline inflation, which currently stands at 13 percent⁷, it is trending downward thanks to the recent appreciation in the pound and weak oil prices. High inflation had compelled the central bank to keep rates high—the overnight lending rate, for example, is still above 16 percent⁸. But with inflation easing, the market's consensus view is that the bank will start cutting rates in coming months, by as much as 3 to 4 percent over the next two years, which should provide a further boost to growth.

All of this has made Egypt a great economic reform story in the eyes of the market, even if the global media still covers it as a regime born in a bloody coup and

backsliding toward dictatorship. Markets are never shy about embracing strongmen who generate accelerating growth, but they also sense that economies subject to the whims of an autocrat can be erratic.

We're optimistic for Egypt, which is now moving past fiscal reform to focus on measures to increase private sector competitiveness, including tax cuts for small- and medium-sized enterprises and land reforms. We'll be watching progress closely, knowing investors will flee at the first sign that el-Sisi's reform discipline is faltering. On balance, however, we think Egypt is on track to become a breakout nation.

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⁶ Source: Haver. Data as of Dec 2018.

⁷ Source: Haver. Data as of June 2019.

⁸ Source: Bloomberg. Data as of August 2019.

⁹ Source: Assets under management as of June 30, 2019. Morgan Stanley Investment Management ("MSIM") is the asset management business of Morgan Stanley. Assets are managed by teams representing different MSIM legal entities; portfolio management teams are primarily located in New York, Philadelphia, London, Amsterdam, Hong Kong, Singapore, Tokyo and Mumbai offices. Figure represents Morgan Stanley Investment Management's total assets under management/supervision.

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