



Egypt

A Welcome Change to the Currency Regime



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highlights the investment opportunity provided by this long-awaited devaluation

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On 03 November the Egyptian pound was allowed to float freely, leading to an immediate 50% fall in its value against the US dollar. We believe this event to be a game changer for the economy, providing an attractive entry point for equity investors.

The Egyptian currency regime had previously been a managed float, but that management had become more rigid and disruptive in recent years. Between January 2011 and October 2016, the Egyptian pound lost only 35% of its value against the US dollar, a period that encompassed two revolutions, a stalling of economic growth, heightened geopolitical risk in the region, and a wider collapse in emerging market currencies. For context, in the same period the South African rand, Brazilian real and Russian rouble all lost approximately 60% of their value.

From March of this year the pound had been fixed at 8.88 to the dollar, with import bans and capital controls in place helping to preserve this artificial level. Equity investors such as ourselves were unable to repatriate funds. There was huge scarcity of hard currency, with the result that a thinly-traded black market developed, with corporates forced to access this in order to bring raw materials into the country.

Some form of devaluation became inevitable, but its magnitude has come as a surprise. For now it appears that we have a fully floating regime, with the pound dropping to over 17 to the dollar. It is still finding a level, but it is clear that a large devaluation risk is no longer hanging over the market. Many economists argue the pound has overshot and is now one of the cheapest currencies globally. Alongside the devaluation, local interest rates were increased by 300bps, financial support was secured from Saudi Arabia, China, UAE and Germany, and an IMF package has been agreed with the first tranche payment received. A eurobond issuance is also expected shortly. Thus the authorities have finally taken a comprehensive set of steps to take the economy forward.

Inevitably there will be pressures – inflation will spike, consumer expenditure will be under strain, and the government will be compelled to support the most vulnerable by strengthening the social safety net – for instance cash subsidies for low income groups to spend on food and fuel have been increased. These risks were building anyway while the exchange rate was pegged. Now at least there are incentives and means for corporates to invest, and we expect to see a marked pick-up here. Egyptian corporates have under-invested for years due to the Arab Spring, Muslim Brotherhood misrule, army coup, and then FX restrictions, with the result that capacity upgrades and expansions are long overdue. International corporates may sense the opportunity to pick up undervalued assets at half their previous price. We also expect wealthy Egyptians, who have been using the black market to take money out of the country, to reinvest.

Investors can gain exposure to Egypt via Charlemagne Capital's Magna Africa Fund. Over 20% of this Fund is currently invested in Egypt, a market which retains many positive features despite the challenges of recent years. A population of around 90 million, mainly young, and growing at 2% to 3% per annum is



structurally very attractive. Egypt remains a strategically important country from a geo-political perspective, as seen by the support it has received in the recent past, and the economy has much to catch up, having grown at an average of only 2% to 3% since 2011, compared to the 5% to 7% of the preceding 15 years.

The Fund's holdings include high quality banks, such as CIB, delivering sustainable returns on equity of around 30% and now poised to grow the balance sheet at up to 40%; and secular defensive consumer names, such as London-listed diagnostic testing provider Integrated Diagnostics Holdings, the dominant player in a high growth market. Other stocks, such as investment bank EFG Hermes, gold miner Centamin and the engineering and construction contractor Orascom Construction have significant US dollar earning streams and assets, and therefore offer reasonable protection against the effects of the weaker pound.

For investors in African equities the past two years have been extremely challenging, with known risks of devaluation in Egypt and Nigeria, two of the largest African markets. With Egypt now finally through to the other side, we can look forward optimistically to improved returns.

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