STUDY

THE IMF PROGRAMME IN EGYPT:

BAILOUT FOR EGYPT OR THE IMF?

Kristina Rehbein
May 2023

Existing vulnerabilities in Egypt were exacerbated by the economic effects of the Russian aggression in Ukraine. Together with other reasons, a fourth loan programme of the IMF was approved for Egypt in December 2022.

The former three IMF loan programmes did not lead to improved debt sustainability, but rather facilitated a heavy borrowing spree - with the IMF becoming a lender of "first resort". Instead of sustainably addressing macroeconomic vulnerabilities, the new programme seems to serve the purpose of bailing out the IMF.

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INTRODUCTION

The International Monetary Fund (IMF) and World Bank Spring Meetings, where the global financial and economic elite meet every year to discuss global economic challenges, painted a dire picture: global growth for the next five years is seen as the weakest in decades, emerging markets face an interrupted recovery from COVID-19 and, while debt vulnerabilities have risen dramatically, fiscal space has shrunk. The economic repercussions of the Russian invasion of Ukraine, such as rising food and fuel prices as well as the rise in global interest rates to curb inflation in addition to high debt, fuel the »perfect storm«.[1]

Adverse economic effects of the Russian aggression in Ukraine have exacerbated existing vulnerabilities in Egypt, which faces financing needs in 2022 and 2023 of a whopping 33 per cent of GDP,[2] among other reasons due to high interest payments, untamed inflation and the reliance on short-term finance, all this leading to the fourth loan programme from the IMF since 2016. The USD 3 billion loan that was approved in December 2022 shall catalyse the needed external finance and lead to macroeconomic stabilisation and debt sustainability.

1

FACILITATING A BORROWING SPREE INSTEAD OF DEBT SUSTAINABILITY

The latter was also a goal of the former two full-fledged programmes in 2016 and 2020 – without much effect. Throughout the 2016 programme, debt was assessed as sustainable but not with a high probability. This assessment did not change in the 2020 agreement, and it did not change in any other IMF assessments, such as in the reports on the requests for the Rapid Finance Instrument during the COVID-19 pandemic in 2020. Rather than improving, debt sustainability deteriorated throughout the programmes with the IMF, with public debt-to-GDP, for example, staying over the risk benchmark set by the IMF to be at 70 per cent of GDP.

Moreover, the expected development of the public debt ratio – a fall of the ratio in the medium term which would prove the success of the programme – did not come true (see Chart 1), proving that forecasts of the IMF on the impact of its reform programmes were too optimistic.

Rather than supporting debt sustainability, the IMF programmes facilitated a heavy borrowing spree – during the programme from 2016, external debt rose by 20 per cent per year. The external debt-service-to-exports ratio has increased by more than 200 per cent since 2015, being at an unsustainable level of more than 30 per cent in 2021.[3]

Despite non-stop IMF programmes since 2016, debt sustainability risks have increased at the start of the new 2023 programme: »Egypt's debt is assessed to be sustainable but not with high probability, and overall risks of sovereign stress are high,[4] […] This assessment is based on the considerable risks due to high debt and gross financing needs.«[5] As is shown in Chart 1, the public debt ratio at the beginning of the programme begins at over 90 per cent and is projected to remain elevated over 80 per cent until the end of the programme. Gross financing needs are projected to remain over 30 per cent until 2028, on average around 35 per cent. This is more than double the ratio the IMF sees as sustainable.

1 See Richtmann, M. (2022): Debt crisis looms for developing countries, in: *DW News*, (27.06.2022); available at: https://www.dw.com/en/debt-crisis-looms-for-developing-countries-amid-perfect-storm/a-62246014.

2 See IMF (2023): World Economic Outlook, April 2023: A Rocky Recovery; available at: https://www.imf.org/en/Publications/WEO/Issues/2023/04/11/world-economic-outlook-april-2023.

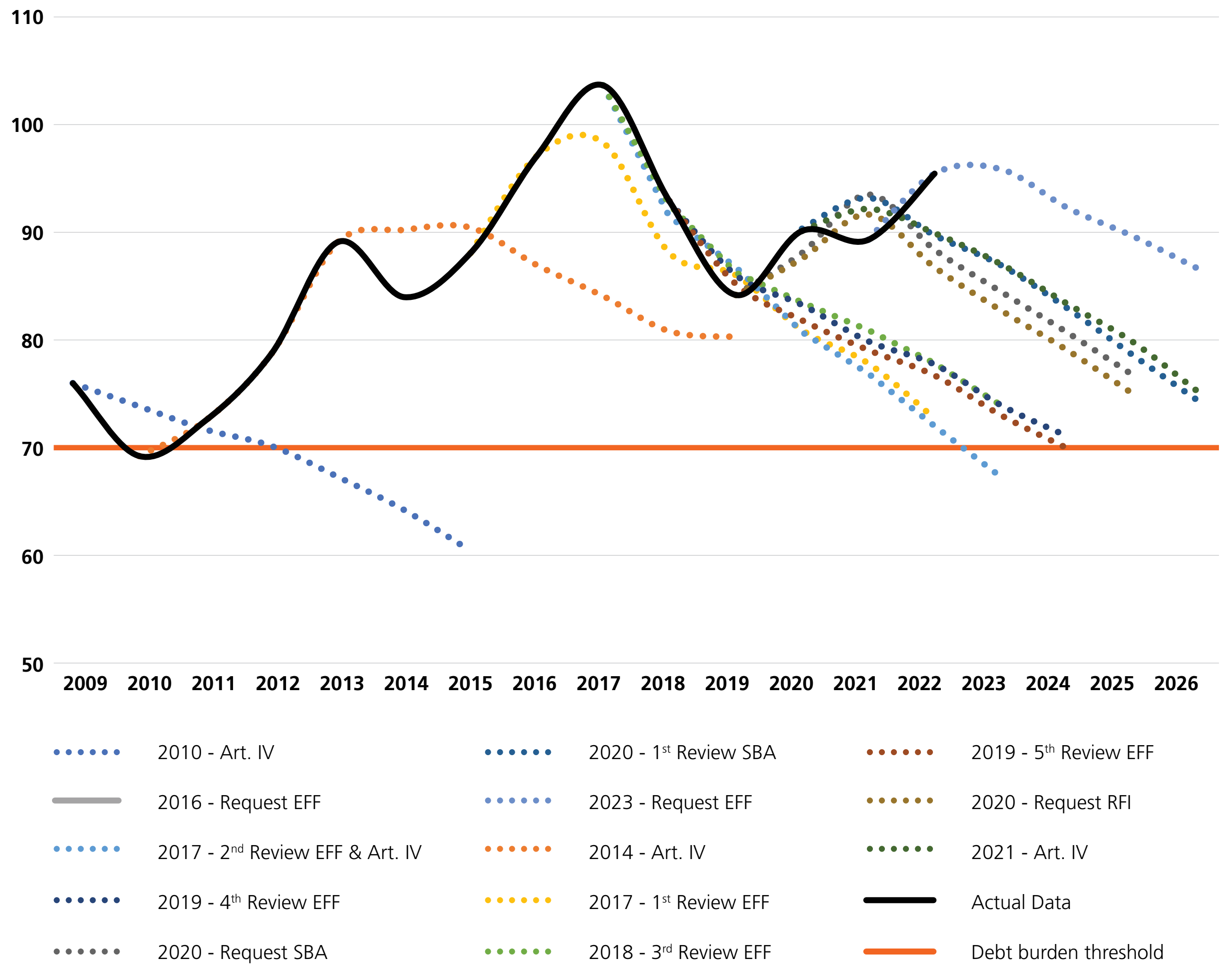
3 Data from International Debt Statistics World Bank, indicator total external debt service to exports for 2021.

4 See IMF (2023): Arab Republic of Egypt – Request for Extended Arrangement under the Extended Fund Facility, p. 13; available at: https://www.imf.org/en/Publications/CR/Issues/2023/01/06/Arab-Republic-of-Egypt-Request-for-Extended-Arrangement-Under-the-Extended-Fund-Facility-527849.

5 Ibid, p. 43.

Chart 1

Actual public debt/GDP compared to short and medium-term projections by the IMF in country reports between 2010-2021



Note: The forecasts in the figure (dotted lines) show the assumed baseline scenarios in each of the mentioned IMF country reports. The baseline scenario describes the development the IMF sees as most realistic. Actual data (the solid black line) is usually t+2 (e.g., 2012 data taken from a 2014 report).

2
HEIGHTENED RISKS TO DEBT SUSTAINABILITY

The IMF does not see much room to manoeuvre for Egypt in the coming programme period. The substantial debt service burden in the short- and medium-term – on average USD 50 billion between 2023 and 2025 – is a strong risk, as is the high burden of interest payments. One of the assumptions by the IMF is that a decreasing interest rate will lead to a decrease in public debt (the so-called favourable »interest-growth differential«). However, in the medium term, the IMF expects interest payments to rise, not to decrease (see Chart 2).

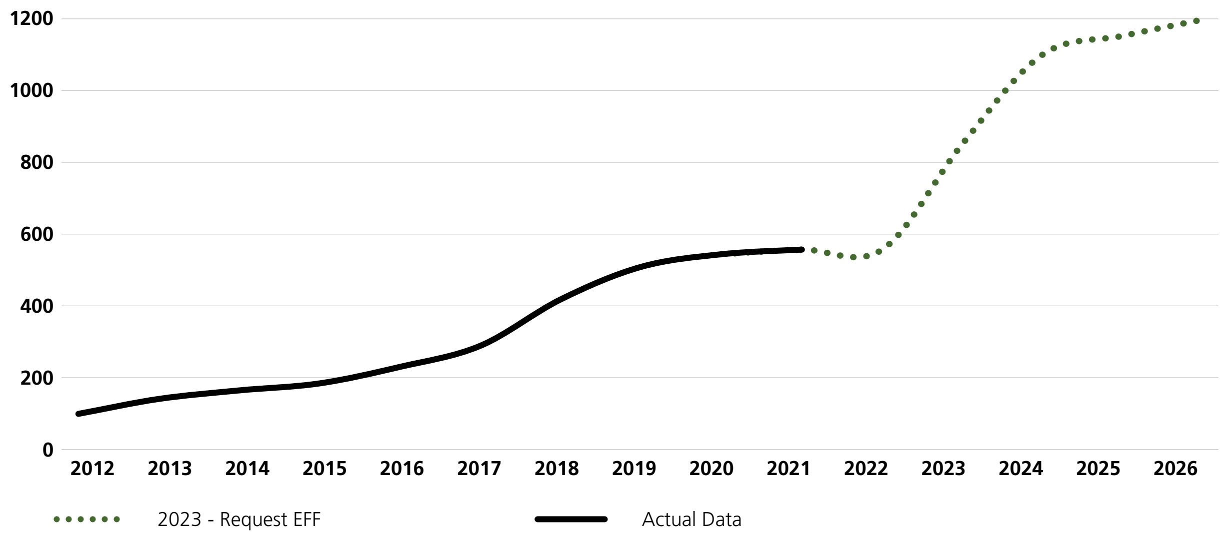
In addition, with regard to the interest rate Egypt currently has to pay for new international capital market borrowing, the situation is dire: Current yields are above 10 per cent,[6] a number which experts usually understand as a country practically having lost capital market access (i.e., access is very expensive or investors are not willing to lend). In fact, Egypt has not tapped the markets since March 2022. Longer-dated dollar bonds even trade below 70 cents to the US dollar – which experts consider the threshold for already distressed debt. In the context of the Russia-Ukraine war, it is difficult to forecast when market access will become easier again, especially as intensifying spill-overs from the war are seen as a highly likely source of risk for Egypt and the programme.[7] At the same time, to ensure the programme is financed, the IMF

6 As of 1 February 2023, average yields were at 11.2 per cent. The higher the bond yield, the higher the interest rate states have to pay to issue new bonds. This is not only related to Egypt: the price at which government bonds of countries in the Global South are traded on secondary markets has plummeted for the majority of countries since March 2022 and has not recovered until February 2023.

7 See Risk Assessment Matrix in IMF (2023): Arab Republic of Egypt – Request for Extended Arrangement under the Extended Fund Facility, p. 41.

expects Egypt to tap markets in the amount of at least USD 3.7 billion until June 2024 – a peculiar assumption and probably an overly optimistic expectation. After all, the same institution announced to the expert world in April 2023 during the IMF and World Bank Spring Meetings that it does not expect a rapid easing of the situation. Other risks the IMF identifies for the programme include, for example, a further rise in short-term debt given the already sizeable debt service burden. At the same time, the IMF expects exactly that to happen.

Chart 2
Absolute interest payments, general government, in billions EGP



Source: Actual data taken from IMF country reports for Egypt between 2014 and 2023. Actual data is usually t+2. Projections (dotted line)

3

THE IMF LENDING INTO UNSUSTAINABLE DEBT SITUATIONS

According to its statutes, the IMF is only allowed to give loans to those countries whose debt is sustainable and which are therefore able to repay their debt. If the IMF finds this is not the case, it is not allowed to lend, or it must make its provision of the loan dependent on a debt treatment. However, there are no clear, mechanical rules at the IMF at which point a debt situation is to be called unsustainable. In countries whose debt sustainability is assessed under the *Sovereign Risk and Debt Sustainability Framework*, the buzzword »sovereign stress« is used instead of »unsustainable debt«, which allows for lending without extraordinary measures such as debt treatment. Generally, there is a systemic reluctance at the IMF to call a debt situation unsustainable, unless a country is already in default.[8] Together with the lack of clear rules when to call out an unsustainable debt situation, the IMF more often than not has lent into unsustainable debt situations – aggravating the situation further.

4

LENDER OF FIRST RESORT

In the case of Egypt there is another issue that comes into play. Although the 2023 loan seems small according to commentators,[9] with this new program, Egypt is the second largest client to the IMF, beaten only by Argentina which, in 2018, received the largest IMF loan ever recorded. In Egypt, the debt to the IMF alone has increased eighteenfold since 2015 – not including the 2023 loan. The IMF has thus become Egypt's largest single creditor, holding more than 20 per cent of the external debt stock of Egypt. Egyptian experts see the IMF in Egypt not as a lender of last resort, but rather first resort – which is lucrative for the Fund: In fact, IMF income from Egypt is projected to account for about 24 per cent of total lending income in 2023. However, the high exposure also leads to exceptional financial and reputational risks for the IMF: Between

8 See Rehbein K. (2023): Dare to take more responsibility: The role of the IMF in delaying debt crises resolutions, in: *Global Sovereign Debt Monitor*, erlassjahr.de and Misereor, https://erlassjahr.de/en/news/gsdm-2023/.

9 See Kaldas T.E. (2022): Twitter thread on 27 October 2022; available at: https://twitter.com/tekaldas/status/1585593034695122944?lang=en.

2023 and 2025, debt service to the IMF alone will amount to more than USD 14 billion. As a claimed lender of last resort, debt to the IMF is usually not restructurable. There is, therefore, a very high interest at the IMF to ensure that Egypt is capable of servicing its debt. And instead of reducing debt, the IMF assumes loan disbursements in the amount of a total of USD 48 billion between 2021 and 2027, around USD 7 billion on average per year. Being only capable of paying old debt with new borrowing is not a sign of improving debt sustainability.

5 PRIVATISATION TO BAILOUT THE IMF

As debt restructuring has not been part of the programme from the start, and in light of the high risks identified to the programme, there is a strong focus from the IMF on mobilising foreign exchange in the short-term to make sure the Egyptian government has the means to repay its debt. The goal of debt collection instead of transformative change is mirrored in conditionalities and assumptions on how to close the financing gap. One is the »divestment programme«: The IMF assumes that Egypt will privatise state assets in the amount of USD 9 billion in the programme period. In general, reducing the footprint of the state and the military in the economy is a relevant and much needed ask and change. However, the IMF expects privatisation proceeds to already materialise in the amount of USD 2.5 billion by June 2023 – and thus raising cash quickly to make sure the first year of the programme is financed in a situation with limited means of finance and a high debt service burden, including to the IMF. Most interestingly, the volume of asset sales for the fiscal year 2023/24 – USD 4.6 billion – is about the same as scheduled debt service payments to the IMF in that period. While the IMF in the programme document on the one hand discusses the need for home-grown private sector-led growth, it becomes clear that on the other hand – to ensure that the IMF programme is financed – member countries from the Gulf Cooperation Council (GCC) will play a central role as countries that have built large surpluses from high world market energy prices in the wake of the Ukraine war. In fact, the programme document states that, if the expected external financing from GCC partners does not come through in full, the programme and Egypt's capacity to repay, is at risk.[10] Already in September 2022, before the IMF agreement for Egypt was signed, Gulf countries made clear that they would change how they would financially support Egypt in the future,[11] confirmed again by Saudi Arabia in Davos in January 2023.[12] After years of very loosely conditioned grants and central bank deposits, Gulf countries now would want to see »returns«, having eyed some of Egypt's profitable assets already for a while. The IMF programme's »divestment« strategy, with the view to ensure the programme is financed without a debt restructuring, therefore openly includes the sale of state assets to Gulf countries, accepted by Gulf countries as a condition of support from their side.

Rather than »sustainably address macroeconomic vulnerabilities and promote private-sector-led growth and job creation«[13] with a catalytic bailout package to Egypt, the programme will seemingly serve the function to bail out the IMF. A tit-for-tat scenario – assets for Gulf countries with backing by the IMF, and increased chances of being repaid for the IMF. This will come at the cost of even higher debt and a potentially lost opportunity for change that will restore economic stability and guarantee social stability.

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10 See IMF (2023): Arab Republic of Egypt – Request for Extended Arrangement under the Extended Fund Facility, p. 10.

11 See among others Kassab, B et al. (2022): The enemy you know: Why Egypt is turning to Qatar to weather crisis, in: *Madamasr* (28.09.2022). Available at: https://www.madamasr.com/en/2022/09/28/feature/politics/the-enemy-you-know-why-egypt-is-turning-to-qatar-to-weather-crisis/

12 See Dahan M.E. and Saba Y. (2023): Davos 2023: Saudi Arabia changing no-strings aid, minister says, in: *Reuters*, (18.01.2023). Available at: https://www.reuters.com/world/middle-east/davos-2023-saudi-arabia-changing-no-strings-aid-minister-says-2023-01-18/.

13 See IMF (2023): Arab Republic of Egypt – Request for Extended Arrangement under the Extended Fund Facility, p. 13.

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IMPRINT

Publisher:
Friedrich-Ebert-Stiftung MENA
Economic Policies for Social Justice
4, rue Bachar Ibn Bord
2078 La Marsa
Tunisia
Email: **info.mena@fes.de**

Responsible for content:
Thomas Claes | Director | Economic Policies for Social Justice
https://mena.fes.de/themes/economy-and-social-justice

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Design: Marc Rechdane