EGYPT ECONOMIC REPORT

A SUCCESSFUL REFORMING MODEL FOR HIGHLY INDEBTED ECONOMIES

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CONTACTS

Research

Marwan S. Barakat
(961-1) 977409
marwan.barakat@bankaudi.com.lb

Jamil H. Naayem
(961-1) 977406
jamil.naayem@bankaudi.com.lb

Salma Saad Baba
(961-1) 977346
salma.baba@bankaudi.com.lb

Fadi A. Kanso
(961-1) 977470
fadi.kanso@bankaudi.com.lb

Gerard H. Arabian
(961-1) 964047
gerard.arabian@bankaudi.com.lb

Farah N. Nahlawi
(961-1) 959747
farah.nahlawi@bankaudi.com.lb

- Booming real sector activity

  Egypt's economy sustained in 2019 its robust growth performance and the improvement in its public finances, while external accounts are stabilizing at broadly favorable levels. Egypt remains committed to its successful reform program, following completion of its three-year Extended Fund Facility with the IMF in November 2019. As a matter of fact, real GDP growth reached 5.5% in FY 2019, the highest in the MENA region, up from 5.3% in FY 2018. This pickup is driven by net exports, as goods and services exports inched up in tandem with a contraction of oil imports (supported by the increase in natural gas production), while private investment is also picking up.

- Balance of payments still in surplus despite widening current account deficit

  Although the pressures on Egypt's trade deficit relatively lessened in 2019, the current account deficit widened by 58.2% over the first nine months of 2019 as per the latest available statistics released by the Central Bank of Egypt. This noticeable rise in the current account deficit was mainly attributed to the significant increase in investment income payments (+58.3% year-on-year), driven by the increase in profit transfers by foreign petroleum companies, in addition to interest payments on external debt (+78.1%), despite the continuous improvement in tourist receipts (+13.9%) and remittances inflows (+2.3%). Still, the balance of payments registered a net surplus of US$ 1.9 billion in the first nine months of 2019, though lower than the US$ 7.5 billion during previous year's corresponding period.

- Fiscal consolidation to anchor public indebtedness reduction remaining on track

  Public finances in Egypt are gradually improving since FY 2017. In fact, the overall budget deficit declined to 8.1% of GDP in FY 2019, compared to 9.7% in FY 2018, in response to continuous fiscal consolidation measures which reduced fuel and electricity subsidies, increased taxes and fees, and significantly improved tax collection and tax administration. In parallel, the primary budget position strengthened in FY 2019, recording a higher than expected surplus of 2% of GDP.

- Dovish monetary policy on reduced inflationary pressures

  Reduced inflationary pressures and the progressive appreciation of the Egyptian pound against the US dollar have prompted the Central Bank of Egypt to maintain a dovish monetary policy over the year 2019, while the CBE's foreign exchange reserves have hit a new historical high level in December 2019 amid rising touristic revenues, increased remittances and the receipt of the final IMF loan payments. Looking forward, with inflation fully normalizing over the course of 2020, hovering around the bottom end of the Central Bank of Egypt's inflation target range of 9% (±3%), the CBE should have room for further rate cuts.

- Favorable year for banks with comfortable activity growth and sound financial standing

  Banks operating in Egypt have benefited from continued positive economic momentum and the spillovers of reforms, enticing liquidity into the sector and enhancing their financial intermediation role by extending new waves of credit to the government and private sector. Measured by the consolidated assets of banks operating in the country, sector activity grew by 9.3% in local currency terms in 11M 2019 (+21.5% in US dollar terms given local currency appreciation) to reach the equivalent of US$ 368.3 billion at end-November.

- Price rebound in Egyptian capital markets on improving macroeconomic conditions

  Egypt's capital markets saw a price rebound in 2019, mainly helped by ongoing fiscal and economic reforms, improving macroeconomic conditions, CBE's dovish monetary policy and attractive market valuations. The bourse main benchmark index (EGX 30) was up by 7.1% in 2019, while the cost of insuring debt closed the year at 277 bps with a net contraction of 114 bps over the year.

- Prolonged economic expansion expected looking ahead

  Assuming a continuation of the path of reforms and a parallel gradual improvement in the business environment, economic growth is expected to reach 5.9% in 2020 (6.0% over the next five years), driven by a recovery in private consumption, investments and exports. Lower unemployment and a strong investment climate should begin to boost private consumption as of this year, although widespread poverty would remain a constraint on consumer demand growth for the time being. The construction and energy sectors would remain the main engines for growth, while sluggish growth in Europe, Egypt's main foreign partner, might somewhat affect tourism and other sectors.

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Egypt's economy sustained in 2019 its robust growth performance and the improvement in its public finances, while external accounts are stabilizing at broadly favorable levels. Egypt remains committed to its successful reform program, following completion of its three-year Extended Fund Facility with the IMF in November 2019.

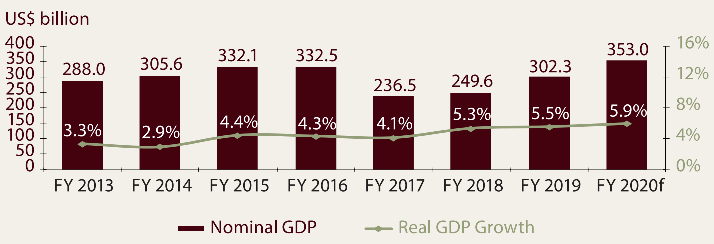
As a matter of fact, real GDP growth reached 5.5% in FY 2019, the highest in the MENA region, up from 5.3% in FY 2018. This pickup is driven by net exports, as goods and services exports inched up in tandem with a contraction of oil imports (supported by the increase in natural gas production). Private investment is also picking up. On the sectoral side, gas extraction, tourism, wholesale and retail trade, real estate and construction have been the main drivers of growth. Parallel to the outstanding growth performance, Egypt's unemployment rate reported a 10-year low of 8.6% in FY 2019, against 10.9% in FY 2018. Still, social conditions remain relatively difficult, as the economy recovers from the preceding period of higher cost of living.

At the monetary level, inflation receded relatively in 2019, paving the way for monetary easing. The Headline Inflation rate reported 7.1% in December 2019, against 12.0% in December 2018. The Central Bank of Egypt has slashed the benchmark deposit rate four times in 2019, moving from 16.75% at end-2018 to 12.25% at end-2019. In parallel, international reserves have risen further to US$ 45.4 billion in December and the current account deficit has reported 3.6% of GDP, continuing its descent since the Central Bank of Egypt's exchange rate reform in 2016 when the current account deficit was 6.0% of GDP. It is worth mentioning that another component of exchange rate liberalization was achieved in September 2019 with the abolition of the "customs dollar" – a fixed exchange rate applicable to trade transactions. It is also worth mentioning that the Egyptian pound appreciated by 10.4% relative to the US$ in 2019, mirroring the improved external and fiscal conditions. Having said that, while a stronger Egyptian pound is likely to weaken the growth impetus from external demand, further monetary easing by the Central Bank of Egypt (CBE) should support a recovery in private consumption and investment.

At the fiscal level, there has been a further improvement in public finances over the past year. Fiscal deficit to GDP decreased from 9.7% in FY 2018 to 8.1% in FY 2019, contracting the debt to GDP ratio from 83.3% to 80.6% respectively. The government's fiscal 2020 budget targets a decline in the deficit to 7.2% of GDP while maintaining a primary surplus of 2%. The budget incorporates the achievement of cost recovery in the pricing for most fuel products and ongoing electricity tariff hikes, implementation of the fuel indexation mechanism, alongside a rise in social spending, civil service salaries, and pension payments.

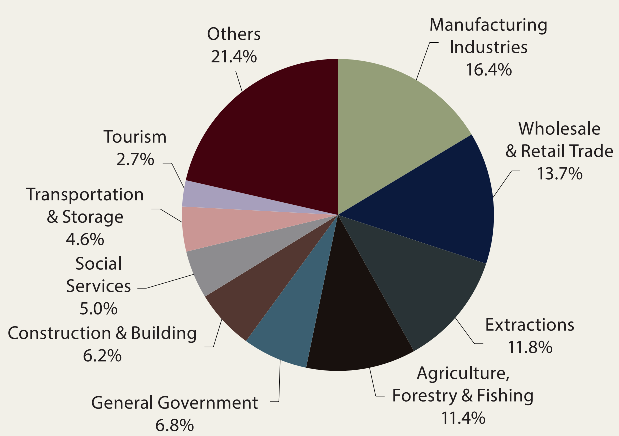
At the capital markets level, equity and fixed income markets were at the mirror image of improving macroeconomic conditions. The Stock Market Price Index expanded by 7.1% in 2019 amid higher turnover and better market liquidity and efficiency. The annual trading value rose by 11.6% year-on-year to reach

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2019)



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

US$ 24.4 billion in 2019. As to fixed income markets, the 5-year CDS spreads, a measure of the market perception of sovereign risks, contracted by 114 bps in 2019 to reach 277 bps at end-year.

At the banking sector level, activity has continued to expand at sound levels, with assets, deposits, loans and profits growing by double-digits annually in US$ terms amid a supportive macroeconomic environment. Deposits grew by 21.7% in US$ terms over the year-to-November 2019. Loans grew by 12.7% over the same period, while total assets grew by 21.5%. The aggregate net profits of listed banks rose by 27.9% in the first nine months of 2019 relative to the same period in 2018 within the context of an improving economy supporting operating conditions, loan growth and profitability.

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

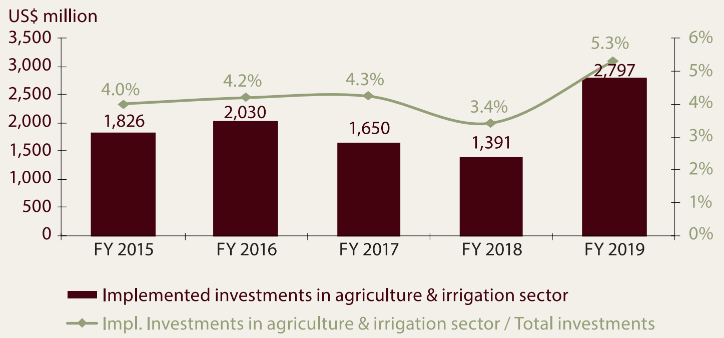
Primary sector continues its improving performance during FY 2019

The primary sector in Egypt maintained its positive performance reporting a growth of 3.4% in FY 2019, slightly upward from a growth of 3.1% a year earlier. Agriculture, fishing and forestry which contributed by 11.4% to the Egyptian economy, nearly unchanged from its level in FY 2018, ranked as the fourth largest contributor following manufacturing, wholesale and retail trade and extractions.

Total implemented investments in the agricultural and irrigation sector nearly doubled in FY 2019 standing at US$ 2,797 million, up from US$ 1,391 million in FY 2018. The share out of total investment ameliorated from 3.4% to 5.3% over the covered period.

It is worth noting that the agriculture sector is extending its networking to many other sectors, notably in transportation, storage, internal and external trade, as well as manufacturing, according to the Egyptian Ministry of Planning. The Sustainable Development Plan pays great attention to the economies of the agricultural sector through achieving a steady increase in investments, developing the sector's performance and raising its production efficiency.

IMPLEMENTED INVESTMENTS IN AGRICULTURE & IRRIGATION SECTOR



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

On another level, the share of bank credit facilities to the sector stood at 1.8% at end-November 2019, edging marginally up from 1.4% at end-November 2018.

At the level of exports, Egyptian agricultural exports increased to more than five million tons in 2019, according to a report from the Ministry of Agriculture and Land Reclamation. The report by the Central Administration of Agricultural Quarantine clarified that exports amounted to about 5.4 million tons, an increase of 238,000 tons compared to 2018. The most important agricultural exports for this period included: citrus, potatoes, onions, grapes, pomegranates, garlic, mangoes, strawberries, beans, guava, cucumbers, peppers and eggplants. The report explained that the total agricultural exports of citrus fruits amounted to about 1.8 million tons, in addition to exporting about 688,000 tons of potatoes, ranking second in agricultural exports after citrus.

In brief, agriculture remains an important sector of the Egyptian economy. It contributes to nearly one-ninth of GDP, employs about one-fourth of the labor force, and serves the country through agricultural exports with an important part of its foreign exchange.

1.1.2. Manufacturing

Manufacturing and extractive industries witness positive performances in past fiscal year

Egypt's manufacturing and extractive industries witnessed strong performances in the past fiscal year, despite relatively high yet easing inflation rates and a relatively challenging operating environment.

To start with, Egypt's manufacturing industries continued growing, though at a slower pace, over the previous eight fiscal years. Manufacturing industries grew by 2.8% in the past fiscal year relative to a growth rate of 4.8% in FY 2018. It is worth noting that manufacturing industries consist of petroleum refining and other manufacturing subsectors.

The country's petroleum refining industries grew by 2.2% in FY 2019, compared to an expansion of 4.1% in the previous fiscal year. Other manufacturing industries posted an increase of 3.0% in FY 2019, compared to a 5.0% rise in FY 2018.

The country's extractive industries grew by 9.8% in FY 2019 compared to a 7.7% rise in the previous fiscal year. Egypt's extractive industries comprise petroleum industries, gas industries, and other extractions.

The country's petroleum industries witnessed a marginal growth rate of 0.1% in the past fiscal year against a slight 0.7% contraction in FY 2018. Gas industries performed more positively, rising by 20.2% in the past fiscal year relative to a 17.9% expansion in the previous fiscal year. Other extractions, the third subsector of extractive industries, grew by 3.3% in FY 2019 up from a 3.1% growth in FY 2018.

As for implemented investments, Egypt's crude oil, natural gas and other manufacturing industries were on a positive path in FY 2019. Implemented investments in crude oil projects more than doubled in the past fiscal year to reach a total of LE 14,494 million. On the other hand, implemented investments in natural gas expanded by 41.0% in FY 2019 to reach LE 105,749 million. Other manufacturing industries expanded by 92.3% in the past fiscal year.

The Economist Intelligence Unit said that the energy sector is one of the engines of growth in Egypt. Production from the Zohr gasfield, which came on stream at end-2017, will sharply reduce (but not eliminate) the need for fuel imports, but capital goods imports will remain high to support the country's infrastructure projects. Sluggish growth in Europe, Egypt's main export market, will also affect tourism and other sectors.

In conclusion, with inflation already easing in 2019 and expected to further ease this year, Egypt's industrial sectors witnessed strong performances in the past year. Going forward, the sector is anticipated to continue growing, especially with the targeted and efficient reforms undertaken by the Egyptian government.

1.1.3. Construction

Construction & building sector remains on positive growth trend

The Egyptian construction and building sector continued performing strongly during FY 2019, contributing to 6.2% of Egypt's GDP. As a matter of fact, the sector grew by 8.8% in the past fiscal year, against a growth rate of 10.0% in FY 2018.

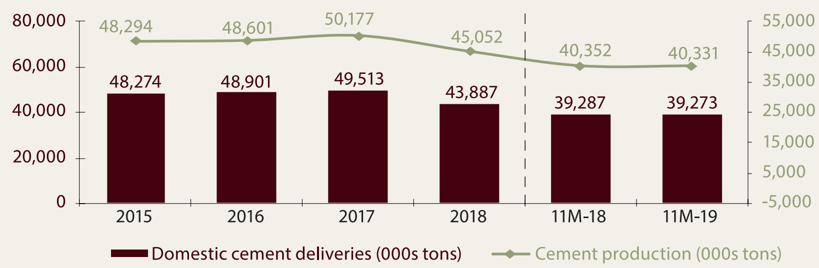
The value of investments in the country's construction sector almost tripled from the past fiscal year, in local currency terms, to attain LE 48.7 billion in FY 2019, as per Central Bank data. The share of investment in construction out of total investments in Egypt stood at 5.3% in FY 2019.

Also, the private sector's share of investments in Egypt's construction sector came in at 32.8%, with its share out of total investment falling from 83.3% in the past fiscal year.

It is worth noting that the construction sector is one of the main engines of growth in Egypt, and the government is taking important steps to support the sector. In partnership with private contractors, the government is pursuing various low-income housing schemes, as well as the construction of a new (administrative) capital city to the east of Cairo, to be completed in 2020.

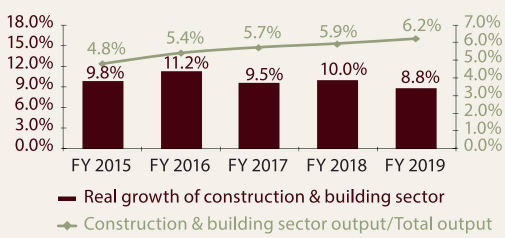
According to Fitch Solutions, Egypt's construction sector is expected to grow by 9.7% year-on-year in 2020, maintaining a trend of strong growth over the last five years. The sector's long-term growth would be driven by government investment in large-scale projects across the transport, power and residential building sectors.

CEMENT PRODUCTION AND DELIVERIES



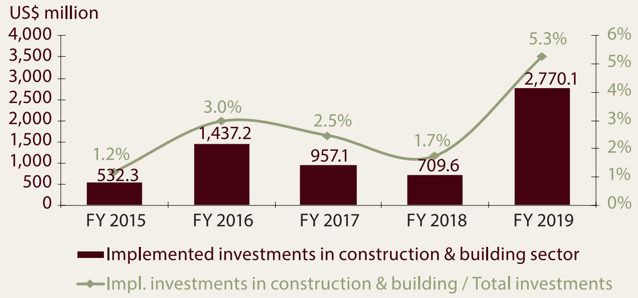
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

CONSTRUCTION & BUILDING SECTOR OUTPUT



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

IMPLEMENTED INVESTMENTS IN CONSTRUCTION & BUILDING



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

The government's spending policies on infrastructure would play a major role in driving growth in the sector. While the government is enacting fiscal consolidation measures, these are largely focused on reducing subsidies, and it is expected that infrastructure projects will continue to receive funding.

Furthermore, boosting tourism-related infrastructure forms a central pillar of the government's economic diversification agenda. A 2 km-long tourist marina in Egypt's New Mansoura City is scheduled to be opened in 2020. The marina project is being executed by the Egyptian Navy and sea prospecting works are under way. When open, the marina will have a capacity to handle 1,000 yachts.

Also, EgyptAir signed a partnership agreement with KMK Investment, and its strategic partner Safe Ports, to build a logistics village at Cairo International Airport, Egypt. Pursuant to the deal, KMK will be responsible for the finance, design and construction of a logistics village at the airport. The firm will also be in charge of operating and supervising EgyptAir's cargo, export and other projects in cooperation with Safe Ports. The project is expected to improve the efficiency, as well as the absorptive capacity, of Cairo International Airport.

1.1.4. Tourism

Egypt's tourism sector continues to report a signicant expansion in FY 2019

The tourism sector maintained its amelioration in FY 2019 with a significant real growth of 20.1% in FY 2019. The sector continues to be one of the country's main economic drivers as reported over recent years. The sector contributed by around 2.7% to the Egyptian economy in FY 2019, up from 2.4% in the previous year.

In details, tourist arrivals expanded from 6,707 thousand tourists in the first nine months of 2018 to 8,902 thousand tourists in the same period of 2019, with corrollary positive impact on tourist nights which ameliorated from 72,133 thousand nights to 97,317 thousand nights over the said periods.

Looking at the tourists breakdown by region, it can be seen that tourists from European countries took over the first rank with a share of 61.7% in the first nine months of 2019 and tourists from the Middle East came in the second position with a share of 21.2%. Tourists from African countries contributed by 6.6% of the total number of tourists, while Asia and the Pacific came after with 5.7%. Americas and other countries took over the last positions with around 4.8% combined of the total number of tourists in the previously mentioned period.

When looking at the performance of four and five stars hotels in Cairo City, the latter reported an improvement in terms of occupancy and RevPar. According to Ernst & Young's11M 2019 hotel benchmark survey, the hospitality sector in Cairo adopted an improving trend whereby hotel occupancy rose by 3.2% from 72.4% in 11M 2018 to 75.6% in the same period of 2019. Consistently, the rooms' yield in Cairo's four and five star hotels registered an increase of 3.8% to stand at US$ 85 in 11M 2019. However, the average room's rate edged down slightly by 0.6% to stand at US$ 113 in the aforementioned period.

According to EY, Cairo City's rising occupancy could be mainly attributed to the successful organization of 41st edition of the Cairo International Film Festival and improved economic conditions. The overall softer room rates could be perceived as a motive to boost occupancy rates amid the economic recovery along with the strengthening of the Egyptian pound.

Moving forward, Cairo City's hospitality sector is expected to perform well in the light of promising initiatives by the Tourism Ministry such as the launch of "Global advertising campaign". Growth in the tourism sector is likely to maintain its position as a positive contributor to the country's economy. High levels of government support are deemed very important in ensuring a positive sentiment for visitors and in maintaining confidence in the sector.

1.2. EXTERNAL SECTOR

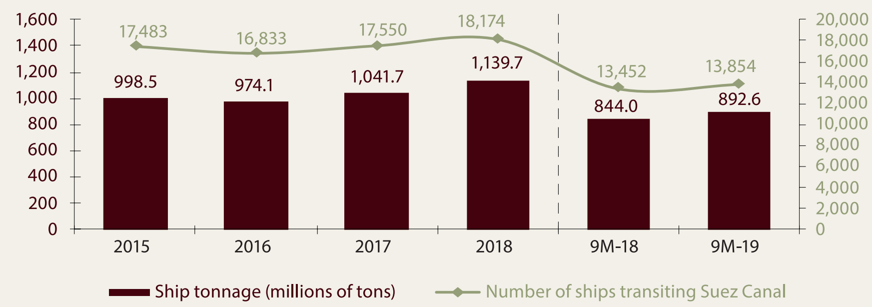
Balance of payments still in surplus despite widening current account deficit

Although the pressures on Egypt's trade deficit relatively lessened in 2019, the current account deficit widened by 58.2% over the first nine months of 2019 as per the latest available statistics released by the Central Bank of Egypt. This noticeable rise in the current account deficit was mainly attributed to the significant increase in investment income payments (+58.3% year-on-year), driven by the increase in profit transfers by foreign petroleum companies, in addition to interest payments on external debt (+78.1%), despite the continuous improvement in tourist receipts (+13.9%) and remittances inflows (+2.3%).

In details, Egypt's foreign trade activity showed a relative stagnation in imports alongside a moderate rise in exports of 3.8% during the first nine months of 2019 when compared to the same period of 2018, contributing to a 2.7% drop in the foreign trade deficit. In fact, Egypt's trade deficit contracted from US$ 28.3 billion during the first nine months of 2018 to US$ 27.6 billion during the same period of 2019. As such, Egypt's foreign trade activity posted a mild increase in terms of volume, as the sum of exports and imports went up by 1.1% moving from US$ 69.5 billion to US$ 70.2 billion during the same period, and consequently, the exports to imports coverage ratio rose from 42.0% to 43.6% between the two periods.

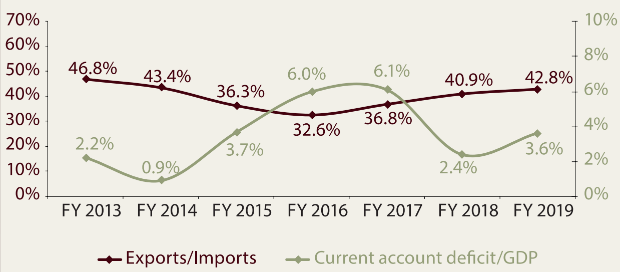
Total imports reached US$ 48.9 billion during the first nine months of 2019, with no change compared to the same period of 2018. As such, the breakdown of imports by product suggests that the most significant increase among the major categories was reported by imports of investment goods with a hike of 25.6% year-on-year to make up 16.2% of total imports during the first nine months of 2019, followed by imports

EVOLUTION OF SUEZ CANAL ACTIVITY



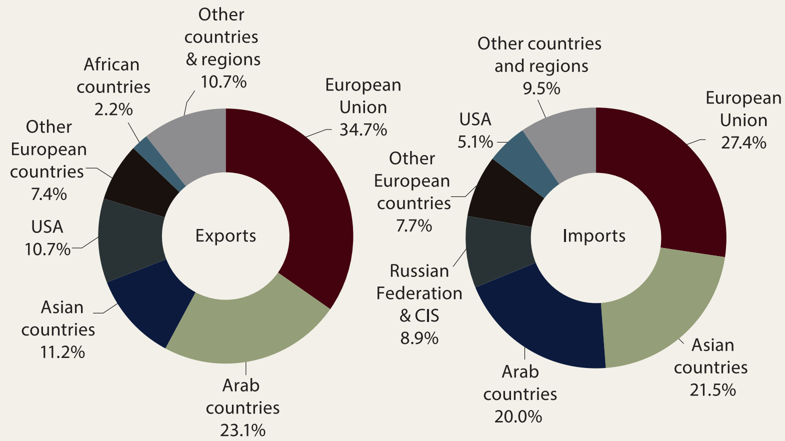
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

FOREIGN SECTOR INDICATORS



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

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (9M 2019)



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

of consumer goods with a rise of 13.0% (or 23.4% of total imports). The most significant decline among the major categories was reported by imports of fuel and mineral oils with a drop of 11.5% (or 18.6% of the total), followed by imports of raw materials (wheat, iron ore, maize, raw cane sugar, etc.) with a decline of 8.9% (or 8.5% of the total), and imports of intermediate goods with a decrease of 2.9% year-on-year to make up 30.8% of total imports over the first nine months of 2019. The breakdown of imports by geographic distribution shows that most of the inward merchandise came from the European Union with 27.4% of the total, followed by Asian countries (excluding Arab countries) with 21.5% of the total, and Arab countries with 20.0% of the total over the first nine months of 2019.

At the level of exports, a total of US$ 21.3 billion was reported during the first nine months 2019, compared to US$ 20.6 billion during the same period of 2018. This lower increase in exporting activity came within the context of the recent appreciation of the Egyptian pound. As such, the breakdown of exports by product suggests that the most significant increase among the major categories was reported by raw materials (fresh vegetables, fresh fruits, potatoes, raw cotton, etc.) with an increase of 13.5% year-on-year to make up 9.8% of total exports during the first nine months of 2019, followed by semi-finished goods (gold, organic and inorganic compounds, cast iron, etc.) with a rise of 4.4% (or 14.8% of total exports), and by fuels and mineral oils with a pick-up of 2.8% year-on-year (or 38.2% of total exports). The geographic distribution of exports indicates that 34.7% of total exports went to the European Union, followed by the Arab countries with 23.1% of the total, and Asian countries (excluding Arab countries) with 11.2% over the first nine months of 2019.

Within this context, the current account deficit widened from US$ 4.4 billion over the first nine months of 2018 to US$ 7.0 billion over the first nine months of 2019. Accordingly, the current account deficit went up from 2.4% of GDP in FY 2018 to 3.6% in FY 2019. In parallel, the capital and financial account shrank by 37.2% during the first nine months of 2019, moving from US$ 13.4 billion to US$ 8.4 billion, mainly attributed to a shift in other investments account from a surplus of US$ 7.6 billion to a deficit of US$ 5.9 billion between the two periods. As such, Egypt's balance of payments registered a smaller surplus of US$ 1.9 billion in the first nine months of 2019, when compared to a larger surplus of US$ 7.5 billion during the previous year's corresponding period.

1.3. PUBLIC SECTOR

Fiscal consolidation to anchor public indebtedness reduction remains on track

Public finances in Egypt have been gradually improving since FY 2017. In fact, the overall budget deficit declined to 8.1% of GDP in FY 2019, compared to 9.7% in FY 2018, in response to continuous fiscal consolidation measures which reduced fuel and electricity subsidies, increased taxes and fees, and significantly improved tax collection and tax administration. In parallel, the primary budget position strengthened in FY 2019, recording a higher than expected surplus of 2% of GDP.

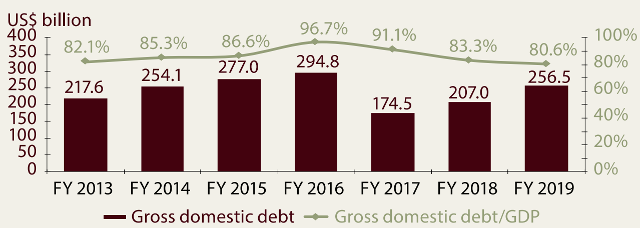
Going further into details, total budget revenues went up by 14.7% in local currency terms during FY 2019 as compared with FY 2018, to reach LE 942 billion (US$ 53.5 billion), or the equivalent of 17.9% of

SELECTED PUBLIC FINANCE INDICATORS

LE billion	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Total budget revenues	465.2	491.5	659.2	821.1	941.9
Total budget revenues/GDP	19.1%	18.1%	19.0%	18.5%	17.9%
Total budget expenditures	733.4	817.8	1,031.9	1,244.4	1,369.9
Total budget expenditures/GDP	30.2%	30.2%	29.7%	28.0%	26.1%
Overall budget deficit	279.4	339.5	379.6	432.6	430.0
Overall budget deficit/GDP	11.5%	12.5%	10.9%	9.7%	8.1%

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

GOVERNMENT INDEBTEDNESS



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

GDP, according to actual figures issued by the Ministry of Finance. In fact, and within the context of an improved tax collection and better tax administration, the important rise in budget revenues was due to a hike in tax revenues by 17.0%, mainly boosted by an increase in taxes on goods and services by 19.1% and a rise in income tax by 20.7% (both accounting for 82% of total tax revenues). In parallel, non-tax revenues went up by 7.3% during FY 2019 as compared with FY 2018, following a drop of 2.7% in FY 2018.

Total budget expenditures were up by 10.1% in local currency terms during FY 2019 relative to FY 2018, to reach LE 1,370 billion (US$ 77.9 billion) or the equivalent of 26.1% of GDP, despite the tangible drop in subsidies, grants and social benefits by 12.7% over the year. In fact, the rise in public expenditures was to a significant extent the result of an increase in interest payments which, remaining a heavy burden on public finances, have increased by 21.9% over the FY 2019, reflecting both the rise in outstanding public debt and higher funding costs, and accounting for 76% of the overall increase in public spending while absorbing around 90% of the overall increase in tax revenues. In parallel, workers' wages and compensations grew by 10.8% (compared to a 6.4% rise in FY 2018). As such, this resulted into a tiny drop of 0.6% in the overall budget deficit in local currency terms in FY 2019, to reach the equivalent of LE 430 billion (or US$ 24.4 billion).

The fiscal consolidation has helped anchor a decline in general government indebtedness ratio from a peak of 96.7% of GDP at the end of FY 2016 to 80.6% of GDP at the end of FY 2019, although central government debt remains high in absolute terms and is still considered a key vulnerability. In fact, the gross domestic debt rose by 16.0% in local currency terms in FY 2019 following a 16.9% expansion in FY 2018, to reach the equivalent of LE 4,289 billion at end-June 2019 (or US$ 256.5 billion). This was mainly triggered by a 13.8% growth in the balances of bonds and bills, within the context of sovereign debt sale aiming at funding the country's fiscal deficit. In parallel, the external debt went up by 17.3% since end-June 2018 to reach US$ 108.7 billion at end-June 2019 (or 36.0% of GDP), as Egypt has sold more than U$ 8 billion of foreign-currency denominated bonds last year.

Last but not least, the fiscal outlook remains favorable in Egypt, with the budget deficit expected to gradually decline to about 7.2% of GDP in FY 2020, while the primary budget position is expected to remain positive in the coming years with a surplus of 2%, according to the State budget for the FY 2020. Total revenues are expected to reach LE 1,134 billion (up from actual LE 942 billion in FY 2019), as tax revenues are expected to reach LE 857 billion (up from actual LE 736 billion). Total expenditures in the FY 2020 budget are expected to reach LE 1,575 billion compared to LE 1,370 billion in FY 2019. However, it is worth mentioning that the overall actual budget deficit went up by 30.9% over the first half of FY 2020 when compared to the same period of FY 2019, as total revenues stagnated, while total expenditures increased by 9.5%, mainly on the back of a significant rise in interest payments of 29.9%.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Dovish monetary policy on reduced inflationary pressures

Reduced inflationary pressures and the progressive appreciation of the Egyptian pound against the US dollar have prompted the Central Bank of Egypt to maintain a dovish monetary policy over the year 2019, while the CBE's foreign exchange reserves have hit a new historical high level in December 2019 amid rising touristic revenues, increased remittances and the receipt of the final IMF loan payments.

Following three years of sharp volatility, consumer prices in Egypt started to normalize in 2019. Egypt's annual headline inflation declined to 3.1% in October 2019, which was its lowest level since December 2005, yet accelerated over the next couple of months to reach 7.1% in December 2019, mainly reflecting the strong unfavorable base effect stemming from the reversal of transitory shock to prices of fresh vegetables in 2018. This compared to a higher inflation rate of 12.0% in December 2018. The core inflation, which strips out energy and food prices, also followed a downward trajectory over the year 2019, reaching 2.4% in December 2019, down from 8.3% in December 2018.

Abated inflation paved the way for monetary easing in 2019. The Central Bank of Egypt cut its key policy rates four times by a total of 450 bps over the year. The overnight deposit rate was slashed from 16.75% at end-2018 to 12.25%; the overnight lending rate was cut from 17.75% to 13.25%; the rate of the main operation was reduced from 17.25% to 12.75%; and the discount rate moved down from 17.25% to 12.75%.

Amidst a track record of economic and fiscal reforms, improvements in macroeconomic stability, dovish monetary policy, and growing influx of foreign currencies, the Egyptian pound gained ground in 2019 and was deemed to be one of the world's top performers, moving from LE/US$ 17.92 at end-2018 to LE 16.05 at end-2019. It saw further appreciation against the US dollar early-2020, trading below the LE/US$ 16 for the first time since March 2017, to reach LE/US$ 15.72 at the time of writing this report.

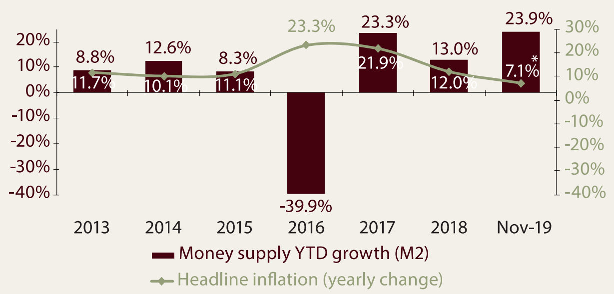
The Central Bank of Egypt's gross official reserves remained on the rise in 2019, mainly supported by a healthy recovery in tourist revenues, strong growth in remittances inflows and the receipt of the last two payments of a US$ 12 billion loan from the IMF in February and August 2019 (for a total of US$ 4 billion), which more than offset the significant rise in the "investment income payments" component in the balance of payments, including interest payments on loans, external facilities and deposits of non-residents.

Accordingly, the CBE's gross official reserves hit a new record high level of US$ 45.4 billion at end-December 2019 as compared to US$ 42.6 billion at end-December 2018, which marks a yearly growth of 6.7%. Within this context, the CBE's gross official reserves covered 21.5% of local currency money supply at end-December 2019 and compared to a higher coverage ratio of 26.3% at end-December 2018.

The broader money supply (M2) expanded noticeably by 23.9% in US$ terms during the first eleven months of 2019, moving up from US$ 203.7 billion at end-2018 to US$ 252.5 billion at end-November 2019 amid rising capital inflows. This followed an expansion of 13.0% in 2018. Money supply in its narrow sense (M1) widened in US$ terms by 27.6% during the first eleven months of 2019, following a lower growth of 13.0% in 2018, to reach US$ 59.9 billion at end-November 2019.

Looking forward, with inflation fully normalizing over the course of 2020, hovering around the bottom end of the Central Bank of Egypt's inflation target range of 9% (±3%), the Central Bank of Egypt should have room for further rate cuts.

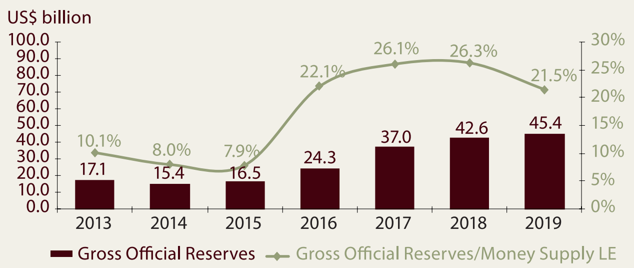
BROAD MONEY AND INFLATION



* December 2019

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

EXCHANGE MARKET INDICATORS



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

1.4.2. Banking Activity

Favorable year for the banking sector with comfortable activity growth and sound financial standing

Banks operating in Egypt have benefited from continued positive economic momentum and the spillovers of reforms, enticing liquidity into the sector and enhancing their financial intermediation role by extending new waves of credit to the government and private sector. Measured by the consolidated assets of banks operating in the country, banking sector activity grew by 9.3% in local currency terms in the first 11 months of 2019 (+21.5% in US dollar terms given the local currency appreciation in the covered period) to reach the equivalent of US$ 368.3 billion at end-November.

The healthy economic growth the country has been witnessing has translated into accrued liquidity at hand for banks operating in Egypt, and thus into a noticeable growth in deposits parked at such institutions. Total deposits rose by 9.6% in local currency terms (+21.7% in US dollar terms) over the first 11 months of the year to reach the equivalent of US$ 259.4 billion at end-November 2019, within the context of high albeit declining interest rates and enhanced financial inclusion.

The breakdown of deposits shows that while government deposits slightly retreated in local currency terms between December 2018 and November 2019, the private sector drove the total deposits base of banks higher. In particular, foreign currency deposits contracted (even when expressed in US dollar terms), which means that local currency funds were solely responsible for the rise in private sector deposits at banks operating in the country. The deposit dollarization ratio consequently reached 17.8% at end-November 2019, against 22.7% at end-December 2018. Going further into details, official figures reveal that the household sector and the private business sector were in respective order the major contributors to the increase in local currency private sector deposits, noting that households convey to deposits their sticky and stable feature as they account for close to 70% of the total.

Deposits accounted for close to 70% of banks' total balance sheets at end-November 2019, thus ensuring the bulk of their funding needs. They also were responsible for around 72% of the total growth in the balance sheets of banks over the covered period. Such additional liquidity was utilized to invest further in government debt papers and to place further funds at banks abroad while continuing to lend to the private sector economy.

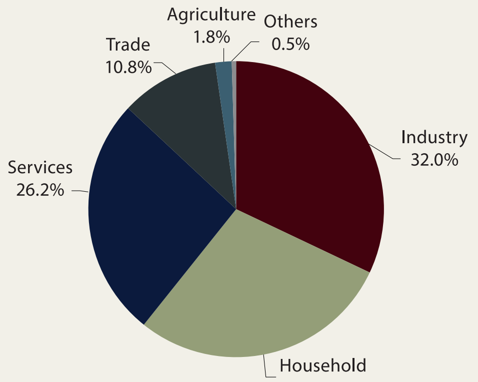
First, and with regards to placements with banks abroad, official figures show that the balances with banks abroad rose by circa 1.8x in the first 11 months of 2019 to account for 5% of total assets and thus boost banks' liquidity ratios. The core liquidity ratio, which we measure as the ratio of cash and balances with banks in Egypt and abroad to total deposits, reached around 35% at end-November 2019, more or less maintaining its end of 2018 levels given the noticeable rise in deposits, and reflecting adequate liquidity both in absolute and relative terms.

BANKING SECTOR INDICATORS

US$ million	2013	2014	2015	2016	2017	2018	Nov-19
Banking Activity							
Assets	242,209	275,375	317,393	218,738	271,022	303,142	368,281
Deposits	189,242	218,210	244,484	152,411	187,462	213,070	259,369
Credit Facilities	79,134	88,028	101,073	71,773	82,398	101,253	114,144
Capital + Reserves	16,296	17,174	18,033	13,985	18,082	19,721	24,728
Growth rates							
Assets	6.9%	13.7%	15.3%	-31.1%	23.9%	11.9%	21.5%
Deposits	10.4%	15.3%	12.0%	-37.7%	23.0%	13.7%	21.7%
Credit Facilities	-2.6%	11.2%	14.8%	-29.0%	14.8%	22.9%	12.7%
Capital + Reserves	2.9%	5.4%	5.0%	-22.4%	29.3%	9.1%	25.4%

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

BANK CREDIT FACILITIES BY ECONOMIC ACTIVITY*



* As at end-November 2019

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

Along the same lines, official Central Bank ratios show that the sector's liquidity coverage ratio in both local and foreign currencies is well above regulatory requirements of 90% for local currency and 100% for foreign currencies. Also, the net stable funding ratio exceeds the 100% regulatory minimum for local and foreign currencies each, thus further mirroring Egyptian banks' comfortable liquidity cushions.

Second, and with regards to investments in government debt papers, Egyptian banks' sovereign exposure continued to increase, as banks are still financing the government's shrinking albeit still high budget shortfall. A look at banks' securities portfolio, and particularly its government sector component, reveals that investments in government securities rose by 6.5% in the first 11 months of 2019 and account for 95% of the total securities portfolio of banks, which highlights the non-negligible sovereign exposure of banks, especially as this accounts for 4.8x their capital and reserves.

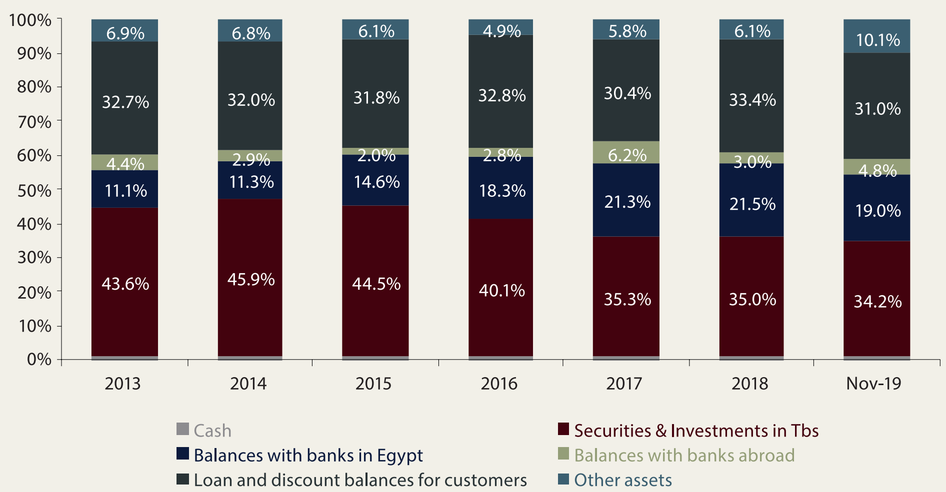
Anyhow, banks operating in Egypt do currently have enough capital to absorb potential pressures on their capital, with the Central Bank indicating that the capital base to risk-weighted assets ratio reached 18.1% at end-September 2019, the bulk of which is composed of Tier 1 capital (Tier 1 ratio of 15.5%). The Central Bank of Egypt plans to further boost capitalization, as in a draft banking law, it calls for an increase of 10x in the minimum capital requirement of Egyptian banks to LE 5 billion and 3x for foreign banks' branches to US$ 150 million.

The continued increase in investments in government debt papers did not come at the expense of private sector lending activity. It is true that total credit facilities rose more moderately over the covered period of 2019, displaying a 1.5% increase in local currency terms (+12.7% in US dollar terms). But it is important to note that credit facilities extended to the government contracted (due to those in foreign currencies), while credit facilities extended to the private sector rose by a healthy 8.9% in local currency terms (+21.0% in US dollar terms).

Among private sector loans, those in foreign currencies also declined, leaving the increase to the local currency side, with retail loans accounting for the largest share in the 11M increase. As such, the loan dollarization ratio of banks operating in Egypt reached 27.7% at end-November 2019, against 36.0% at end-December 2018. Credit expansion could continue in the period ahead, given decreasing interest rates and pursued government funding initiatives for the industrial, tourism and mortgage sectors.

The continued expansion in banks' credit volumes did not come at the expense of asset quality metrics, which remain favorable on the overall so far. The non-performing loans to total loans ratio edged up slightly to reach 4.5% at end-September 2019, remaining well below the emerging markets and global averages in the 7% range. Similarly, practically all NPLs are covered by provisions, with the provisioning

BANKING SECTOR ASSET COMPOSITION



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

ratio at 97.4% at end-September 2019. It is also worth mentioning that the sector regulator decreased the single-name lending limit from 20% of Tier 1 capital to 15% in 2019, which should reduce concentration risks and reflect favorably on the asset quality of Egyptian banks.

Last but not least, and in the absence of recent consolidated sector statistics on banking profitability, we resorted to the analysis of the aggregated results of 17 banks that published financials up to end-Q3 2019 (on a financial year basis, i.e. end-September) and provided by Bureau Van Dijk – a Moody's Analytics company. The latter reveal that credit expansion favored a quantity-effect that lead to a double-digit rise in net interest income coupled with a healthy increase in net fee income on the back of positive economic performance across the board, which generated a 25% yearly increase in banks' bottom lines (expressed in US dollar terms) over the first nine months of 2019.

All in all, the Egyptian banking sector has had a positive year in 2019, with additional deposits channeled unto boosting liquidity with foreign banks while continuing to finance the public and private sectors of the economy. Banks maintain adequate capitalization, liquidity and asset quality while benefiting from a rise in profitability metrics given the overall favorable environment, thus reinforcing their financial standing.

1.4.3. Equity and Bond Markets

Price rebound in Egyptian capital markets on improving macroeconomic conditions

Egypt's capital markets saw a price rebound in 2019, mainly helped by ongoing fiscal and economic reforms, improving macroeconomic conditions, CBE's dovish monetary policy and attractive market valuations. The cost of insuring debt closed the year with contractions following 2018 expansions.

The Egyptian Exchange benefited from improved investor sentiment over the year 2019, mainly helped by a track record of economic and fiscal reforms, improvements in macroeconomic stability, four interest rate cuts by the Central Bank of Egypt that have contributed to driving demand for consumer goods and supported corporate capital expenditure financed by lower borrowing costs, in addition to some favorable corporate earnings and attractive market valuations. The Egyptian stocks traded at a P/E of 8.5 times at year-end 2019 as compared to a much higher P/E of 12.1 times at end-2018.

The bourse main benchmark index (EGX 30), which is the price index of the 30 most highly capitalized and liquid stocks, closed the year 2019 at 13,962 as compared to 13,036 in 2018, up by 7.1%, while the EGX 70, which includes top 70 companies in terms of liquidity and activity after excluding the constituents of EGX30, dropped by 23.0% year-on-year.

Two out of 12 sectors in the Egyptian Exchange registered price gains in 2019, while ten sectors posted price contractions. The best performing sector was the banking sector, which posted significant price rises of 31.5% year-on-year, noting that it is the largest sector by market capitalization (representing 30.4% of total market capitalization), followed by the travel and leisure sector with +13.2%, noting that its market capitalisation represents 5.1% of total market capitalization. In contrast, the industrial goods, services and automobiles sector posted price contractions of 33.5%, followed by the basic resources sector (-32.4%), the construction and material sector (-30.0%), the chemicals sector (-21.3%), the food and beverage sector (-20.2%), the telecommunications sector (-5.4%), the personal and household products sector (-4.9%), the real estate sector (-3.6%), the healthcare and pharmaceuticals sector (-3.2%) and the financial services sector excluding banks (-1.1%).

Along an equity price rebound, the number of listed companies on the Egyptian Exchange declined from 220 companies at end-2018 to 218 companies at end-2019. This led to a 5.5% contraction in the market capitalization in local currency terms, moving from LE 749.7 billion at end-2018 to LE 708.3 billion at end-2019, though the market capitalization expanded by 5.5% in US dollar terms on the back of a 10% yearly appreciation in the Egyptian pound against the greenback.

The total volume of traded shares dropped from 60,771 million shares in 2018 to 49,789 million shares in 2019. The total number of transactions contracted by 20.8%, moving from circa 6.28 million transactions in 2018 to circa 4.97 million transactions in 2019. However, the total trading value rose from LE 358.5 billion in 2018 to LE 409.7 billion in 2019, up by 14.3%, marking a growth of 21.2% in US dollar terms.

Egyptian market players captured 67.1% of the total value traded over the year 2019, while foreign investors accounted for the remaining 32.9%. Institutional investors captured 73.8% of activity in 2019, allocated between 43.4% for Egyptian institutions and 30.4% for international institutions, while individuals accounted for the remaining 26.2%, allocated between 23.7% for Egyptians and 2.5% for foreigners. Within this context, it is worth mentioning that international institutional investors were net buyers in 2019, recording net inflows of LE 42.3 billion as compared to net inflows of a LE 5.7 billion in 2018. Given a yearly increase in total activity and a contraction in the market capitalization in local currency terms, the turnover ratio, measured by total trading value to market capitalization, increased from 48.1% in 2018 to 55.3% in 2019.

The Egyptian Exchange launched on February 2, 2020 an equally weighted index EGX70EWI, replacing the existing EGX 70. The newly-introduced index has many advantages: 1) it includes the most active companies after excluding the constituents of EGX30, thus providing wider tools for investors to monitor market performance; 2) it gives every company a weight of 1.43% at each quarterly review; 3) it complies with the amended percentage mentioned in the executive regulations of the capital market law, which would contribute to the promotion of mutual funds' performance; and 4) it increases the chance of developing financial products such as Exchange Traded Funds. Within this context, it is worth mentioning that the review and development process ended with 17 sectoral indicators instead of 12 before structuring the sectors, as new sectoral indicators were introduced.

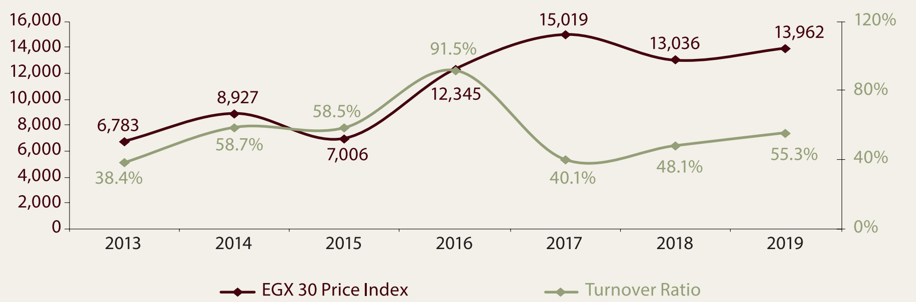
In parallel, the Egyptian fixed income market was at the mirror image of economic and fiscal reforms and improving macroeconomic stability over the year 2019, as reflected by healthy price gains across

CAPITAL MARKETS INDICATORS

	2013	2014	2015	2016	2017	2018	2019
Market capitalization (US$ billion)	61.4	69.9	54.9	33.2	46.4	41.8	44.1
Total value traded (US$ million)	23,555	41,044	32,091	30,389	18,640	20,128	24,394
Non-Arab foreign participation as % of total value traded	14.3%	9.7%	11.1%	11.5%	17.7%	23.2%	26.1%
Total volume of traded securities (million)	29,190	57,230	45,078	68,559	77,946	60,771	49,789
Total number of transactions (000s)	4,790	7,328	4,875	6,008	7,034	6,278	4,970
No. of listed companies	212	214	221	222	222	220	218
No. of traded companies	204	206	209	209	213	218	213
% Change in price index (EGX 30)	24.2%	31.6%	-21.5%	76.2%	21.7%	-13.2%	7.1%
P/E ratio (times)	15.2	20.2	13.6	26.6	18.8	12.1	8.5
Dividend yield	6.5%	9.3%	7.7%	9.0%	5.7%	6.9%	8.0%
CDS spreads (bps)	605	282	531	450	316	391	277

Sources: Egypt Stock Exchange, Bank Audi's Group Research Department

STOCK MARKET PERFORMANCE



Sources: Egypt Stock Exchange, Bank Audi's Group Research Department tenors. US dollar-denominated sovereigns maturing in 2022 and 2040 registered yearly price rises of 6.0 pts and 21.0 pts respectively. Euro-denominated sovereigns maturing in 2025 and 2030 saw decent price expansions of 5.35 pts and 16.82 pts respectively in 2019. This favourable momentum was extended to January 2020, mainly supported by increased investor confidence in the Egyptian economy and the government's strong reform commitment. As to cost of insuring debt, Egypt's five-year CDS spreads contracted by 114 bps in 2019 to reach 277 bps at year-end, and saw further contractions in January 2020, reaching 264 bps at month-end.

Improving macroeconomic and fiscal conditions prompted international rating agencies to upgrade Egypt's credit rating in 2019. Fitch upgraded in March 2019 Egypt's long-term foreign currency Issuer Default Rating to "B+" from "B", citing Egypt's further progress in implementing economic and fiscal reforms, which are driving improved macroeconomic stability, fiscal consolidation and stronger external finances. The outlook is "stable".

Also, Moody's upgraded in April 2019 the long-term foreign and local currency issuer ratings of the Government of Egypt to "B2" from "B3". The outlook was changed to "stable" from "positive". The decision to upgrade the rating primarily reflects 1) Moody's expectation that ongoing fiscal and economic reforms would support a gradual but steady improvement in Egypt's fiscal metrics and raise real GDP growth; 2) Moody's increasing confidence that factors such as Egypt's large domestic funding base support its resilience to refinancing shocks notwithstanding the government's very high borrowing needs and interest costs. The "stable" outlook balances, according to Moody's, the downside risks posed by very weak debt affordability and large financing needs, against the possibility that strong reform commitment could deliver higher growth and lower borrowing needs and shore up resilience to changing financing conditions.

Regarding new bond issues, Egypt raised in 2019 a total of US$ 6 billion and € 2 billion through the sale of bonds, noting that the Ministry of Finance has issued for the first time in November 2019 a 40-year bond, the longest-dated international bond in the MENA region.

A closer look at bond issuances shows that Egypt raised in February 2019 US$ 4 billion through the issuance of international bonds in three different tranches: US$ 750 million five-year bonds with annual interest rates of 6.2%; US$ 1.75 billion 10-year bonds with annual interest rates of 7.6%; and US$ 1.5 billion 30-year bonds with annual interest rates of 8.7%. The order book size exceeded US$ 21.5 billion. Also, Egypt raised in April 2019 € 2 billion through the issuance of a € 750 million six-year bond at a coupon of 4.75% and a € 1.25 billion 12-year bond at a coupon of 6.375%. The bond sale attracted demand of circa € 9 billion. Finally, Egypt raised in November 2019 US$ 2 billion through the issuance of a three-tranche US dollar-denominated bond: US$ 500 million four-year bond at a yield of 4.55%, US$ 1 billion 12-year bond at a yield of 7.05% and US$ 500 million 40-year bond at a yield of 8.15%. The issuance was seven times oversubscribed, with total bids of US$ 14.5 billion.

Looking forward, Egypt's solid macro fundamentals, a sustained appreciation in the Egyptian pound and further rate cuts by the CBE amid reduced inflationary pressures would help attracting demand for Egyptian securities, while the Ministry of Finance would continue to focus on extension of debt duration.

2. CONCLUDING REMARKS

Assuming a continuation of the path of reforms and a parallel gradual improvement in the business environment, economic growth is expected to reach 5.9% in 2020 (6.0% over the next five years), driven by a recovery in private consumption, investments and exports. Lower unemployment and a strong investment climate should begin to boost private consumption as of this year, although widespread poverty would remain a constraint on consumer demand growth for the time being. The construction and energy sectors would remain the main engines for growth, while sluggish growth in Europe, Egypt's main foreign partner, might somewhat affect tourism and other sectors.

At the monetary level, it is estimated that inflation has fully normalized, forecasting inflation at 10% in 2020 and an average of 7% over the next five years. With respect to monetary policy, there are prospects for up to 200 bps rate cuts in 2020, a magnitude of cuts that allows CBE to ease monetary policy further – together with easing liquidity conditions – while also maintaining a stable outlook for the exchange rate, which is key for preventing inflationary pressures from re-emerging. A more flexible exchange rate policy will stay in place, with capital controls eased. It is projected that usable reserves would cover an average of five months of current account payments over the next couple of years and could be sufficient to mitigate liquidity risks in the event of an acceleration in portfolio outflows.

At the fiscal level, the overall fiscal deficit is also expected to continue declining gradually over the medium term. Fiscal deficit as a percentage of GDP should contract from 8% in 2019 to 7% in 2020, while continuing its descent to reach 3.3% at a five-year horizon. The newly adopted fuel indexation mechanism should help shielding the budget from exchange rate movements or global oil price shocks. Despite the large public deficits and domestic debt stock, it is expected that the government will be able to raise debt locally, because the banking system remains significantly liquid, thanks to sound deposit growth.

At the external level, external accounts are not expected to vary much over the next few years. The current account deficit is expected to hover around 2.3% of GDP due to the balancing effects of an expected improvement in the services trade surplus against a decline in private transfers. Having said that, sources of foreign income such as official transfers, tourism receipts, remittances and Suez Canal earnings are likely to be affected by sluggish global growth in 2020, but would continue to grow on the overall.

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, comparatively strong growth dynamics, the good financial soundness of the banking sector and the wide ranging fiscal and economic reform program. Challenges are tied to the persistently elevated security risks, the sizable fiscal deficits entailing large borrowing requirements, the large population growth, the still high unemployment despite recent decline, and the persisting social pressures amid eroded real incomes.

While strengths outpace challenges and opportunities exceed threats, there is a need to continue implementing ambitious structural reforms and sustain its macroeconomic stabilization path. The softening global economic growth and trade outlook might exert some pressures on the Egyptian economy looking forward. Such an environment calls for the necessity of a new wave of structural reforms that can translate into more significant job creation and improved productivity at large.

DISCLAIMER

Bank Audi sal - Group Research Department - Bank Audi Plaza - Bab Idriss - PO Box 11-2560 - Lebanon - Tel: 961 1 994 000 - email: research@bankaudi.com.lb