A new Hit: Fitch changes Egypt's outlook to negative, affirms its rating at B+

Abstract

On the 8th of November 2022, Fitch changed Egypt's outlook to negative. The revision of the view to Negative reflects the deterioration in Egypt's external liquidity position and reduced prospects for bond market access, leaving the country vulnerable to adverse global conditions at a time of high current account deficits (CADs) and external debt maturities. This short paper will start by defining what this rating means and briefly analyzing how such a rating impacts the Egyptian economy and will conclude by recommending some factors that would lead to a positive rating.

Introduction

Credit rating (CR) is a tool for determining the risk of non-payment by measuring the capabilities of the debtor (whether individuals, companies, or countries) to pay back the loan. As a result, the likelihood of default can be predicted. The higher the risk, the higher the loan cost or required interest rate.

There are four leading world-class CR institutions: S&P Global, Moody's, Fitch Ratings, and Morningstar DBRS.

On May 26th, Moody's issued its CR for Egypt's government's long and short-term issuer default, keeping CR at the same degree as turning its outlook into negative from stable. On

November 8th Fitch followed; this paper is to explain what CR is and the impacts of the changing perspective into negative on the Egyptian economy.

Two Sides

Every CR institution has a two sides rating, one for the outlook, which addresses the future, and the other rating, which concerns the present.

The Ratings

The rating is the degree of the default risk; with higher ratings, chances are low. Ratings value the stakes at the moment of the report of the long- and short-term debt issuers; the following table shows the rating degrees of Fitch and Moody's since they were the last updates:

Rating degrees of Moody's and. Fitch.

Moody's	Fitch	Description
Aaa	AAA	Prime
Aa1	AA+	High grade
Aa2	AA	
Aa3	AA-	
A1	A+	Upper medium grade
A2	A	
A3	A-	
Baa1	BBB+	Lower medium grade
Baa2	BBB	
Baa3	BBB-	
Ba1	BB+	Non-investment grade speculative
Ba2	BB	Highly speculative
Ba3	BB-	
B1	B+	
B2	B	
B3	B-	

Caa1	CCC	Substantial risks
Caa2	CCC	
Caa3	CCC (low)	
Ca	CC	
C	C	

The Table Shows that the two Institutions value Egypt's governmental debt as Highly Speculative, which is the second lowest grade, and lower than the non-investment grade, which increases the interest rate of Egyptian Bonds.

The Outlook

The outlook is the instructions predictions for the bonds in the medium term, and it comes mainly in three degrees:

- Positive: means better macroeconomic conditions in the medium run, which lower default risks.
- Stable: means the same economic conditions of the update will be kept.
- Negative: economic conditions are to be worse.

The two institutions see worth economic conditions for the Egyptian economy in the medium run since both turned the outlook to negative.

The Negative outlook impacts investors' sentiment to get their money into the economy, whether direct or indirect; this effect worsens when the rating grade is in the non-investment degrees.

The Impacts

The impacts of Fitch's negative outlook on the Egyptian economy are vast. Still, the most significant effects are the Egyptian Pound, Egyptian Bourse, and Egypt's foreign reserve currency, which we will shed light upon:

Egyptian Bourse

The effect of Fitch's decision is channeled to the Bond market through two steps. First, investors pull out of the need for fear of their shares being devaluated, and second, the investors considering investing will refrain, which ends equities and bonds devaluating.

Egyptian Pound

As investors withdraw from the Egyptian Bourse, they exchange LE for USD to take it out of the country, reducing demand for the LE and boosting orders for the USD. In contrast, the Egyptian government cannot provide, resulting in a depreciation of the LE against the USD.

The LE's exchange rate affects the entire Egyptian economy due to the significant value of imports, resulting in increased inflation.

foreign reserve currency

With investors pulling out of the Egyptian economy, they pressure the foreign exchange reserve, as they are taking out the USDs, which lowers the economy's ability to sustain long periods of strategic imports, turning back into fewer imports, less supply, and finally higher prices.

Conclusion

Fitch's decision to revise Egypt's outlook to negative will harmfully affect the Egyptian economy; it will mainly have implications on the Egyptian bourse, the value of the Egyptian pound, and the foreign reserve currency as it will decrease if investors start to pull out of the Egyptian market. Therefore, we can recommend some factors that would lead to a positive rating upgrade in case of their improvement by the Egyptian government. First, in terms of external finances, the reduction in external vulnerabilities, for example, through improved bond market access, narrowing of the current account deficit, and build-up of international reserves or other liquidity buffers, supported by a credible exchange rate framework, is needed. Second, in terms of public finances and macroeconomic policy, there is a need for progress on fiscal consolidation and economic reforms supporting IMF program performance and a further reduction in the gross general government debt/GDP ratio to a level closer to the 'B' median over the medium term. Last, on the structural level, significant improvement across structural factors over the medium time, such as governance standards, the business environment, and income per capita, to levels closer to 'B' and 'BB' rated sovereigns is also needed.