EXECUTIVE BOARD MEETING

EBS/20/91
Supplement 1

CONFIDENTIAL

May 6, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Arab Republic of Egypt—Assessment of the Risks to the Fund and the Fund's Liquidity Position**

Board Action:	Executive Directors' **consideration** (Formal)
Tentative Board Date:	**Monday, May 11, 2020**
Publication:	Yes*
Questions:	Mr. Moore, FIN (ext. 39391) Ms. Bhattacharya, FIN (ext. 38388) Mr. Kitano, FIN (ext. 37557)
Document Transmittal in the Absence of an Objection and in accordance with Board policy:	After Board Consideration—African Development Bank, Islamic Development Bank, World Trade Organization

***The Secretary's Department has been notified by the authorities that their explicit consent is required prior to the publication of Board documents. At the time of circulation of this paper to the Board, the authorities have indicated that they consent to the Fund's publication of this paper.**

INTERNATIONAL MONETARY FUND

CONFIDENTIAL

ARAB REPUBLIC OF EGYPT

May 6, 2020

ASSESSMENT OF THE RISKS TO THE FUND AND THE FUND'S LIQUIDITY POSITION

Approved By
Andrew Tweedie and Petya Koeva Brooks

Prepared by the Finance and Strategy, Policy, and Review Departments.

CONTENTS

INTRODUCTION

1. This note assesses the risks to the Fund arising from the proposed purchase under the Rapid Financing Instrument (RFI) for Egypt and its effects on the Fund's liquidity, in accordance with the policy on exceptional access. The Egyptian authorities have requested a purchase under the RFI of 100 percent of quota (SDR 2,037.1 million) to alleviate an urgent balance-of-payments need. The COVID-19 pandemic, and its global economic and financial consequences, is causing severe disruptions that could put Egypt's hard-won macroeconomic stability at risk without adequate external support. While maximum access under an RFI will still leave a financing gap, it will ease immediate external financing pressures. The remaining gap is expected to be met by a combination of a prospective Stand-By Arrangement (SBA) with the IMF, which the authorities have requested, as well as financing from other multilateral and official bilateral creditors.

BACKGROUND

2. Egypt completed a three-year EFF arrangement in 2019, its first Fund-supported arrangement since the 1990s.

- Egypt's most recent Fund arrangement was an EFF arrangement for an amount of SDR 8,597 million, or approximately US$12 billion (422 percent of quota), approved on November 11, 2016. All reviews were concluded and the arrangement fully drawn, with the Executive Board completing the fifth and final review on July 24, 2019. Egypt's EFF-supported reform program was largely successful in achieving macroeconomic stabilization, addressing external and domestic imbalances, and putting debt on a downward trajectory while also implementing a first wave of structural reforms. Still, public debt and gross financing needs have remained elevated and a significant structural reform agenda remains.

- In the 1990s, Egypt had three arrangements with the Fund, including two that were treated as precautionary (Table 1): a two-year precautionary SBA, approved on October 11, 1996, for an amount of SDR 271 million (40 percent of quota); and a three-year arrangement under the Extended Fund Facility (EFF), approved by on September 20, 1993, for SDR 400 million (59 percent of quota). Egypt purchased SDR 147 million out of SDR 234 million (51 percent of quota) available under an SBA arrangement approved on May 17, 1991.

Table 1. Egypt: IMF Financial Arrangements and Fund Exposure, 1986–2030
(in millions of SDR)

Year	Type of New Arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount of New Arrangement	Amount Drawn	Fund Exposure 1/	
1986						25.0	
1987	SBA	15-May-1987	30-Nov-1988	250.0	116.0	128.5	
1988						116.0	
1989						116.0	
1990						87.0	
1991	SBA	17-May-1991	31-May-1993	234.4	147.2	89.0	
1992						147.2	
1993	EFF	20-Sep-1993	19-Sep-1996	400.0	0.0	147.2	
1994						132.2	
1995						69.5	
1996	SBA	11-Oct-1996	30-Sep-1998	271.4	0.0	10.9	
1997						0.0	
:						:	
:						:	
2015						0.0	
2016	EFF	11-Nov-2016	29-Jul-2019	8,596.6	8,596.6	1,970.1	
2017						4,298.3	
2018						5,731.1	
2019						8,596.6	
2020	RFI	May 2020		*2,037.10*		*10,633.7*	2/
2021						*10,469.5*	2/
2022						*9,947.1*	2/
2023						*8,992.0*	2/
2024						*6,660.1*	2/
2025						*4,208.7*	2/
2026						*2,776.0*	2/
2027						*1,507.4*	2/
2028						*597.0*	2/
2029						*119.4*	2/
2030						*0.0*	2/

Source: Finance Department
1/ As of end-December, unless otherwise stated.
2/ Figures in italics include prospective transactions under the proposed RFI purchase. As of the end of fiscal year starting on July 1 and ending on June 30.

3. Egypt's total external debt has risen considerably since 2016. Total external debt remained below 20 percent of GDP during 2012/13 through 2015/16 but rose in the wake of the sharp devaluation in November 2016. External debt plateaued at around 36 percent of GDP at end-2018/19 (Table 2). Medium- and long-term borrowings by the public sector have the largest share in external debt. Compared with other exceptional access borrowers, overall external debt as a share of GDP is relatively modest, but public external debt is slightly above the median (Figure 1).

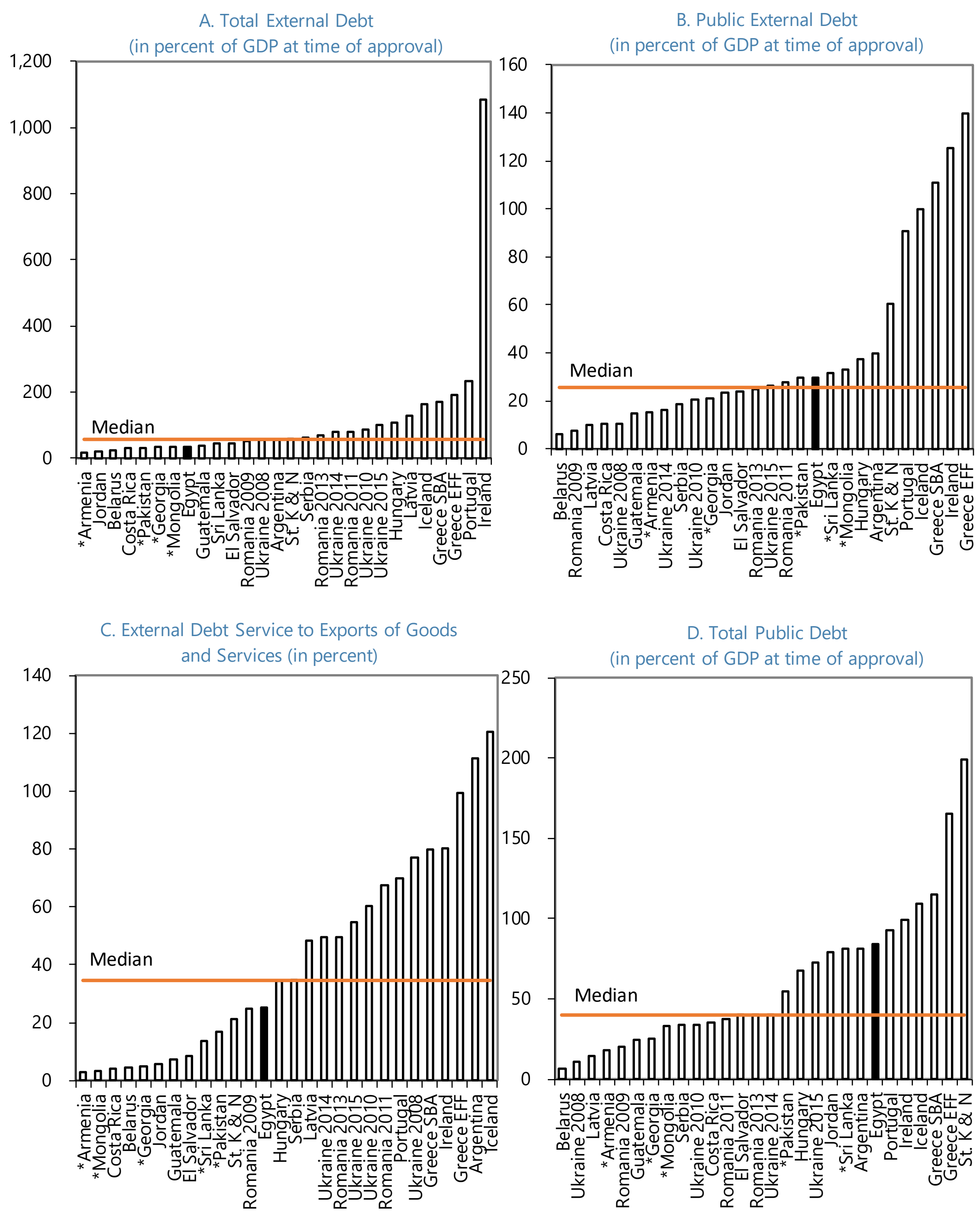
Table 2. Egypt: External Debt Structure, 2012/13–2018/19 1/ 2/

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
	(In billions of U.S. Dollars)						
Total External Debt	43.2	46.1	48.1	55.8	79.0	92.6	108.7
Medium and long-term debt	36.2	42.4	45.5	48.7	66.8	80.4	97.6
Bonds	5.2	6.1	4.9	3.5	9.0	14.3	19.4
of which Public	5.2	6.1	4.9	3.5	9.0	14.3	19.4
Loans	31.0	36.3	40.5	45.3	57.8	66.1	78.3
Public	31.0	36.3	40.5	45.1	57.6	65.6	77.9
Multilateral	12.0	12.2	12.2	14.1	21.8	28.4	32.8
of which IMF	1.4	1.4	1.3	1.3	4.0	9.3	11.2
Use of Fund Credit	0.0	0.0	0.0	0.0	2.7	8.1	10.0
SDR Allocation	1.4	1.4	1.3	1.3	1.2	1.3	1.2
Bilateral (including official deposits)	18.5	23.5	26.7	27.8	29.4	28.8	30.0
Repo and suppliers' credit	0.6	0.5	1.5	3.1	6.5	8.4	15.1
Private non-guaranteed	0.0	0.0	0.0	0.2	0.2	0.5	0.4
Short-term external debt	7.0	3.7	2.6	7.0	12.3	12.3	11.1
Central Bank	4.5	0.5	0.0	3.2	8.2	6.3	3.2
Banks	0.8	0.9	1.4	1.9	1.1	1.8	3.7
Other sectors	1.8	2.3	1.1	1.9	3.0	4.1	4.2
	(In Percent of GDP)						
Total External Debt	15.0	15.1	14.5	16.8	30.8	37.0	36.0
Medium and long-term debt	12.6	13.9	13.7	14.7	26.0	32.1	32.3
Bonds	1.8	2.0	1.5	1.1	3.5	5.7	6.4
of which Public	1.8	2.0	1.5	1.1	3.5	5.7	6.4
Loans	10.8	11.9	12.2	13.6	22.5	26.4	25.9
Public	10.8	11.9	12.2	13.6	22.5	26.2	25.8
Multilateral	4.2	4.0	3.7	4.2	8.5	11.4	10.9
of which IMF	0.5	0.5	0.4	0.4	1.6	3.7	3.7
Use of Fund Credit	0.0	0.0	0.0	0.0	1.1	3.2	3.3
SDR Allocation	0.5	0.5	0.4	0.4	0.5	0.5	0.4
Bilateral (including official deposits)	6.4	7.7	8.1	8.4	11.5	11.5	9.9
Repo and suppliers' credit	0.2	0.2	0.5	0.9	2.5	3.4	5.0
Private non-guaranteed	0.0	0.0	0.0	0.1	0.1	0.2	0.1
Short-term external debt	2.4	1.2	0.8	2.1	4.8	4.9	3.7
Central Bank	1.6	0.2	0.0	1.0	3.2	2.5	1.1
Banks	0.3	0.3	0.4	0.6	0.4	0.7	1.2
Other sectors	0.6	0.7	0.3	0.6	1.2	1.6	1.4

Source: Central Bank of Egypt (CBE), Haver Analytics, and IMF staff estimates.
1/ As of the end of fiscal year starting on July 1 and ending on June 30.
2/ Public debt includes official deposits, which are not covered in the general government concept for the public DSA.

4. **Public debt and gross financing needs remain high.** Gross public debt is estimated at 87.5 percent of GDP in 2019/20 (see EBS/20/91), down from a peak of 103 percent in 2016/17, but well above the median for recent exceptional access cases (Figure 1). It also considerably exceeds the MAC DSA debt benchmark of 70 percent of GDP for emerging markets. Domestic debt is high and under upward pressure from the potential fiscal impact of the COVID-19 pandemic; there are also risks that could arise from materialization of contingent liabilities related to state-owned enterprises. Gross financing needs are projected to exceed 30 percent of GDP through 2025, more than double the existing MAC DSA framework's benchmark of 15 percent of GDP for emerging markets. However, the authorities have indicated their commitment to resuming fiscal consolidation as the crisis abates, which is projected to put public debt on a downward trajectory from 2021/22. The authorities have also implemented a strategy to extend maturities on the large stock of treasury bills. Additional mitigating factors include room for domestic financing given Egypt's large domestic banking system, a significant part of which is public sector-controlled, and the authorities' well-advanced discussions with bilateral creditors to extend maturities on their deposits at the CBE.

Figure 1. Debt Ratios for Recent Exceptional Access Arrangements 1/ 2/



Source: Egyptian authorities and IMF staff estimates.
1/ Estimates as reported in relevant staff reports on the request or augmentation of SBAs or EFF arrangements approved since September 2008. For Egypt, ratios reflect end-FY2019 data.
2/ Asterisks indicate PRGT-eligible countries at the time of the program.

PURCHASE UNDER THE RFI—RISKS AND IMPACT ON FUND FINANCES[1]

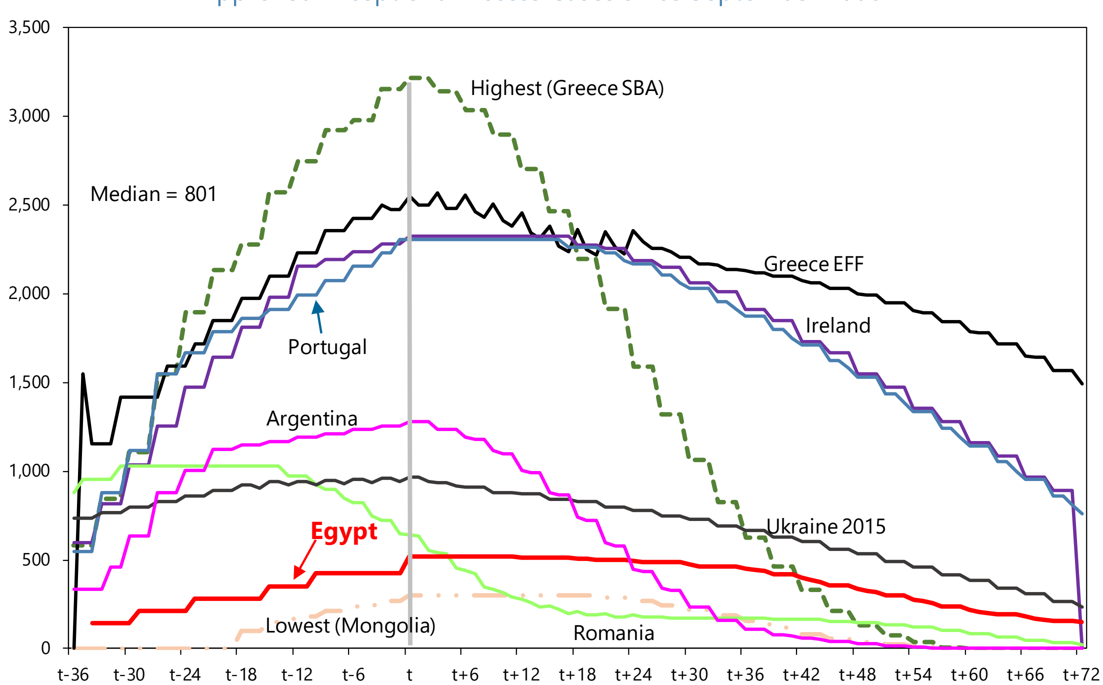
A. Risks to the Fund

5. Access under the proposed RFI purchase would exceed the cumulative access limit, but be modest relative to recent exceptional access cases (Figures 2 and 3). Purchases under the 2016 EFF arrangement brought Egypt close to the normal cumulative access limit (435 percent of quota), with credit outstanding at 422 percent of quota. With the proposed RFI purchase, credit outstanding will rise to 522 percent of quota. This is relatively modest compared with other recent exceptional access cases, notably the large arrangements to support European borrowers in the early 2010s and more recently Argentina.

Figure 2. Credit Outstanding in the GRA around Peak Borrowing 1/

(in percent of quota)

Approved Exceptional Access Cases since September 2008 2/

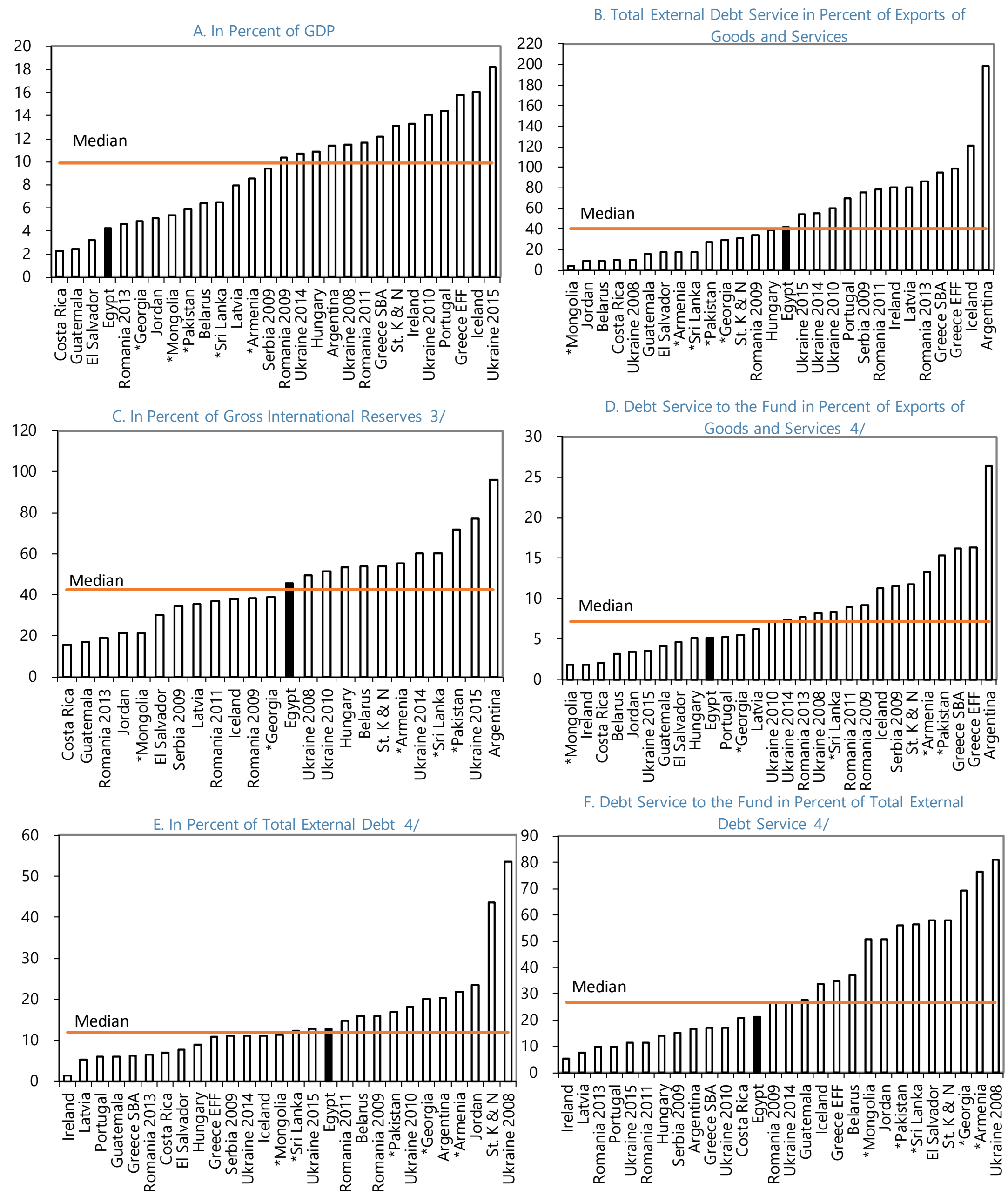


Source: Finance Department and IMF staff estimates.
1/ Peak borrowing "t" is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.
2/ Based on quotas at the time of approval, i.e., pre-14th Review quotas for all countries except Argentina and Egypt. Median credit outstanding at peak is 801 percent of quota; average is 1,028 percent of quota.

[1] The impact of the requested SBA is outside the scope of this assessment and will be assessed separately at a later stage.

Figure 3. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Cases 1/ 2/

Peak Fund Exposure Ratios ***Peak Debt Service Ratios***



Source: Egyptian authorities and IMF staff estimates.

1/ Estimates as reported in relevant staff reports on the request or augmentation of SBAs or EFF arrangements approved since September 2008.

2/ Asterisks indicate PRGT-eligible countries at the time of the program. In Panel F, Georgia's debt service to the Fund includes one from PRGF loan.

3/ Excluding arrangements with members belonging to the euro area at the time of the approval of the arrangement: Greece, Ireland, and Portugal.

4/ For arrangements of which total external debt (or debt service) ratio is not available, public external debt ratio is shown instead.

Table 3. Egypt: Capacity to Repay Indicators 1/ 2/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
Exposure and Repayments (In SDR millions)											
GRA credit to Egypt	10,633.7	10,469.5	9,947.1	8,992.0	6,660.1	4,208.7	2,776.0	1,507.4	597.0	119.4	0.0
(In percent of quota)	(522.0)	(513.9)	(488.3)	(441.4)	(326.9)	(206.6)	(136.3)	(74.0)	(29.3)	(5.9)	(0.0)
Charges due on GRA credit 3/	255.9	248.0	258.4	279.9	223.2	125.3	45.5	25.0	12.6	4.4	0.7
Repurchases under EFF	0.0	164.2	522.4	955.2	1,313.4	1,432.8	1,432.8	1,268.6	910.4	477.6	119.4
Repurchases under RFI	0.0	0.0	0.0	0.0	1,018.6	1,018.6	0.0	0.0	0.0	0.0	0.0
Debt service due on GRA credit 4/	255.9	412.1	780.8	1,235.0	2,555.1	2,576.6	1,478.2	1,293.6	923.0	482.0	120.1
Debt and Debt Service Ratios											
In percent of GDP											
Total external debt	32.8	33.0	31.0	27.6	26.0	24.6	22.7	21.2	20.1	19.3	18.8
External debt, public	30.2	31.0	30.0	27.4	24.2	22.4	20.7	19.3	18.3	17.5	17.1
GRA credit to Egypt	4.2	4.1	3.7	3.1	2.2	1.3	0.7	0.4	0.1	0.0	0.0
Total external debt service	4.0	4.1	5.4	6.3	4.4	3.7	3.4	3.1	2.9	2.7	2.6
Public external debt service	3.3	2.9	4.7	5.4	2.6	2.5	2.2	2.0	1.9	1.8	1.7
Debt service due on GRA credit	0.1	0.2	0.3	0.4	0.8	0.8	0.4	0.3	0.2	0.1	0.0
In percent of Gross International Reserves											
Total external debt	327.3	369.5	356.8	342.9	290.1	247.2	228.2	213.1	201.6	193.6	188.8
External debt, public	302.0	346.6	345.3	340.9	269.9	224.9	207.6	193.9	183.4	176.1	171.8
GRA credit to Egypt	42.1	45.6	42.5	39.0	24.4	13.0	7.5	3.6	1.2	0.2	0.0
Debt service due on GRA credit	1.0	1.8	3.3	5.4	9.4	7.9	4.0	3.1	1.9	0.9	0.2
In percent of Exports of Goods and Services											
Total external debt service	29.0	40.1	41.1	41.3	26.6	22.0	19.9	18.4	17.2	16.2	15.6
Public external debt service	24.2	28.2	35.7	35.0	16.0	15.0	13.1	12.1	11.3	10.7	10.3
Debt service due on GRA credit	0.7	1.6	2.2	2.8	5.1	4.7	2.4	1.8	1.1	0.5	0.1
In percent of Total External Debt											
GRA credit to Egypt	12.8	12.3	11.9	11.4	8.4	5.2	3.3	1.7	0.6	0.1	0.0
In percent of Total External Debt Service											
Debt service due on GRA credit	2.6	3.9	5.4	6.8	19.2	21.3	11.8	9.9	6.6	3.2	0.7
In percent of Total Public External Debt											
GRA credit to Egypt	13.9	13.1	12.3	11.4	9.0	5.7	3.6	1.8	0.7	0.1	0.0
In percent of Total Public External Debt Service											
Debt service due on GRA credit	3.1	5.5	6.2	8.0	32.0	31.2	18.0	14.9	10.0	4.9	1.1

Source: Egyptian authorities, Finance Department, and IMF staff estimates.

1/ Assumes a drawing under the RFI and indicators based on the macroeconomic scenario presented in the accompanying staff report. GRA credit and debt service due on GRA credit includes amounts under the proposed RFI purchase and the 2016 EFF arrangement.
2/ Fiscal year starts on July 1 and ends on June 30.
3/ Includes GRA basic rate of charge, surcharges, service charges, and SDR charges. Of charges due in FY2020, SDR 62.5 million is due in the period following Executive Board consideration of the proposed RFI purchase.
4/ Includes charges due on GRA credit and repurchases. Of the FY2020 figure, SDR 62.5 million is due in the period following Executive Board consideration of the the proposed RFI purchase.

6. While Egypt already has sizable Fund credit outstanding, peak Fund exposure metrics would generally remain below or close to recent exceptional access cases. In particular, peak Fund exposure ratios (stock of outstanding obligations to the Fund as a share of GDP, gross international reserves, and total external debt) are below or close to the median for exceptional access cases approved by the Fund since September 2008 (Figure 3). The same applies for most key external debt service ratios, including total external debt service, and debt service obligations to the Fund, in percent of exports of goods and services. Capacity to repay indicators (Table 3) are also broadly in line with those for recent exceptional access borrowers from the GRA in recent years (Figure 3). Nonetheless, in the wake of the COVID-19 pandemic, Egypt—and the global economy—face exceptionally high uncertainties, implying a significant risk of more adverse outcomes for the currently projected risk indicators.

B. Impact on the Fund's Liquidity Position and Credit Exposure

7. The proposed RFI purchase would have a modest impact on the Fund's liquidity position. With the RFI purchase, the Fund's Forward Commitment Capacity (FCC) would decline by around 1.1 percent from its current level of SDR 192 billion (Table 4). Since Egypt is not a member of the Financial Transactions Plan (FTP), there would be no additional second-round impact on the FCC, when Egypt purchases under the RFI.

8. The marginal impact of the proposed RFI on the Fund's overall credit exposure would be limited, but it would add to what is already the Fund's second largest outstanding credit (Table 4, Figure 4).

- Egypt will remain the Fund's second largest borrower under the current GRA lending portfolio. After the purchase under the proposed RFI and together with the previous purchases under the 2016–19 EFF arrangement, Egypt's GRA credit outstanding will account for 14 percent of total Fund credit outstanding, which is second by a large margin to Argentina (42 percent).

- Credit concentration measured by the Fund's exposure to the top five borrowers would increase marginally from 77.4 percent to 78.0 percent.

- The Fund's current level of precautionary balances significantly exceeds the credit exposure to Egypt. The exposure to Egypt after the purchase under the RFI would amount to 64 percent of the estimated level of precautionary balances (PBs) at end-FY2020. The estimated ratio of total Fund credit outstanding to PBs would rise from 443 percent to 456 percent after the purchase.

- Were Egypt to accrue arrears on charges, the Fund's burden sharing mechanism would be clearly insufficient to cover such arrears. GRA charges for Egypt, projected at SDR 248 million for 2020/21, significantly exceed the Fund's residual burden-sharing capacity, which has very low capacity in the current interest rate environment.

Table 4. Egypt: Impact on GRA Finances
(in millions of SDR unless otherwise noted)

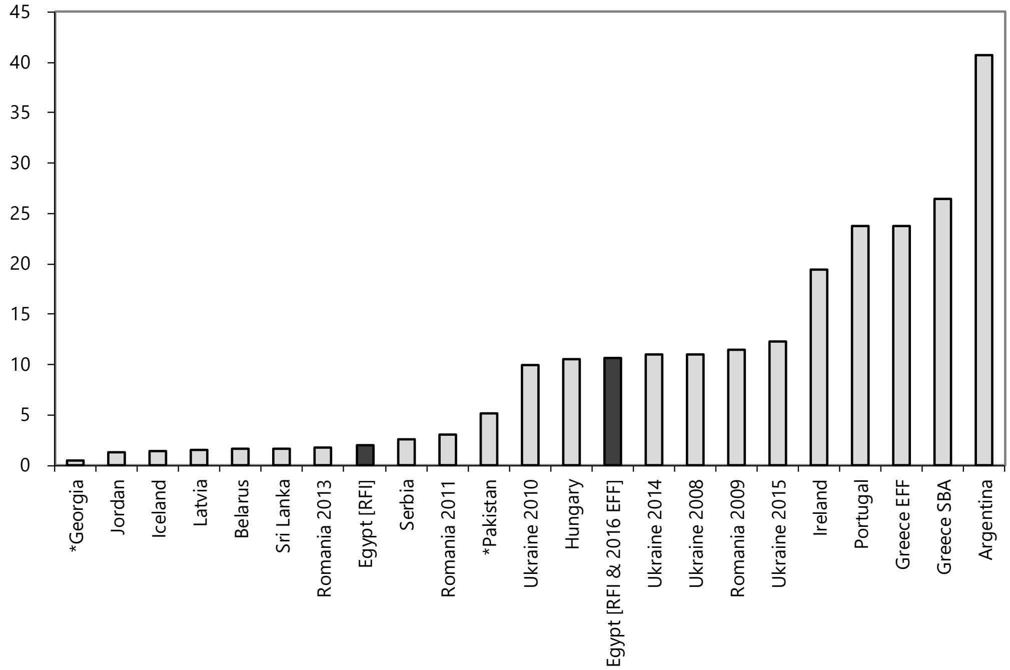
	As of 5/1/2020
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	191,892.2
Impact of the RFI approval on the FCC 2/	-2,037.1
(in percent of current one-year FCC)	-1.1
Prudential measures	
Fund GRA credit outstanding to Egypt 3/	10,633.7
In percent of current precautionary balances	63.7
In percent of total GRA credit outstanding	14.0
Fund GRA credit outstanding to top five borrowers	
In percent of total GRA credit outstanding	77.4
In percent of total GRA credit outstanding including Egypt's RFI purchase	78.0
Egypt's annual GRA charges in percent of Fund's residual burden sharing capacity for 2020/21	2,345
Memorandum items	
Fund's precautionary balances (end-FY2020)	16,700
Fund's residual burden-sharing capacity 4/	10.6

Sources: Egyptian authorities, Finance Department, and IMF staff estimates.

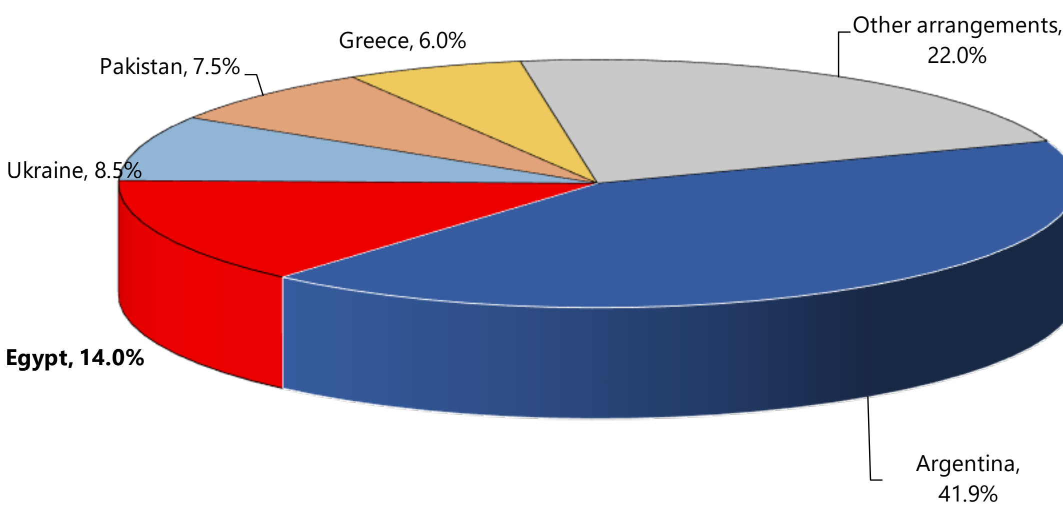
1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include resources under the New Arrangements to Borrow or the 2016 Bilateral Borrowings Agreements.
2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.
3/ Projected credit outstanding for Egypt at approval of the proposed RFI, which amounts to the sum of purchase under the RFI and credit outstanding under the 2016 EFF arrangement.
4/ Burden-sharing capacity is calculated based on the floor for remuneration which, under current policies, is 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges.

Figure 4. Exceptional Access Levels and Credit Concentration

A. Total Access of Recent Exceptional Access Arrangements 1/
(In billions of SDRs)



B. Credit Concentration of Fund GRA Exposure 2/
(As a percentage of total credit outstanding)



Source: Finance Department.
1/ Does not include FCL arrangements as well as arrangements with relatively low access in SDRs. Asterisks indicate countries that were PRGT-Eligible at the time of approval.
2/ Total credit outstanding refers to credit outstanding as of May 1, 2020 plus Egypt's purchase under the proposed RFI.

ASSESSMENT

9. The proposed RFI purchase is intended to help Egypt cope with the global impact of the COVID-19 pandemic and maintain macroeconomic stability. A sharp slowdown in domestic activity is expected as a result of the containment measures introduced to slow the spread of the virus. At the same time the external balance is expected to deteriorate from portfolio outflows, weaker FDI, the shock to tourism, and weaker remittances. EMBIG spreads have risen sharply—reflecting a broader sell-off across emerging and frontier markets—and the authorities have drawn down on their still-substantial foreign exchange reserve buffer. While maximum access under an RFI will still leave a financing gap in 2019/20 and 2020/21, the RFI will serve as a bridge while allowing the authorities to explore options to fill the remaining gap. These options include prospective support from an SBA requested by the authorities—for which a separate risk assessment will be prepared at a later stage—as well as possible support from other multilateral institutions and official bilateral creditors.

10. Egypt's capacity to repay the Fund is adequate. Capacity to repay indicators are broadly in line with those for other recent exceptional access arrangements. Downside risks to Egypt's repayment capabilities arise from the unusual uncertainty about the duration and magnitude of the outbreak and the persistence of measures to contain it. If the crisis turns out to be more severe and/or longer than expected, the output losses could be larger and the recovery would be delayed. Additional risks include large public gross financing needs that could leave Egypt vulnerable to a prolonged loss of market access, and materialization of contingent liabilities to the state. At the same time, several factors mitigate these risks, including that a significant portion of the financing need is based in domestic currency, substantial foreign exchange reserves buffers, and exchange rate flexibility as a crucial shock absorber. The authorities are cognizant of the risks, and have been taking measures to lower the risks of the public debt profile, including by lengthening debt maturities.

11. The proposed purchase under the RFI will have a modest impact on the Fund's liquidity, and—together with Egypt's prior purchases under the EFF—a moderate impact on the Fund's credit exposure. On approval, the Fund's liquidity will be reduced by the full amount of the purchase and the Fund's remaining lending capacity will fall by a modest 1.1 percent. While Egypt's request under the RFI is small compared with past exceptional access arrangements, Egypt will, on the basis of the Fund's current lending portfolio, remain the second largest borrower of GRA resources (by a large margin after Argentina). The RFI will leave the Fund's credit exposure to Egypt at 64 percent of current precautionary balances, and at 14 percent of total GRA credit outstanding.