

## Getting ‘Curves’ in Shape: What Moves Yields in Egypt?

### Analyst

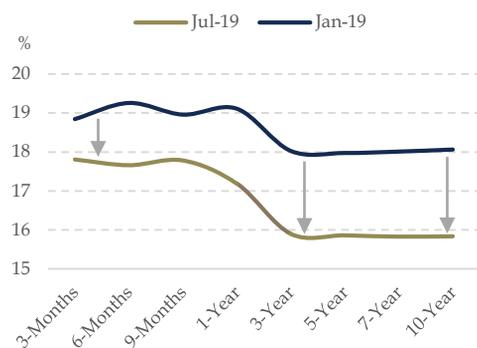
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Egypt’s Treasury auctions have been interesting since the EGP flotation in November 2016. Analyzing T-bills and T-bonds auctions and behavior of yields gives many signals about key economic aspects, such as inflation, FX, and interest rates as well as investor preference and the government’s objectives. In this note, we try to list down a few key observations from Treasuries’ auctions in Egypt.

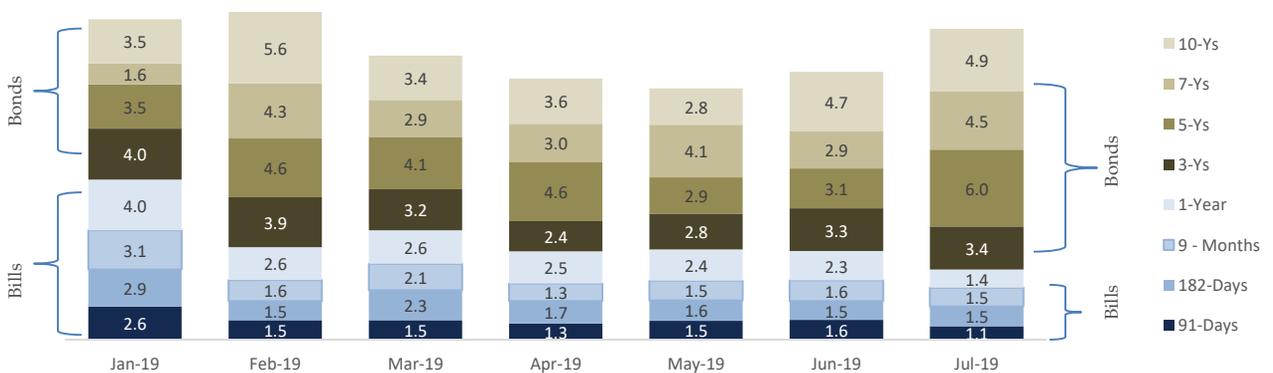
### Egypt’s yield curve (July 2019 vs. January 2019)



Source: CBE, SHUAA Securities Egypt.

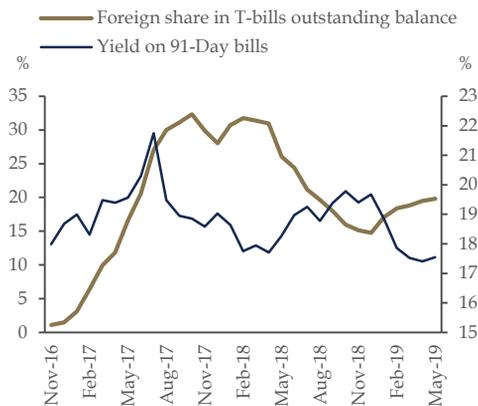
- Yields clearly reflect an expected downward trajectory for interest rates:** Yields on Egypt’s local debt have been inverted (with a humped shape) since the EGP flotation, in a clear message of investors’ awareness of an inevitable easing cycle in the medium term, and that the exceptionally high yields were temporary. Since January 2019, yields on different tenors of Treasuries have been steadily going down, coinciding with revived international inflows into emerging markets (after the distress that prevailed during H2 2018), especially with an appreciating EGP and relatively-low inflation readings. All these factors helped lead monthly average yields down year-to-date.
- This is reflected in increasing appetite for longer maturities:** Investors’ appetite has grown stronger to longer maturities, with average coverage (bid-to-cover) ratio for T-bills retreating from 3.2 in January to 1.5 in July. Meanwhile, average coverage ratio for T-bonds increased from 3.1 to 4.7.
- The government, in turn, is trying to limit the surge in short-term yields:** As relatively modest appetite for lower maturity T-bills keeps yields stubbornly high, the Egyptian government has been trying to tweak its own appetite to keep yields in check. Since January, the government has been sticking to its required amounts. That is, the ratio of accepted-to-required amounts of T-bills declined from about 1.3 registered in January to exactly 1 in July, and even falling below 1 for some maturities. On the other side, the same ratio for Treasury bonds increased from 1.7 to 2.9 during the same period.

### Bid-to-cover ratios: Increased investor appetite for Treasuries comes in favor of longer maturities



Source: CBE, SHUAA Securities Egypt.

## Yields (right), strongly impacted by foreign appetite, move in the opposite direction



Source: CBE, SHUAA Securities Egypt.

- Then comes a question: What drives Treasury yields in Egypt?** Yields on Treasuries have shown an interesting behavior over the past three years or so. They have been responding to various interrelated factors, including monetary, fiscal, and global. Observing the average yield on a monthly basis for different tenors during the period from November 2016 through July 2019, we presume that these are the main factors that drive yields:

  - Foreign appetite for local debt:** We believe this has been the most dominant and powerful factor explaining yields movements during most of the post-flotation era.
  - Inflation figures and expected inflation behavior:** High expected inflation pushes yields up, naturally, as (1) higher yields are needed to compensate for time value of money and (2) high inflation suggests a looming hike in interest rates which, again, causes yields to go up.
  - Key policy rates:** Surprisingly, yields do not usually respond immediately, neither fully, to changes in key policy rates but rather reflect prediction about them. That is, yields usually go down in anticipation of a policy rate cut, and vice versa. However, sometimes yields' response to CBE policy rate actions turn out to partial and short-lived. Sometimes, yields might even reverse direction after the action is already taken.
  - Foreign exchange expectations:** Naturally, the EGP appreciation (or more accurately expectations of a prolonged appreciation) spurs foreign appetite for Egyptian local debt. This was clear since January 2019, as the EGP's continuous appreciation – among other factors such as the remission of the EM crisis in H2 2018 – helped inject an additional cumulative USD6bn in five months (January-June 2019).
- Summing up:** Treasury yield is a multi-variate function which is affected by expectations of many variables, including inflation, interest rates, and others. The yield curve in Egypt, despite being inverted, conveys a positive perception about the inflation path and monetary easing in the medium term. Besides, the Egyptian government's preferences in Treasury auctions clearly favor longer-term maturities for their lower yields due to higher coverage ratio by investors. Meanwhile, the government barely sticks to its required amounts for short maturities and sometimes even accepts lower amounts. With no eyed threats to foreign inflows to the Egyptian local debt market (save for any EM crises), we see yields continuing to shift lower over time, more so for longer-term as opposed to short-term yields before it eventually normalizes.

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