



COUNTRIES IN FOCUS:

Cyprus & Egypt

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Strong headwinds -- especially from rising interest rates and soft external demand -- should keep the economy on a weak footing over the next few quarters

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A new EGP depreciation is on the cards, yet its timing is uncertain, due to political noise

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NBG – Economic Analysis Division

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Emerging Markets Analysis

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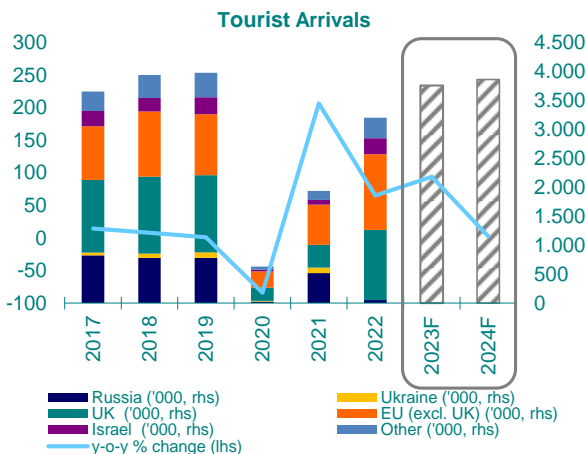
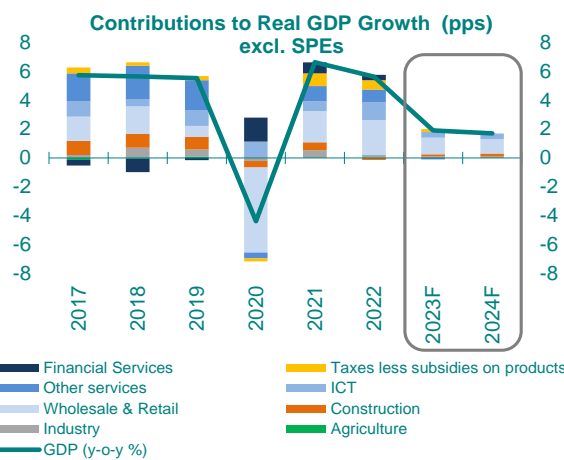
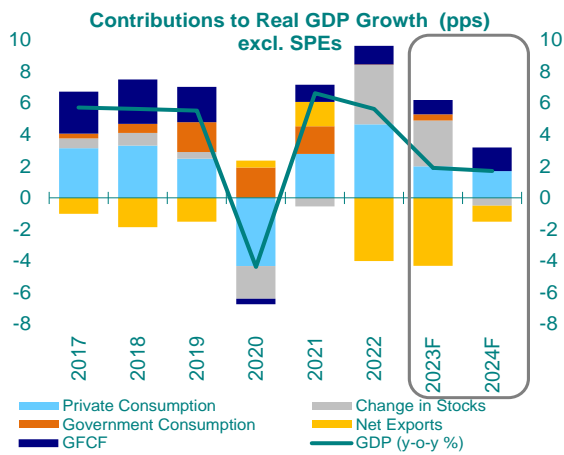
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Cyprus

BBB / Ba1 / BBB (S&P/ Moody's / Fitch)



	18 Sep.	3-M F	6-M F	12-M F
1-M EURIBOR (%)	3.8	4.1	4.1	4.0
EUR/USD	1.07	1.08	1.09	1.10
Sov. Spread (2028, bps)	104	105	105	100

	18 Sep.	1-W %	YTD %	2-Y %
CSE 100	132	0.3	47.6	96.3

	2020	2021	2022	2023F	2024F
Real GDP Growth (%)	-4.4	6.6	5.6	1.9	1.7
Inflation (eop, %)	-1.1	4.8	7.9	3.5	2.0
Cur. Acct. Bal. (% GDP)	-10.1	-6.8	-9.1	-8.1	-6.8
Fiscal Bal. (% GDP)	-5.8	-2.0	2.1	1.7	1.7

Sources: Reuters, CYSTAT & NBG estimates

GDP growth eased in Q2:23 (to a still solid 2.1% y-o-y), on the back of slowing private consumption and weakening external demand. Private consumption remained the main driver in Q2:23, with its growth rate, however, easing markedly, reflecting the adverse impact of rising interest rates and still elevated inflation. Private consumption would have been much weaker, had it not been for partial wage indexation (an increase of 4.4% was implemented in January 2023, covering c. 45% of employees) and full indexation of pensions. Note that the labour market has shown resilience, supported by the expansion of labour-intensive services sectors, with the unemployment rate falling below the 6.0% mark for the first time in more than a decade. At the same time, fixed investment expanded, but sluggishly, while stock rebuilding continued, albeit at a slower pace. Unsurprisingly, slowing domestic demand growth benefited net exports, which, nonetheless, remained a drag on overall growth, reflecting, inter alia, weakening external demand, especially for financial and other business services. Note that the tourism sector continued to overperform, with tourist arrivals rising by c. 25% y-o-y in Q2:23, falling slightly behind the levels seen during the same period in 2019. All said, annual GDP growth eased to 2.1% in Q2:23 from 3.1% in Q1:23, with sequential GDP growth, however, turning negative (down 0.4% against an increase of 1.1% in Q2:23) for the first time since the pandemic.

Strong headwinds -- especially from rising interest rates and soft external demand -- should keep the economy on a weak footing over the next few quarters. Weak economic growth in the EU (projected at 0.8% in FY:23 and 1.4% in FY:24 against 3.5% in FY:22) cannot but affect further the Cypriot economy, in view of the latter's export-oriented nature -- with tourism and business services accounting for the lion's share (c. 14.0% and 35.0% of FY:22 GDP, respectively). Still, a favourable base effect from the massive relocation of foreign companies in Cyprus (with more than 1100 firms -- most of them operating in the ICT sector -- with 9000 employees registering locally in FY:22) should help moderate the impact of softer external demand.

Similarly, despite gradually easing inflation and a resilient labour market, private consumption is unlikely to gain much steam in the short-term, in view of high interest rates (see below) and the phasing-out of the state measures mitigating the impact of high inflation.

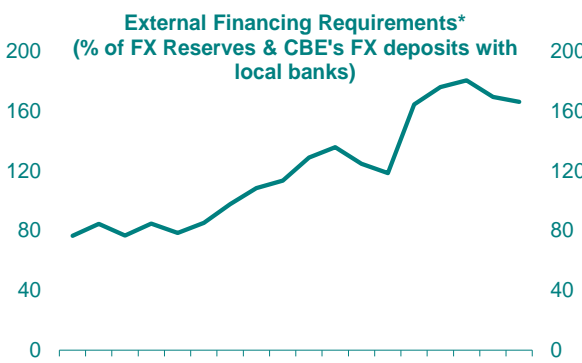
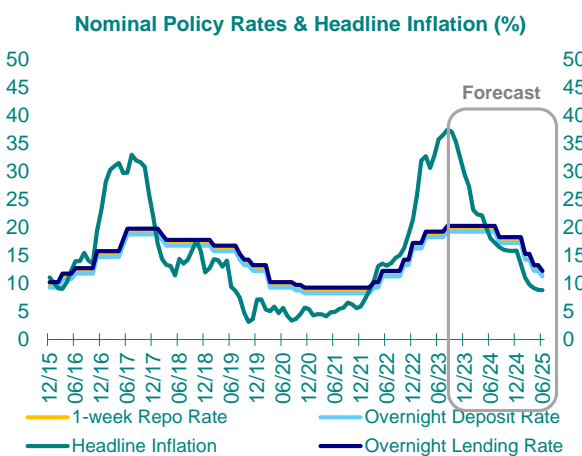
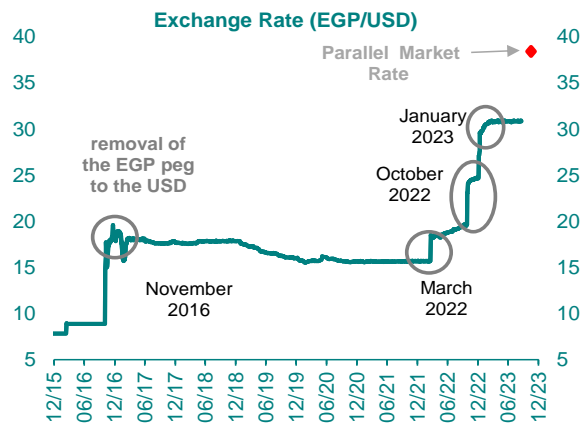
Importantly, investment in non-construction projects is set to accelerate, following the implementation of the RRF Plan (with Cyprus due to receive funds worth 5.0% of its FY:21 GDP in 2021-26). At the same time, strong external demand for real estate and the continuation of some big (mainly energy and tourism) infrastructure projects should sustain construction activity in FY:23 and FY:24, largely compensating for weaker domestic demand for residences.

All said, we see GDP growth easing to 1.9% in FY:23 from 5.6% in FY:22, still above the EU average. Assuming that inflation stabilizes at normal levels in FY:24, we see economic activity gaining momentum, especially in H2, with the underlying annual growth rate easing, nonetheless, slightly to 1.7%, due to a weaker carry-over effect (projected at 0.1 pp versus 0.9 pps in the previous year).

Worryingly, despite recent deleveraging, private sector's indebtedness remains high (at 248% of GDP at end-2021, well above the euro area average of 144%), posing a downside risk to economic outlook, in view of high interest rates (note that the bulk of debt contracts in Cyprus have variable interest rates). Importantly, however, domestic banks' strong capitalisation and highly liquid position provide a line of defense against financial stress. Delays in the execution of the RRF plan and sticky inflation could also drag GDP growth lower in the period ahead.

Egypt

B / B2 / B+ (S&P / Moody's / Fitch)



* 4-quarter rolling Current Account Deficit & Short-term debt & Long-term debt maturing over next 4 quarters

	18 Sep.	3-M F	6-M F	12-M F
O/N Interbank Rate (%)	19.3	19.3	19.3	17.3
EGP/USD	30.9	30.9	39.0	38.4
Sov. Spread (2029, bps)	1,347	1,300	950	700

	18 Sep.	1-W %	YTD %	2-Y %
HERMES 100	2,261	3.2	38.6	88.2

	20/21	21/22	22/23E	23/24F	24/25F
Real GDP Growth (%)	3.3	6.7	3.9	3.9	4.5
Inflation (eop. %)	4.9	13.2	35.7	18.0	8.8
Cur. Acct. Bal. (% GDP)	-4.3	-3.5	-2.2	-2.2	-2.4
Fiscal Bal. (% GDP)	-6.8	-6.1	-6.2	-6.7	-6.4

Sources: Reuters, CBE & NBG estimates

A new EGP depreciation is on the cards, yet its timing is uncertain, due to political noise. Recall that the FX rate has been practically fixed at EGP 30.9/USD since March '23. However, strong underlying depreciation pressures on the currency, as highlighted by the large gap between the official and parallel market rates, with the latter hovering around EGP 39.0/USD (i.e. down c. 20.0% from current levels), together with large external debt repayments looming ahead, suggest that a new FX adjustment is on the cards. The CBE's relatively weak FX reserve position (amounting to USD 34.9bn or USD 18.9bn adjusted for IMF disbursements), which together with the CBE's FX deposits with local banks, covers just a fraction of Egypt's external financing needs (see chart) further corroborate this view, especially considering the tight global financing conditions.

Convergence of the official EGP/USD exchange rate to that of the parallel market (or slightly below, as strong pent-up FX demand appears to have inflated the latter) should enable the completion of the 1st IMF review, which has been on hold since March '23. In the event, and assuming that authorities signal shift to a "durable" flexible exchange rate regime, as agreed with the IMF, we expect confidence in the EGP to increase gradually, helping to attract FDI (including privatizations, with Egypt having reportedly already raised nearly half of the end-2024 targeted amount of USD 5bn, to date) and portfolio investment, while encouraging Egyptian expatriates to transfer money through official channels, allowing the CBE to rebuild its FX reserve position. Recall that Egypt was forced to resort to the IMF last year, when the CBE's heavy interventions to maintain EGP stability in the wake of the Russia-Ukraine crisis (with surging global commodity prices boosting the current account deficit, due to Egypt's reliance on food imports to cover its needs, on the one hand, and heavy portfolio withdrawals adding to financing pressures, on the other hand) led FX reserves to fall into the danger zone.

Unsurprisingly, a weaker EGP would fuel further the already record-high inflation (up 37.4% y-o-y in August against 14.6% a year ago and a low of 4.1% in mid-2021), prompting the CBE to maintain its tightening bias. Besides cooling down domestic demand and anchoring inflation expectations, high interest rates should lure foreign investors to Egypt's debt market, which has traditionally been the most significant source of hard currency, helping to close the external financing gap. Recall that the CBE has so far raised rates by 1100 bps, with its key overnight deposit rate currently standing at 19.25%, while suspending several subsidised lending initiatives.

Worryingly, tightening financing conditions could pose risks to financial stability, in view of the deep sovereign-bank nexus (with banks holding 60% of public debt, equivalent to c. 40% of their assets). At the same time, high interest rates and the weaker EGP cannot but stress the private sector's debt repayment capacity (with the low NPL ratio, 3.5%, offering, however, a good starting point). Encouragingly, private banks' high regulatory capital buffers and strong internal capital generation capacity should provide some cushion to these risks.

All said, in view of growing political noise, there is exceptional uncertainty surrounding the timing of the (inevitable) FX adjustment, and thus the accuracy of our forecasts. Indeed, the fear of social unrest, amid fresh signs of dissent -- despite the limited political space available to the opposition -- has reportedly prompted authorities to consider bringing the Presidential election forward from March '24 to December '23. In the event, it is highly unlikely to witness any meaningful change in policies during the pre-election period, and as so, we expect the FX adjustment to take place only in early-2024.

DETAILED MACROECONOMIC DATA

CYPRUS					
	2020	2021	2022	2023f	2024f
Real Sector					
Nominal GDP (EUR million)	21,897	24,019	27,006	28,566	29,866
GDP per capita (EUR)	24,548	26,677	29,669	31,041	32,132
GDP growth (real, %)	-4.4	6.6	5.6	1.9	1.7
Unemployment rate (% aop)	7.6	7.5	6.8	6.5	6.2
Prices and Banking					
Inflation (% eop)	-1.1	4.8	7.9	3.5	2.0
Inflation (% aop)	-0.6	2.4	8.4	3.8	2.8
Loans to the Private Sector (% change, eop)	-5.6	-5.0	-12.1		
Customer Deposits (% change, eop)	-0.6	5.4	2.8		
Loans to the Private Sector (% of GDP)	132.0	114.3	89.3		
Retail Loans (% of GDP)	61.2	50.9	42.6		
Corporate Loans (% of GDP)	70.8	63.4	46.7		
Customer Deposits (% of GDP)	188.0	180.7	165.3		
Loans to Private Sector (% of Deposits)	70.2	63.2	54.0		
Foreign Currency Loans (% of Total Loans)	---	---	---		
External Accounts					
Merchandise exports (EUR million)	2,969	3,590	4,570	4,527	4,646
Merchandise imports (EUR million)	7,180	7,907	10,454	10,660	10,928
Trade balance (EUR million)	-4,211	-4,318	-5,884	-6,133	-6,282
Trade balance (% of GDP)	-19.2	-18.0	-21.8	-21.5	-21.0
Current account balance (EUR million)	-2,202	-1,638	-2,463	-2,308	-2,038
Current account balance (% of GDP)	-10.1	-6.8	-9.1	-8.1	-6.8
Net FDI (EUR million)	7,454	4,369	8,143	10,382	12,977
Net FDI (% of GDP)	34.0	18.2	30.2	36.3	43.5
International reserves (EUR million)	---	---	---	---	---
International reserves (Months ^a)	---	---	---	---	---
Public Finance					
Primary balance ^b (% of GDP)	-3.7	-0.2	3.6	3.3	3.3
Fiscal balance ^b (% of GDP)	-5.8	-2.0	2.1	1.7	1.7
Gross public debt (% of GDP)	113.8	101.2	86.5	80.5	72.7
External Debt					
Gross external debt (EUR million)	175,543	168,003	180,003	178,003	176,003
Gross external debt (% of GDP)	801.7	699.5	666.5	623.1	589.3
External debt service (EUR million)	---	---	---	---	---
External debt service (% of reserves)	---	---	---	---	---
External debt service (% of exports)	---	---	---	---	---
Financial Markets					
Policy rate (ECB refinancing rate, % eop)	0.0	0.0	2.5	4.0	3.0
Policy rate (ECB refinancing rate, % aop)	0.0	0.0	0.7	3.7	3.6
3-Y T-bill rate (% eop)	-0.1	-0.2	2.6	3.8	3.6
Exchange rate: USD (eop)	1.221	1.137	1.070	1.080	1.110
Exchange rate: USD (aop)	1.142	1.183	1.053	1.081	1.095

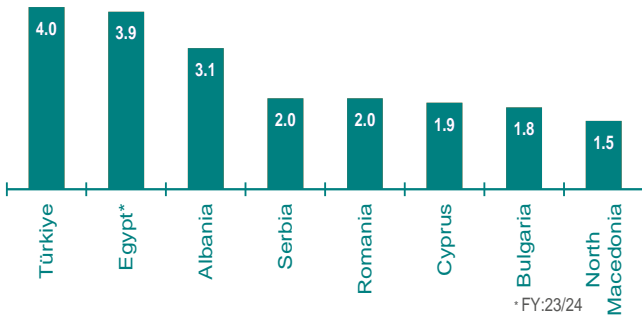
f: NBG forecasts; a: months of imports of GNFS; b: cash basis

EGYPT					
	2020/21*	2021/22*	2022/23e*	2023/24f*	2024/25f*
Real Sector					
Nominal GDP (USD million)	424,516	476,690	392,355	387,601	410,203
GDP per capita (USD)	4,158	4,577	3,694	3,577	3,712
GDP growth (real, %)	3.3	6.7	3.9	3.9	4.5
Unemployment rate (% aop)	7.3	7.3	7.3	7.5	7.4
Prices and Banking					
Inflation (% eop)	4.9	13.2	35.7	18.0	8.8
Inflation (% aop)	4.5	8.4	23.8	28.2	13.1
Loans to the Private Sector (% change, eop)	21.2	23.6			
Customer Deposits (% change, eop)	19.2	24.7			
Loans to the Private Sector (% of GDP)	26.5	27.8			
Retail Loans (% of GDP)	8.9	9.5			
Corporate Loans (% of GDP)	17.6	18.3			
Customer Deposits (% of GDP)	74.4	80.2			
Loans to Private Sector (% of Deposits)	35.6	34.6			
Foreign Currency Loans (% of Total Loans)	12.7	11.3			
External Accounts					
Merchandise exports (USD million)	28,677	43,906	40,363	40,942	42,892
Merchandise imports (USD million)	70,736	87,302	74,056	75,769	81,459
Trade balance (USD million)	-42,060	-43,396	-33,693	-34,827	-38,567
Trade balance (% of GDP)	-9.9	-9.1	-8.6	-9.0	-9.4
Current account balance (USD million)	-18,436	-16,551	-8,525	-8,681	-9,796
Current account balance (% of GDP)	-4.3	-3.5	-2.2	-2.2	-2.4
Net FDI (USD million)	4,835	8,591	10,094	11,356	12,492
Net FDI (% of GDP)	1.1	1.8	2.6	2.9	3.0
International reserves (USD million)	40,584	33,376	34,807	37,607	40,607
International reserves (Months ^a)	6.5	4.2	6.5	5.8	5.6
Public Finance					
Primary balance (% of GDP)	1.3	1.3	1.2	0.7	0.9
Fiscal balance (% of GDP)	-6.8	-6.1	-6.2	-6.7	-6.4
Gross public debt (% of GDP)	86.2	89.9	88.5	90.0	85.0
External Debt					
Gross external debt (USD million)	137,860	155,709	165,000	175,000	178,000
Gross external debt (% of GDP)	32.5	32.7	42.7	45.1	43.4
External debt service ^b (USD million)	15,400	26,100	25,000	32,000	36,800
External debt service ^b (% of reserves)	37.9	78.2	71.8	85.1	90.6
External debt service (% of exports ^c)	37.5	40.5	39.4	48.9	52.9
Financial Markets					
Policy rate (O/N deposit rate, % eop)	8.3	11.3	18.3	19.3	11.3
Policy rate (O/N deposit rate, % aop)	8.5	8.9	15.3	19.2	15.6
3-M T-bill rate (% eop)	13.2	15.4	22.0	17.6	9.6
Exchange rate: USD (eop)	15.66	18.76	30.85	38.00	39.50
Exchange rate: USD (aop)	15.70	16.45	25.72	34.68	38.75

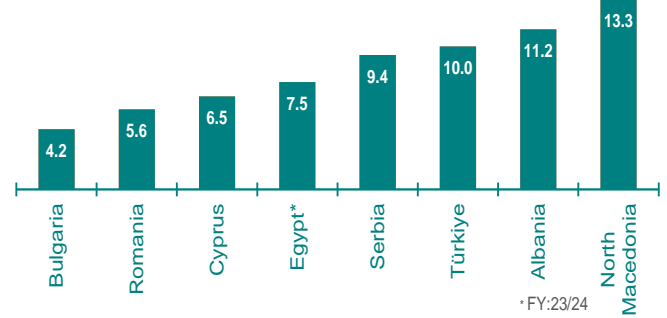
*: fiscal year starting in July and ending in June; f: NBG forecasts; a: months of imports of GNFS

REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

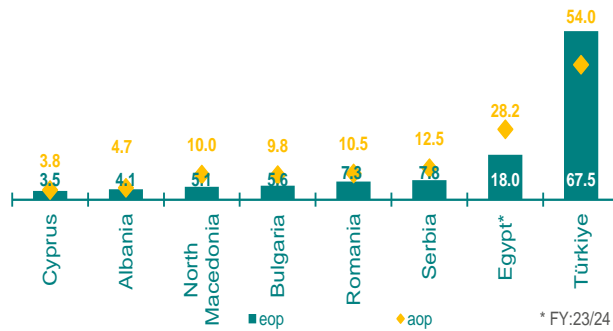
Real GDP Growth (% , 2023F)



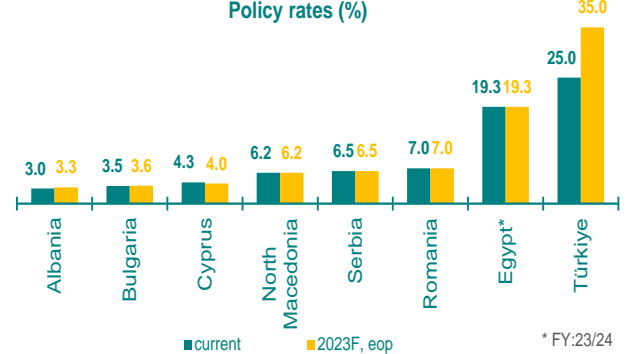
Unemployment (% , 2023F, aop)



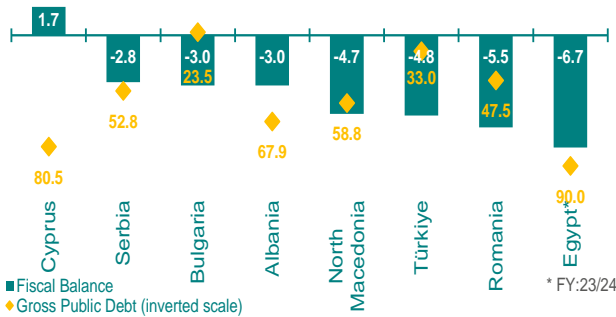
Headline inflation (% , 2023F)



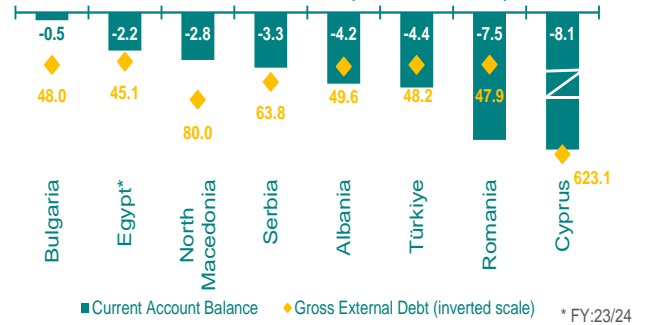
Policy rates (%)



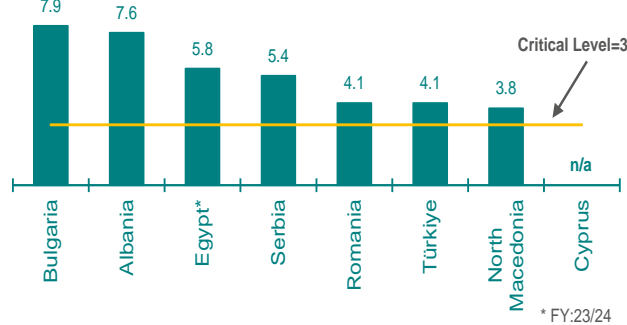
Public Finance (% of GDP, 2023F)



External Accounts (% of GDP, 2023F)

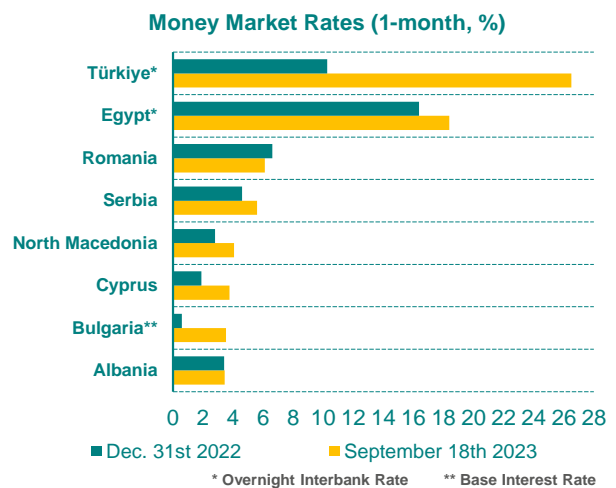
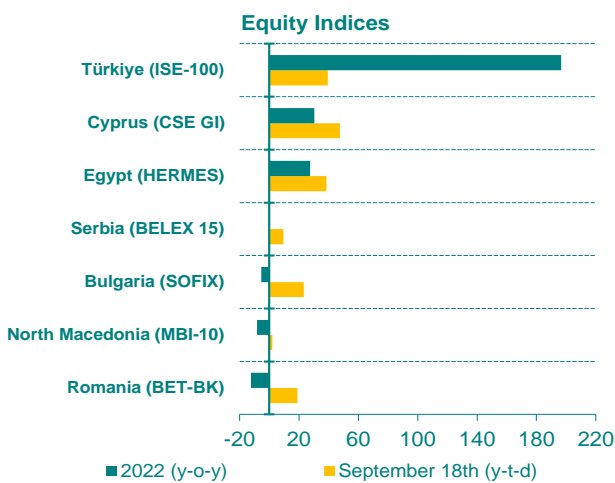
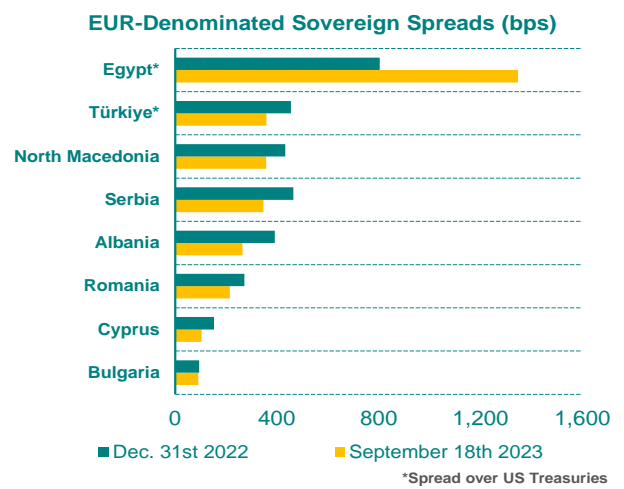
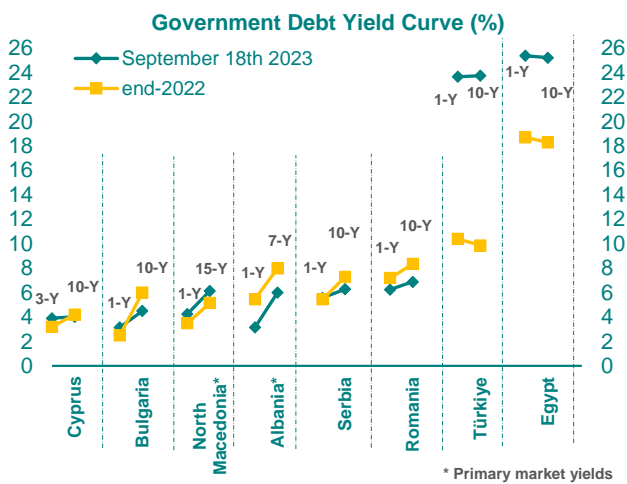
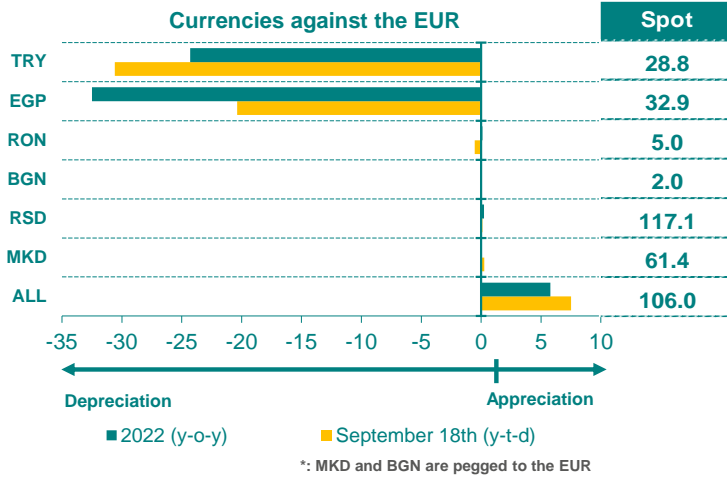


FX Reserves (Months of Imports, 2023F)



Sources: National Sources & NBG estimates

REGIONAL SNAPSHOT: FINANCIAL MARKETS



Sources: Reuters & NBG estimates

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