Bank Audi

EGYPT ECONOMIC REPORT

MARCH 2021

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MODEST RECOVERY SEEN DOWN THE LINE WHILE SOME RISKS TO THE OUTLOOK PERSIST

Egypt managing well the arising challenges

Egypt has managed well the COVID-19 pandemic and the related disruption to economic activity by adopting proactive measures to address health and social needs and support the sectors most directly affected by the crisis. The growth slowdown has so far been less severe than expected with Egypt set to be among the few countries with positive growth rate in the past year. External market conditions have also improved with a strong return of portfolio inflows. While growth has somehow declined from 5.6% in FY 2019 to 3.5% in FY 2020, Egypt remains the Top performing economy in the Arab world.

Noticeable balance of payment deficit despite rising remittances

Egypt's external sector deteriorated during the first nine months of 2020 consequently yielding a deficit in BOP of US$ 9.1 billion versus a surplus of US$ 1.9 billion in 2019 as per latest available statistics released by the Central Bank of Egypt. This noticeable aggravation in the overall deficit was mainly triggered by the deterioration in the services balance (-63.6% year-on-year) mainly due to a temporary drop in Egypt's tourism (-65.8% year-on-year) representing a volume of US$ 6.6 billion. It is worth mentioning that amid this challenging period, current transfers achieved a 10.8% increase year-on-year mainly due to rise in the remittance of the Egyptians abroad amounting to US$ 22.1 billion in the first nine months of 2020, versus US$ 19.8 billion in the first nine months of 2019.

Continuous improvement in public finances

Public finances in Egypt continued to improve in FY2020 despite the Coronavirus pandemic, as the country's economic reforms in recent years had allowed it to absorb the Coronavirus shock. In fact, the overall budget deficit declined to 7.9% of GDP in FY2020, compared to 8.2% in FY2019, owing to continuous fiscal consolidation measures and a lower increase in spending. Budget execution is on track to achieve the program target for FY2020/21.

Monetary easing following COVID-19 outbreak and on reduced inflationary pressures

The Central Bank of Egypt maintained its dovish monetary policy in 2020 following the outbreak of the Coronavirus pandemic and in response to declining inflationary pressures. Concurrently, the foreign exchange reserves entered into a contractionary mode for the first time in six years, while the Egyptian pound appreciated marginally despite market tremors.

Noticeable banking sector resilience amid tough environment

The Egyptian banking sector showed a noticeable resilience in a tough operating environment. Measured by total assets, banking activity grew by 19.7% in US$ terms over the first nine months of 2020 to reach US$ 436.9 billion at end-September, the equivalent of 121% of GDP. Deposits grew by 21.4% and loans rose by 28.3% over the same nine month period, while shareholders' equity increased by 23.8% to reach US$ 30.9 billion, the equivalent of 7% of total banking sector assets at end-September.

Mixed price movements in Egyptian capital markets following Coronavirus outbreak

Egypt's equity market was severely hit by the rapid spread of the Coronavirus pandemic in 2020 and fears about a global economic fallout, yet bounced back early 2021 on prospects of a global reopening following a progress in COVID-19 vaccine rollouts and on reflation bets. In contrast, the Egyptian fixed income market saw mostly upward price movements in 2020, mainly tracking US Treasuries move, as growing global growth concerns due to rising Coronavirus cases globally flocked demand for safe-haven assets. Yet, this trend was reversed during the first two months of 2021, on bets that vaccines rollouts and an unprecedented US relief package would sustain a global economic recovery and fuel inflationary pressures.

Egypt's economic conditions to improve looking ahead

Looking forward, Egypt's economic conditions are likely to improve. After having been one of the few countries to record positive growth in the past year, the country is set to record modest recovery in most sectors. Tourism recovery is yet likely to be much more protracted, with global travel disruptions expected to linger well into 2021. Having said that, risks to the outlook remain significant, including a second wave of COVID-19, less favorable financing conditions for emerging markets and a drop in remittances.

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Egypt has managed well the COVID-19 pandemic and the related disruption to economic activity by adopting proactive measures to address health and social needs and support the sectors most directly affected by the crisis. The growth slowdown has so far been less severe than expected with Egypt set to be among the few countries with positive growth rate in the past year. External market conditions have also improved with a strong return of portfolio inflows. While growth has somehow declined from 5.6% in FY 2019 to 3.5% in FY 2020, Egypt remains the top performing economy in the Arab world. However, there are still risks to the outlook, particularly as a second wave of the pandemic increases uncertainty about the pace of the domestic and global recovery as per the IMF.

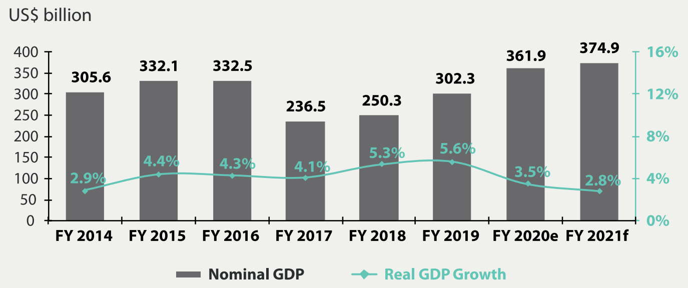
At the external level, the current account deficit is set to have declined to 3.2% of GDP in fiscal year 2020 from 3.6% in fiscal year 2019, supported by more resilient remittances than initially expected. For fiscal 2021, Moodys expects a renewed widening of the current account deficit to 3.7% of GDP in light of continued subdued tourism revenues and its expectation of weaker remittance inflows over time as weak economic activity persists also in source countries.

At the fiscal level, budget execution is on track to achieve the program target for FY2020/21. The existing budget envelope provides sufficient flexibility to accommodate any additional support for vulnerable groups in the event of a second wave of COVID-19, while maintaining the program's fiscal objectives. It is worth mentioning that among the measures adopted to limit the fallout of the pandemic the government adopted a temporary "Corona tax" of 1% on all public and private sector salaries, and 0.5% on state pensions in order to support sectors and SMEs most affected by the pandemic. The measure started in August 2020 and will remain in place for one year.

At the monetary level, the Central Bank of Egypt's (CBE) data driven approach to monetary policy has been instrumental to anchor inflation expectations and achieve low and stable inflation. Monetary easing in recent months should further support economic activity and ease appreciation pressures from large capital inflows, which has had a dampening effect on inflation.

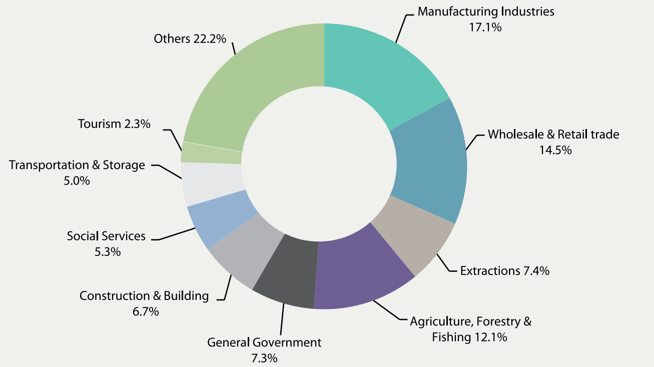
The banking system has been resilient thus far, having entered the crisis well-capitalized and with ample liquidity. The CBE's initiatives have helped ensure continued access to credit through the crisis; ongoing financial sector supervision will be critical to maintain the resilience of the banking sector as crisis initiatives begin to expire. Within this context, banking activity has continued to expand at sound levels, with assets, deposits and loans growing by double-digits annually in USD terms amid a supportive macroeconomic environment. Deposits grew by 16.9% in USD terms over the year-to-August 2020. Loans grew by 21.4% over the same period, while total assets grew by 15.3%. The aggregate net profits of listed banks yet contracted by 8.9% in the first nine months of 2020 relative to the same period in 2019 on the basis of the results of 9 out of 11 listed banks.

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2020)



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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At the capital markets level, equity and fixed income markets were at the mirror image of challenging macroeconomic conditions. The stock market price index contracted by 22.3% in 2020 amid higher turnover and better market liquidity and efficiency. The annual trading value rose by 79.3% year-on-year to reach US$ 43.8 billion in 2020. As to fixed income markets, the 5-year CDS spread, a measure of the market perception of sovereign risks, expanded by 62 bps in 2020 to reach 339 bps at end-year.

The detailed developments in the real sector, external sector, public sector and financial sector follow next, while the concluding remarks are meant to address the main issues facing the near and medium term outlook.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture

Egyptian government continues its efforts in backing up primary sector

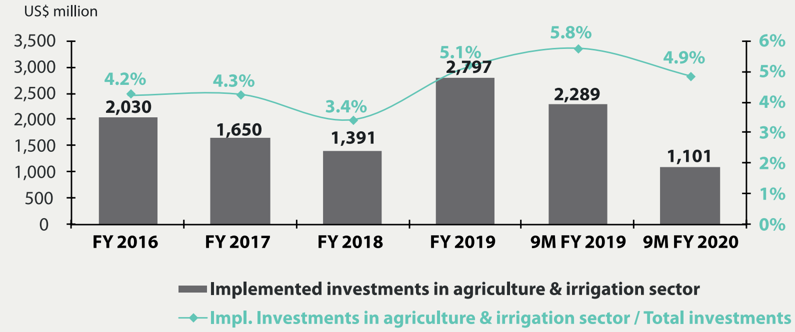
Egypt's primary sector continued its positive performance reporting a growth of 3.3% in FY 2020, unchanged from its level in the previous year, as the Egyptian government moves forward with its investment in land reclamation projects, increasing the area available for agricultural output. In FY 2020, agriculture, fishing and forestry contributed by 12.1% to the Egyptian economy, up from 11.4% in FY 2019. The sector came as the third largest contributor following manufacturing and wholesale and retail trade.

Total implemented investments in the agricultural and irrigation sector declined from US$ 2,289 million in 9M FY2019 to US$ 1,101 million in the same period of FY 2020. The share out of total investment retreated from 5.8% to 4.9% over the covered period.

On another level, the share of bank credit facilities to the sector stood at 1.8% at end-September 2020, edging marginally up from 1.2% at end-September 2019.

In details, a number of government programs would back up wheat production in Egypt. The World Bank-funded Farm-Level Irrigation Modernization Project, established in 2013, aims to increase the efficiency of the country's irrigation system by 75%, as it will enhance water irrigation by substituting underground plastic pipes. Furthermore, the Egyptian government looks after recycling treated municipal and industrial water waste and drainage water for irrigation purposes. At the level of the consumer, subsidy reform will

IMPLEMENTED INVESTMENTS IN AGRICULTURE & IRRIGATION SECTOR



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

improve efficiency. The government is streamlining its food subsidy scheme, which costs about US$ 4.5 billion per year, as per Fitch Solutions.

On a side note, the country has been suffering with water scarcity concerns with the ongoing construction of the Grand Ethiopian Renaissance Dam. This has put downward pressure on rice production in Egypt shifting the country's production from a surplus to a deficit.

In a forward look, the Egyptian government is expected to bolster public investments into the agricultural sector as the COVID-19 shocks encourage greater food security. According to Fitch Solutions' latest estimates, it is suggested that government investments into agribusiness will increase to LE 34.5 billion in FY 2021 along with a robust increase in area dedicated for wheat and sugar.

1.1.2. Manufacturing

Manufacturing and extractive industries report mixed performances

The activity of Egypt's manufacturing and extractive industries saw a mixed performance in FY 2020. While manufacturing continued to post growth though at a slower pace, extractive industries shifted into a negative performance.

In details, Egypt's manufacturing industries, which includes petroleum refining and other manufacturing subsectors, continued expanding though at a slower pace. Manufacturing industries grew by 1.4% in FY 2020 relative to a growth rate of 2.8% in FY 2019. This comes along as the International Financial Corporation has been increasing its support to Egypt's manufacturing sector, with the aim of improving efficiencies, supporting innovations, and replenishing working capital.

Growth in Egypt's petroleum refining industries speeded up to 17.3% in FY 2020, compared to a rise of 2.2% in the previous fiscal year, while other manufacturing industries posted a retreat of 3.5% in FY 2020, reversing the 3.0% growth posted in FY 2019.

The country's extractive industries shrank by 3.0% in FY 2020 compared to a 9.8% rise in the previous fiscal year. Egypt's extractive industries comprise petroleum industries, gas industries and other extractions.

In details, the Egyptian petroleum industries encountered a slowdown of 3.1% in the FY 2020 against a slight 0.1% rise in FY 2019. Gas industries posted a negative performance as well, falling by 4.3% in FY 2020 relative to a 20.2% expansion in the previous fiscal year. Other extractions, the third subsector of extractive industries, grew by 2.4% in FY 2020 slower than a 3.3% growth in FY 2019. It is worth noting that Egypt's consumption of refined petroleum products fell by 10% in 2020 as an effect of the COVID-19 pandemic on domestic and industrial consumption, decreasing from an average 706,890 b/d in 2019 to 636,200 b/d in 2020, as per Fitch Solutions.

At another level, the shares of implemented investments in Egypt's crude oil, natural gas and other manufacturing industries out of total investments declined in 9M FY 2020. Implemented investments in crude oil projects retreated by around 40.0% in 9M FY 2020 to reach a total of LE 31,141 million. On the other hand, implemented investments in natural gas contracted by 15.8% in 9M FY 2019 to reach LE 67,560 million. However, other manufacturing industries edged up marginally to stand at LE 83,067 million in the aforementioned period.

In sum, the manufacturing and extractive industries reported mixed performance on various indicators. In support of the sector, the Egyptian State promoted a national program to enhance local industrialization for the period from 2019 to 2024, which is targeted on raising the competitiveness of local products, support productive activities in promising industrial sectors, maximize the use of available productive capacities, stimulate investments directed at deepening local manufacturing, and develop an integrated system for evaluating suppliers while working on establishing a highly competitive supplier base of small and medium industries to link them with major manufacturers.

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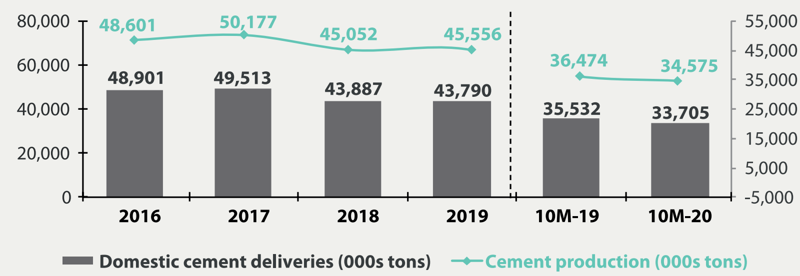
1.1.3. Construction

Construction & building sector maintains its stability despite the pandemic

The construction and building sector maintained its growth though at a slower pace in FY 2020, contributing to 6.7% of the country's GDP. As a matter of fact, the sector posted an expansion of 4.4% in FY 2020, compared to a growth of 8.8% in the previous fiscal year. This is mainly backed up by the structural reforms launched over the past couple of years, coupled with the flexible approach to dealing with the COVID-19 pandemic by allocating 2% of the country's GDP to support the more vulnerable economic sectors and industries, reduced the economic shock to a certain extent.

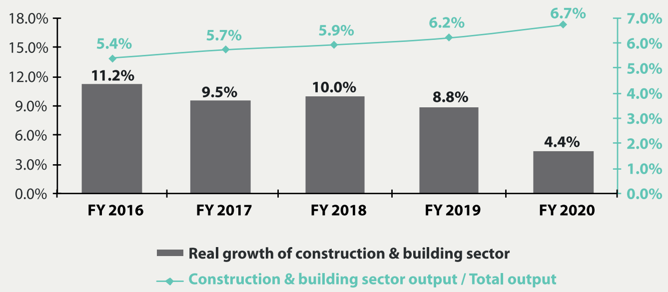
In details, the residential rental market recorded single-digit. Almost 2,500 units were completed in Cairo in 2020, bringing the total residential stock to around 162,000 units. In terms of performance, demand across the rental market remained resilient, especially towards the second half of 2020. This resulted in rental increases. Asking office rents in New Cairo were unchanged as high-quality space remains limited. Meanwhile, in the office market, landlords in other areas of Cairo have become more flexible with their lease terms, offering various incentives to retain tenants, as per JLL.

CEMENT PRODUCTION AND DELIVERIES



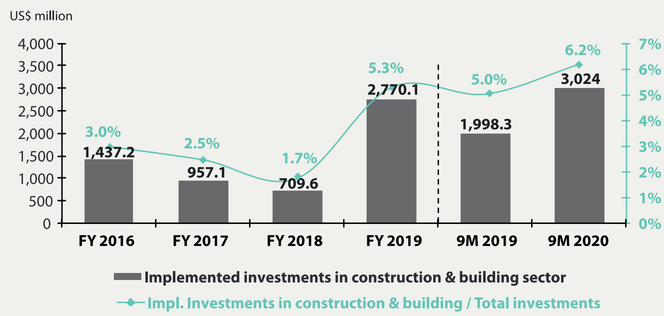
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

CONSTRUCTION & BUILDING SECTOR OUTPUT



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

IMPLEMENTED INVESTMENTS IN CONSTRUCTION & BUILDING SECTOR



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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The value of investments in the Egypt's construction sector rose by 37.2% year-on-year to stand at LE 48,814 million in 9M 2020. The share of investment in construction out of total investments in Egypt stood at 6.2% in 9M FY 2020, up from 5.0% in the same period of the previous fiscal year.

At the level of construction material, cement production and deliveries reported a contraction in the first ten months of 2020. The former retreated from 36,474 thousand tons in 10M 2019 to 34,575 thousand tons in the corresponding period of 2020, while the latter declined from 35,532 thousand tons to 33,705 thousand tons over the same period. This comes along as the country moved in May to halt building activities in a bid to limit building violations and illegal construction across the country, affecting all its sub-industries. The ministry ordered all ongoing construction of private housing to stop until owners or developers present building plans that meet legal requirements such as allowing for enough parking spots. However, this decision did not apply to construction work at national projects commissioned by authorities.

The construction sector saw a positive outturn despite project delays, suspensions and employment cuts amid the virus breakout. Although the pandemic had a crippling effect on various sectors, Egypt's construction sector has been one of the few that maneuvered the crisis well.

1.1.4 Tourism

Noticeable contraction in Egypt's tourism sector due to COVID-19 pandemic

Egypt's tourism sector was hit by the spread of the COVID-19 pandemic in FY 2020 with a decline of 17.3%, following a growth of 20.1% in the previous fiscal year. Fitch Solutions estimate that international arrivals plummeted by 69.5% in 2020 to just 4.1 million, down from a peak of 13.6 million in 2019, due to the pandemic.

Flight suspensions, border closures and fleet groundings remained the norm for much of the first half of 2020, while the situation showed some improvement in the second half of the year as leisure tourism flights to key resort towns such as Hurghada and Sharm el Sheikh began again.

When looking at the performance of four and five stars hotels in Cairo City, the latter reported a deceleration in terms of occupancy, average daily room rate and RevPar. According to Ernst & Young's 2020 hotel benchmark survey, the hospitality sector in Cairo adopted a retreating trend whereby hotel occupancy fell by 46% from 76% in 2019 to 30% in 2020. In parallel, the rooms' rate in Cairo's four and five star hotels registered a decrease of 20.5% to stand at US$ 92 in 2020. Subsequently, the average room's yield edged down by 68.6% to stand at US$ 27 in the aforementioned year.

Recently, the Central Bank of Egypt issued LE 2 billion in tranches to support the tourism sector. The first tranche will start with an amount of LE 1 billion for the Credit Risk Guarantee Company. This is to ensure the balances of the guarantees issued by the company for banks, to cover part of the associated risks and to finance tourism companies, as per a statement. The statement said that the move comes within the initiative to replace and renew land hotels, floating hotels and tourist transport companies. It does not include the 3 billion Egyptian pounds that was allocated from the Ministry of Finance's initiative. The Egyptian Central Bank said that the decision was in light of the initiative issued in January 2020 and its amendments.

In sum, the COVID-19 pandemic had an unprecedented adverse impact on global tourism and travel, as well as Egyptian tourism in particular which faced a year of severe contractions in 2020.

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1.2. EXTERNAL SECTOR

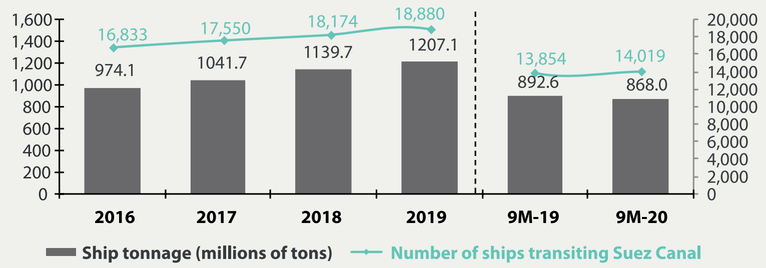
BOP shifting from surplus to deficit amid Covid-19 pandemic

Despite the fact that Egypt was resilient and was operating more normally compared to the external world during the lockdown of the current pandemic phase, still its external sector deteriorated during the first nine months of 2020 consequently yielding a deficit in the balance of payments of US$ 9.1 billion versus a surplus of US$ 1.9 billion 2019, as per latest available statistics released by the Central Bank of Egypt. This noticeable aggravation in the overall deficit was mainly triggered by the deterioration in the services balance (-63.6% year-on-year) mainly due to a temporary drop in Egypt's tourism revenues (-65.8% year-on-year) representing a volume of US$ 6.6 billion. This was directly related to the strict lockdown phases implemented globally hindering the tourism activity. It is worth mentioning that amid this challenging period, current transfers achieved a 10.8% increase year-on-year mainly due to rise in remittances of the Egyptians abroad amounting to US$ 22.1 billion in the first nine months of 2020 versus US$ 19.8 billion in the first nine months of 2019.

Egypt's foreign trade activity showed a moderate decrease in imports alongside with exports during the first nine months of 2020 in comparison to the same period of 2019, contributing to a 5.0% drop in the foreign trade deficit. In fact, Egypt's trade deficit contracted from US$ 27.6 billion during the first nine months of 2019 to US$ 26.3 billion during the same period of 2020. Consequently, the exports to imports coverage ratio dropped from 43.6% to 41.2% between the two periods.

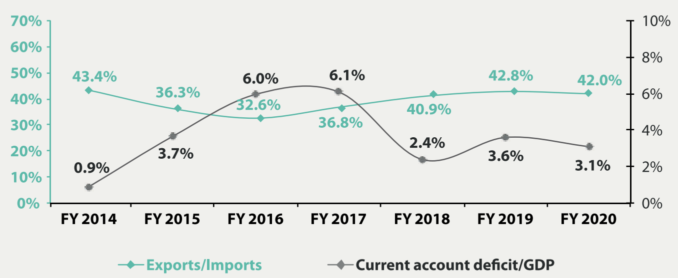
In parallel, total imports reached US$ 44.7 billion during the first nine months of 2020 versus US$ 48.9 billion in same period of 2019. The breakdown of imports by products over first half of 2020, as per the latest available statistics by the Central Bank of Egypt, reported a significant increase in raw materials registering a hike of 33.0% year-on-year, followed by imports of consumer goods showing an increase of 10.3% year-on-

EVOLUTION OF SUEZ CANAL ACTIVITY



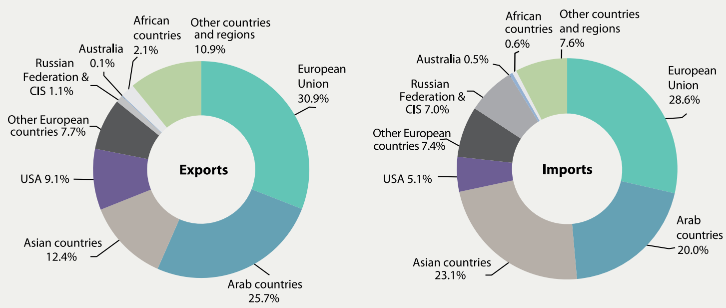
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (1H-20)



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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year (constituting 28% of total imports) for first half of 2020. The biggest decline among the major imported categories reported was in fuel and mineral oils with a drop of 45% year-on-year (constituting 11% of total imports), followed by imports of investment goods (liquid, air pumps, data treatment computers, cranes, etc…) with a decline of 28% (constituting 14% of total imports). The breakdown of imports by geographical distribution shows that most of the inward merchandise came from the European Union with 28.7% of the totals, followed by Asian countries (excluding Arab countries) with 24.3% of the totals, and Arab countries with 19% of the total over the first half of 2020.

At the level of exports, activity dropped from US$ 21.3 billion in the first nine months of 2019 to US$ 18.4 billion in the first nine months of 2020, registering a decrease of 13.7%. This decline in exporting activity came alongside with the pandemic phase where global demand has dropped tremendously during the first half of 2020 affecting the foreign exports of Egypt. Based on the latest statistics by Central Bank Egypt, the breakdown of exports by products during the first half of 2020 reveals that the most significant increase among the major categories was by semi-finished goods (gold, organic and inorganic compounds, animals, vegetables…) with an increase of 47.2% year-on-year to make up 23% of total exports during the first half of 2020. Exports of fuel, mineral oils & products witnessed a drop of 38.4% (or 28.7% of total exports at first half 2020). The geographical distribution of exports during same period indicates that 29% of total exports went to the European Union, followed by the Arab countries with 27% of the total over the first half of 2020.

Within this context, the current account deficit widened from US$ 7.0 billion over the first nine months of 2019 to US$ 9.4 billion during respective period of 2020. Accordingly, the current account deficit to GDP is expected to record 4.2% in FY21 from 3.2% in FY20 as per the IMF. In parallel, the capital and financial account shrank by 52% during the first nine months of 2020, moving from US$ 8.4 billion to US$ 4.2 billion between the two periods. This was triggered by the contraction in FDI by 35.9% year-on-year and affected by the economic squeeze amid the pandemic phase mainly in the first quarter of 2020.

1.3. PUBLIC SECTOR

Narrowing fiscal deficit ratio on fiscal consolidation measures and lower increase in spending

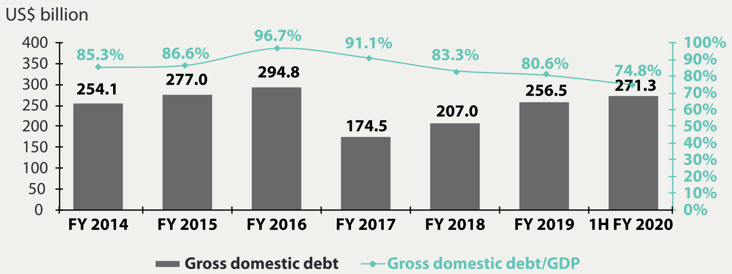
Public finances in Egypt continued to improve in FY2020 despite the Coronavirus pandemic, as the country's economic reforms in recent years had allowed it to absorb the Coronavirus shock. In fact, the overall budget deficit declined to 7.9% of GDP in FY2020, compared to 8.2% in FY2019, owing to continuous fiscal consolidation measures and a lower increase in spending.

SELECTED PUBLIC FINANCE INDICATORS

LE billion	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Total budget revenues	491.5	659.2	805.7	941.9	975.4
Total budget revenues/GDP	18.1%	19.0%	18.3%	17.9%	16.7%
Total budget expenditures	817.8	1,031.9	1,229.1	1,369.9	1,434.7
Total budget expenditures/GDP	30.2%	29.7%	27.9%	26.1%	24.6%
Overall budget deficit	339.5	379.6	432.7	430.0	462.8
Overall budget deficit/GDP	12.5%	10.9%	9.8%	8.2%	7.9%

Sources: Ministry of Finance, Bank Audi's Group Research Department

GOVERNMENT INDEBTEDNESS



Sources: Ministry of Finance, IMF, Bank Audi's Group Research Department

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Going further into details, total budget revenues rose by 3.6% in local currency terms during FY2020 as compared with FY2019, to reach LE 975.4 billion (US$ 59.7 billion), or the equivalent of 16.7% of GDP, according to actual figures issued by the Ministry of Finance. The important rise in budget revenues was due to a hike in non-tax revenues by 14.6%, with the growth in the "other" component accounting for two-third of the hike, followed by the "financing investment" with 23.3% of it, the "sales of goods and services" component with 17.5%, and the "grants" component with 8.8% of it, while the "property income" component saw a contraction of 16.1%. In parallel, tax revenues went up by a shy 0.5% during FY2020 as compared with FY2019, following a drop of 17.2% over the FY2019.

Regarding budget expenditures, they were up by 4.7% in local currency terms during FY2020 relative to FY2019 (compared to a higher growth of 11.5% in FY 2019), to reach LE 1,435 billion (US$ 87.8 billion) or the equivalent of 24.6% of GDP. The slower increase in spending was to a significant extent the result of a tangible drop in subsidies, grants and social benefits by 20.3% over the year, while workers' wages and compensations, purchases of goods and services, other expenditures, and purchases of non-financial assets registered a yearly growth ranging between 6.6% and 33.7%. This resulted into a 7.6% increase in the overall deficit in local currency terms in FY 2020, to reach the equivalent of LE 463 billion and accounting for 7.9% of GDP in FY 2020, down from 8.2% of GDP in FY 2019, due to continuous fiscal consolidation measures.

In parallel, the gross domestic debt rose by 1.7% in local currency terms during the first half of FY 2020 or the equivalent of LE 72.3 billion (US$ 4.5 billion), following a 15.8% expansion in FY 2019, to reach the equivalent of LE 4,354 billion at end-December 2019, according to the latest figures release by the Central Bank of Egypt. This was mainly driven by a 3.3% growth in the "balances of bonds and bills" or the equivalent of LE 127.7 billion (US$ 8.0 billion), within the context of sovereign debt sale aiming at funding the country's fiscal deficit, noting that Egypt sold in November 2019 a US$ 2 billion triple-tranche bond. As such, the gross domestic debt to GDP went down from 80.5% as at end-June 2019 to 74.8% as at end-December 2019, as per the CBE. In parallel, the external debt went up by 13.6% since end-June 2019 to reach US$ 123.5 billion at end-June 2020 (or 34.1% of GDP), as Egypt has sold U$ 7 billion of foreign-currency denominated bonds over the covered period.

Last but not least, the fiscal outlook remains favorable in Egypt, with the budget deficit expected to gradually decline to about 6.3% of GDP in FY2021, while the primary budget position is expected to remain positive in the coming year with a surplus of 2%, according to the State budget for the FY2021. Total revenues are expected to reach LE 1,289 billion (up from budget LE 1,134 billion in FY2020), as tax revenues are expected to reach LE 965 billion pounds (up from budget LE 857 billion in FY 2020). Total expenditures in the FY2021 budget are expected to reach LE 1,713 billion compared to LE 1,575 billion budgeted in FY2020. Within this context, it is worth mentioning that the State budget for FY2021 includes a stimulus package of LE 100 billion, the largest in Egypt's history, which is set to increase general government debt to GDP in FY2021.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Monetary easing following COVID-19 outbreak and on reduced inflationary pressures

The Central Bank of Egypt maintained its dovish monetary policy in 2020 following the outbreak of the Coronavirus pandemic and in response to declining inflationary pressures. Concurrently, the foreign exchange reserves entered into a contractionary mode for the first time in six years, while the Egyptian pound appreciated marginally despite market tremors.

Consumer prices in Egypt subsided in 2020, mainly reflecting the outbreak of the COVID-19 pandemic and its impact on economic activity, and the government measures to avoid any supply-chain induced shortages in the market. Accordingly, the annual headline urban inflation averaged 5.0% in 2020 as compared to 9.2% in 2019, marking its lowest level since 2005. Within this context, it is worth mentioning that while the "food and beverages" group remains the largest component in the CPI basket, its weight declined from 39.9% to 32.7% with the release of the 10th CPI series starting from September 2019 data. In parallel, the core inflation, which excludes the impact of temporary price shocks on inflation that could result from weather conditions, supply

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disruptions or infrequent resetting of prices by the government, averaged 2.3% in 2020 versus 5.8% in 2019. Under these conditions, the CBE has revised its next inflation target to 7% (±2 percentage points) on average during 2022 Q4, down from 9% (±3 percentage points) on average during 2020 Q4.

In response to declining inflationary pressures and in the aim to combat the impact of the Coronavirus pandemic on the domestic economy, the Central Bank of Egypt slashed its key policy rates three times over the year 2020 by a total of 400 bps, following four rate cuts of 450 bps in 2019. In details, the CBE preemptively lowered interest rates by 300 bps on March 16, 2020 in an unscheduled MPC meeting to support economic activity in light of the global and domestic developments emanating from the outbreak of COVID-19 pandemic. This was followed by two rate cuts of 50 bps each in September 2020 and November 2020 in response to eased inflationary pressures, as the annual headline urban inflation reached 3.4% in August 2020, its second lowest rate recorded in almost 14 years after October 2019's figure.

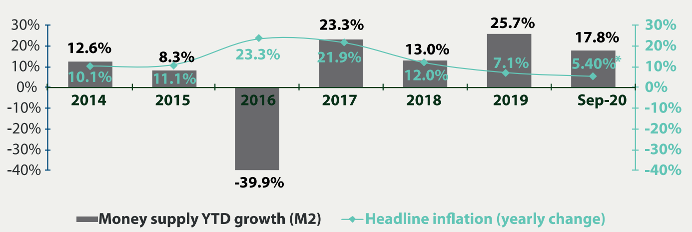
Within this context, the overnight deposit rate was slashed from 12.25% at end-2019 to 8.25% at end-2020; the overnight lending rate was cut from 13.25% to 9.25%; the rate of the main operation was reduced from 12.75% to 8.75%; and the discount rate moved down from 12.75% to 8.75%. These decisions mainly reflect the CBE's data-driven approach to monetary policy, which has been instrumental to anchor inflation expectations and achieve low and stable inflation, as per the IMF.

In parallel, the Central Bank of Egypt's gross official reserves saw in 2020 their first yearly contraction since 2014, falling by US$ 5.3 billion when compared to end-2019 to reach US$ 40.1 billion at end-December, as the global uncertainty stemming from the Coronavirus outbreak took its toll on portfolio investments in emerging markets in March 2020, including the Egyptian market, while the CBE continued to draw on its reserves over the year to meet external obligations of US$ 1.6 billion, including a US$ 1 billion bond that has matured in April 2020, and as the pandemic also trimmed the remittances and brought tourism to a halt. Within this context, the CBE's gross official reserves coverage ratio to local currency money supply fell from 21.5% at end-December 2019 to 15.4% of at end-December 2020.

The exodus by foreign investors during the first half of 2020 failed to rattle the Egyptian pound, thanks to a string of measures adopted by the Central Bank of Egypt to offset the impact of the Coronavirus pandemic, and given renewed significant capital inflows since June 2020 -reflecting improving global financial conditions- which have offset the decline in tourism inflows, and due to improved sentiment after Egypt secured a 12-month US$ 5.2 billion Stand-By-Agreement from the IMF aimed to alleviate the economic impact of the pandemic, maintain macroeconomic stability and support reforms. Under these circumstances, the Egyptian pound managed to appreciate by 1.9% against the US dollar in 2020 despite market tremors, moving from LE/US$ 16.05 at end-December 2019 to LE 15.75 at end-December 2020.

The broader money supply (M2) expanded by 17.8% in US$ terms during the first nine months of 2020, moving from US$ 256.1 billion at end-2019 to US$ 301.7 billion at end-September 2020, mainly due to the increase in

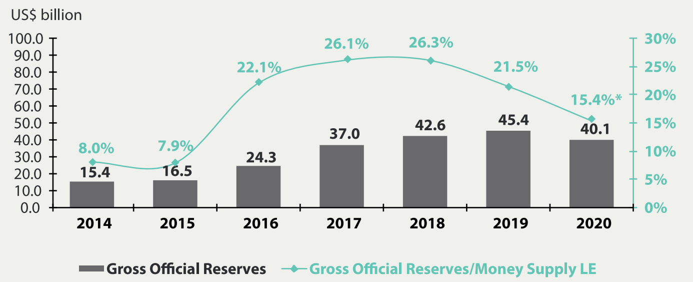
BROAD MONEY AND INFLATION



** December 2020*

Sources: Central Bank of Egypt, Bank Audi's Group Research Department

EXCHANGE MARKET INDICATORS



**Money Supply LE is at end-September 2020*

Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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contribution of fiscal deficit financing sources within M2 as well as the private sector credit. This followed a higher expansion in money supply (M2) of 25.7% in 2019. Concurrently, money supply in its narrow sense (M1) widened terms by 19.2% in US$ during the first nine months of 2020, following a growth of 28.5% in 2019, to reach US$ 71.9 billion at end-September 2020.

Looking forward, the Central Bank of Egypt would continue to closely monitor economic developments and would stand ready to take any additional steps that may be necessary to restore inflation to the target range. The CBE's rate cuts, the projected rebound in domestic activity and the base effects from the low inflation this year are likely to contribute to a higher inflation in 2021, according to the IMF.

1.4.2. Banking Sector

Noticeable banking sector resilience amid tough environment

The Egyptian banking sector showed a noticeable resilience in a tough operating environment. Measured by total assets, banking activity grew by 19.7% in US$ terms over the first nine months of 2020 to reach US$ 436.9 billion at end-September, the equivalent of 121% of GDP. Deposits grew by 21.4% and loans rose by 28.3% over the same 9-month period, while shareholders' equity increased by 23.8% to reach US$ 30.9 billion, the equivalent of 7% of total banking sector assets at end-September.

Egyptian banks are funded by stable domestic deposits, which account for 73% of total assets. Of that, diversified household deposits which are low-cost and highly stable, account for a high 69% of the total. For 2021, Moody's expects deposits to increase by 10%-12%, supported by ongoing efforts to deepen financial inclusion through the use of financial technology, as well as by remittances from a loyal Egyptian diaspora.

Egyptian banks' access to long-term market funding in foreign currencies has improved, a sign of increased investor confidence that followed the country's decision in 2016 to allow its currency to float freely. For 2021, banks are expected to maintain access to long-term foreign funding despite the more fragile market conditions, while maintaining a low exposure to confidence-sensitive short-term interbank funding with foreign banks. Foreign funding is sourced mainly from international banks and development finance institutions such as the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank.

At the liquidity level, Egyptian banks are highly liquid, with cash and interbank balances accounting for 19% of their total assets, while an additional 39% is invested in government securities. Healthy inflows of deposits and CBE's high reserve requirements will ensure liquidity stays strong. Within the same context, the banks' improving net foreign assets position and their ability to access foreign funding are noteworthy.

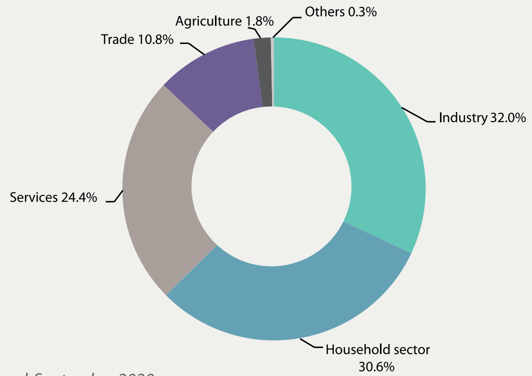
The Egyptian banking sector continues to be profitable. The banks return on tangible assets was 1.2% as of June 2020, and is expected at around 1.0% for the year to come. Moody's actually foresees profitability

BANKING SECTOR INDICATORS

in US$ million	2014	2015	2016	2017	2018	2019	Sep-20
Banking Activity							
Assets	275,375	317,393	218,738	271,022	303,142	364,869	436,865
Deposits	218,210	244,484	152,411	187,462	213,070	263,956	320,398
Credit Facilities	88,028	101,073	71,773	82,398	101,253	117,792	151,090
Capital + Reserves	17,174	18,033	13,985	18,082	19,721	24,990	30,929
Growth rates							
Assets	13.7%	15.3%	-31.1%	23.9%	11.9%	20.4%	19.7%
Deposits	15.3%	12.0%	-37.7%	23.0%	13.7%	23.9%	21.4%
Credit Facilities	11.2%	14.8%	-29.0%	14.8%	22.9%	16.3%	28.3%
Capital + Reserves	5.4%	5.0%	-22.4%	29.3%	9.1%	26.7%	23.8%

Sources: Central Bank of Egypt, Bank Audi's Group Research Department

BANK CREDIT FACILITIES BY ECONOMIC ACTIVITY*



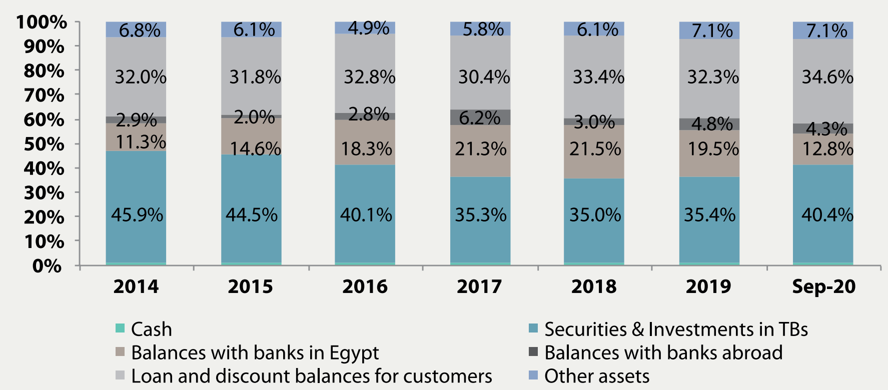
** As at end-September 2020*

Sources: Central Bank of Egypt, Bank Audi's Group Research Department

to fall relatively in 2021. They believe the greatest impact will come from an expected squeeze in net interest margins, triggered by (i) the CBE's 400-basis-point cumulative interest rate cut and (ii) increased cost of funding given the high-yielding (15% for a 3-year) certificates of deposits issued by the two large State-owed banks during the second and third quarter of 2020, to discourage deposit dollarization. Profits will also be eroded by sluggish loan growth and business generation, and higher provisioning as loan delinquencies accelerate.

With respect to capitalization, Egyptian banks reported a sector aggregate Tier 1 capital of 17.7% of risk-weighted assets and an equity-to-assets ratio of 7.7% as of June 2020. State-owned banks typically hold lower capital than private-sector banks and are therefore more vulnerable to capital erosion. Despite the expectation of lower profitability, capital ratios are expected to remain broadly stable because reduced capital generation will be offset by lower dividend payments and moderate growth in risk-weighted assets, the denominator of the ratio. According to Egypt's new Banking Act, banks are required to hold minimum capital of LE 5 billion (around USD 315 million), up from LE 500 million. The move will encourage sector consolidation as some smaller banks do not meet the new requirements at large.

BANKING SECTOR ASSET COMPOSITION



Sources: Central Bank of Egypt, Bank Audi's Group Research Department

1.4.3. Equity and Bond Markets

Mixed price movements in Egyptian capital markets following Coronavirus outbreak

Egypt's equity market was severely hit by the rapid spread of the Coronavirus pandemic in 2020 and fears about a global economic fallout, yet bounced back early 2021 on prospects of a global reopening following a progress in COVID-19 vaccine rollouts and on reflation bets. In contrast, the Egyptian fixed income market saw mostly upward price movements in 2020, mainly tracking US Treasuries move, as growing global growth concerns due to rising Coronavirus cases globally flocked demand for safe-haven assets. Yet, this trend was reversed during the first two months of 2021, on bets that vaccines rollouts and an unprecedented US relief package would sustain a global economic recovery and fuel inflationary pressures.

The Egyptian Exchange registered double-digit price falls in 2020, mainly weighed down by concerns over a global economic downturn amid Coronavirus-induced lockdowns and on profit-taking operations following 2019's price gains. A closer look at the bourse main benchmark index (EGX 30) shows that the index has reached a 40-month low of 8,757 on March 18, 2020 after the outbreak of the Coronavirus pandemic (marking a year-to-date drop of 37.3%). Yet, the EGX 30 managed to recoup some losses after the Egyptian President decided on March 22, 2020 to allocate LE 20 billion to support the Egyptian Exchange, and following the government's decision to put the capital gain tax on hold till December 31, 2021 and reduce the stamp tax imposed on the total proceeds from selling or buying listed securities from 0.15% to

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0.05%, in addition to optimism about Coronavirus vaccine rollout.

Under these conditions, the bourse main benchmark index (EGX 30) closed the year 2020 at 10,845, marking a contraction of 22.3% relative to year-end 2019, yet rebounded to 11,525 at end-February 2021 following a broad rollout of COVID-19 vaccines globally and on rising hopes about a global economic recovery.

Eight out of 16 sectors in the Egyptian Exchange registered price contractions in 2020, while eight sectors posted price gains. The worst performing sector was the health care and pharmaceuticals sector, which posted the largest price slumps of 22.3%, followed by the food, beverages and tobacco sector with -17.8% %, the banks sector with -17.7%, the non-bank financial services sector with -11.9%, the basic resources sector with -6.2%, the travel and leisure sector with -3.5%, the real sector with -3.3%, and the building materials sector with -0.1%. In contrast, the paper and packaging sector posted price rises of 98.6%, followed by the IT, media and telecommunication sector with +88.0%, the contracting & construction engineering sector with +53.9%, the textile and durables sector with +40.3%, the industrial goods, services and automobiles sector with +17.4%, the education services sector with +14.5%, the trade & distributors sector with +10.2%, and the shipping & transportation services sector with +3.8%. Within this context, it is worth highlighting that the total market capitalisation of the falling sectors represents 75.4% of the total market capitalisation.

Along with an equity price fall, the number of listed companies on the Egyptian Exchange declined from 218 companies at end-2019 to 215 companies at end-2020. This resulted into an 8.3% contraction in the market capitalization in local currency terms, moving from LE 709 billion at end-2019 to LE 650 billion at end-2020, noting that in US dollar terms the market capitalization contracted by 5.5% year-on-year, given a 1.9% appreciation in the Egyptian pound against the greenback.

The total volume of traded shares surged from 49,789 million shares in 2019 to 92,884 million shares in 2020, up by 86.6%. The total number of transactions increased significantly by 173.4%, moving from circa 4.97 million transactions in 2019 to circa 8.62 million transactions in 2020. The total trading value rose from LE 409.7 billion in 2019 to LE 689.7 billion in 2020, up by 68.3%, marking a growth of 79.3% in US dollar terms.

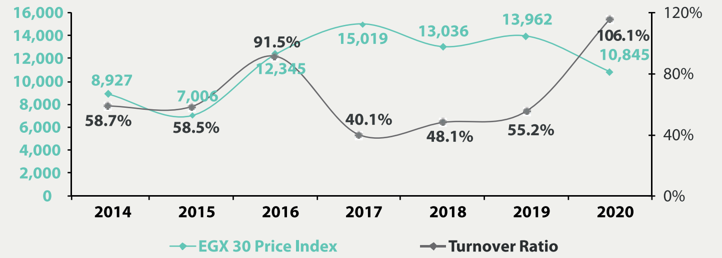
Egyptian market players captured 74.1% of the total value traded in 2020, while non-Arab foreign investors

CAPITAL MARKETS INDICATORS

	2014	2015	2016	2017	2018	2019	2020
Market capitalization (US$ billion)	69.9	54.9	33.2	46.4	41.8	44.2	41.2
Total value traded (US$ million)	41,044	32,091	30,389	18,640	20,128	24,394	43,734
Non-Arab foreign participation as % of total value traded	9.7%	11.1%	11.5%	17.7%	23.2%	26.1%	22.5%
Total volume of traded securities (million)	57,230	45,078	68,559	77,946	60,771	49,789	92,884
Total number of transactions (000s)	7,328	4,875	6,008	7,034	6,278	4,970	8,619
No. of listed companies	214	221	222	222	220	218	215
No. of traded companies	206	209	209	213	218	213	214
% Change in price index (EGX 30)	31.6%	-21.5%	76.2%	21.7%	-13.2%	7.1%	-22.3%
CDS spread (bps)	282	531	450	316	391	277	339

Sources: Egyptian Exchange, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Egyptian Exchange, Bank Audi's Group Research Department

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accounted for 22.5% of it, followed by Arab market players with 3.4% of it. Within this context, it is worth mentioning that the Egyptian Exchange attracted 28,368 new investors in 2020, distributed as follows: 89.7% Egyptian investors, 7.6% non-Arab foreign investors, and 2.7% Arab investors. Given a yearly increase in total activity and a contraction in the market capitalization, the turnover ratio, measured by total trading value to market capitalization, increased from 55.2% in 2019 to 106.1% in 2020.

In contrast, activity in the Egyptian fixed income market was mostly skewed to the upside in 2020, mainly tracking rises in US Treasuries on global growth concerns amid rising Coronavirus cases globally, and supported by Egypt's high real interest rates and the "stable" outlook affirmed by three international credit rating agencies following the spread of the pandemic.

In fact, Moody's affirmed in May 2020 the long-term foreign and local currency issuer ratings of the Government of Egypt at "B2" with a "stable" outlook. The affirmation of the "B2" rating and "stable" outlook reflect Egypt's ongoing credit strengths and challenges that Moody's does not expect to change materially relative to similarly-rated sovereigns through the global shock posed by the Coronavirus pandemic.

Concurrently, Fitch affirmed in July 2020 Egypt's long-term foreign currency Issuer Default Rating at "B+" with a "stable" outlook, citing a recent track record of fiscal and economic reforms, policy commitment to furthering the reform program and ready availability of fiscal and external financing amid the COVID-19 crisis.

Also, Standard & Poor's affirmed in November 2020 its "B/B" long-term and short-term foreign and local currency sovereign credit ratings on Egypt, with a "stable" outlook. The "stable" outlook reflects S&P's expectation that the weakening of external and government debt metrics would be temporary, and gradually improve from 2022, supported by higher GDP and current account receipts.

A closer look at individual bonds shows that US dollar-denominated sovereigns maturing in 2022, 2023, 2024, 2025 and 2040 registered yearly price rises of up to 2.08 pts in 2020. Euro-denominated sovereigns maturing in 2030 posted price expansions of 1.52 pt over the year. Yet, this favourable momentum was reversed over the first two of months of 2021, mainly tracking a global sell-off mood, on bets that a progress in the rollout of Coronavirus vaccines and a US$ 1.9 trillion US relief package would sustain a global economic recovery and fuel inflationary pressures. As to cost of insuring debt, Egypt's five-year CDS spreads expanded by 62 bps in 2020 to reach 339 bps at end-December, noting that it has reached a high level of 662 bps on March 23, 2020 on global growth concerns following the outbreak of the COVID-19. The cost of insuring debt registered year-to-date contractions of 24 bps over the first two months of 2021 to reach 315 bps at end-February.

Regarding new bond issues, Egypt launched in May 2020 a triple-tranche US$ 5 billion bond to take advantage from low borrowing costs and as the North African country is looking to build a fiscal room to counter the economic effects of the Coronavirus pandemic. In details, Egypt sold US$ 1.25 billion four-year bonds at a coupon rate of 5.75%; US$ 1.75 billion 12-year bonds at a coupon rate of 7.625%; and US$ 2.0 billion 30-year bonds at a coupon rate of 8.875%. The order book size exceeded US$ 13.6 billion. Also, Egypt issued in October 2020 the first green bond in the MENA region worth US$ 750 million at a coupon of 5.25%.

Moving to the year 2021, Egypt raised in February US$ 3.75 billion from the sale of a triple-tranche bond. Egypt sold US$ 750 million five-year bonds at a coupon rate of 3.875%, US$ 1.5 billion 10-year bonds at a coupon rate of 5.875% and US$ 1.5 billion 40-year notes at a coupon rate of 7.5%. The bond sale was more than four times oversubscribed, attracting total bids of US$ 16.5 billion. Within this context, it is worth mentioning that this bond offering was the first after the Egyptian Parliament has approved borrowings of up to US$ 7 billion in FY 2021.

All in all, Egypt would continue to embark into a multipronged plan to ease the cost of borrowing by diversifying funding sources and extending maturities through gradual shifts into longer-dated instruments, noting that the country's financing needs are expected to increase in the coming period as payments to the IMF and Eurobond holders begin ramp up.

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CONCLUSION

Looking forward, Egypt's economic conditions are likely to improve. After having been one of the few countries to record positive growth in calendar year 2020, the country's real GDP growth, projected to be at 2.8% over FY 2021, with modest recovery expected in all sectors except tourism, is likely to recover thereafter. Tourism recovery is likely to be much more protracted, with global travel disruptions expected to linger well into the year to come. Having said that, risks to the outlook remain significant, including a second wave of COVID-19, less favorable financing conditions for emerging markets and a drop in remittances.

At the monetary level, inflation is forecasted at 6.2% in 2021 and at an average of 7.4% over the next five years. This suggests that the threat of significantly elevated inflation is noticeably behind over the medium term, thus alleviating pressure on monetary policy. It is yet important that monetary policy remain data driven to anchor inflation within the Central Bank of Egypt's target range, with due consideration of the multiple trade-offs and their price impact. Egypt's foreign exchange reserves and access to domestic and external debt markets should allow it to cover higher external and fiscal financing needs and upcoming maturities over the next 12 months.

Despite high exposure, Egypt's credit metrics are broadly resilient to financing shocks, in part due to policy credibility and effectiveness would likely exert positive pressure on financial standing. Over the medium term, a marked improvement in debt affordability and reduction in gross financing needs, resulting from a lengthening track record of credible and effective fiscal, economic and debt management, would likely lead rating agencies to upgrade the rating. Evidence of a sustained improvement in the labor market and in nonhydrocarbon exports could also support an upgrade by signaling higher competitiveness that would boost Egypt's resilience to shocks.

When assessing the outlook for Egypt, it is important to have a glance on strengths and challenges. Strengths actually revolve around a large and diversified economy, a track record of reform commitment and implementation, a broad domestic funding base and robust foreign exchange reserves that exceeds external debt payments over the next year and provide buffers against significant capital outflows from emerging markets in the wake of the coronavirus pandemic, in addition to the fact that primary budget surpluses have been restored and are likely to be maintained. Challenges are tied to high government debt, low debt affordability and very large refinancing needs, in addition to social pressures from high youth unemployment and lingering susceptibility to political event risks.

While strengths outpace challenges and opportunities exceed threats, there is a need to continue sustaining the macroeconomic stabilization path. According to the Article IV report on Egypt released this January, the IMF believes that continued progress on fiscal reforms is important to provide additional space for high priority spending on health and education. The CBE's data-driven approach to monetary policy has helped anchor inflation expectations and achieve low and stable inflation. The IMF welcomed the authorities' strong commitment to financial stability, while unlocking Egypt's growth potential requires continued progress on structural reforms at large.

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