EGYPT ECONOMIC REPORT

AMID THE SPILLOVER EFFECTS OF WIDE MACROECONOMIC PRESSURES AND THE PROSPECTS OF AN AMBITIOUS ADJUSTMENT PROGRAM

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- A mixed year for the overall Egyptian economy

The year 2016 was mixed for the Egyptian economy which is facing both opportunities and challenges. The country is going through large structural reforms which are set to secure sound growth in the economy in the medium term. However, such reforms carry intermediate costs, mainly at the level of monetary and exchange pressures that add to geopolitical and security threats with considerable burden on the real sectors of the economy. The Egyptian economy reported a real GDP growth of 3.8% in 2016, slightly lower than the 4.2% registered in the previous year, but still outpacing overall population growth. The real sector slowdown comes within the context of shrinking foreign demand amid lower touristic receipts and financial inflows, while domestic demand continues to grow satisfactorily.

- Widening current account deficit despite contracting trade deficit

Although the pressures on Egypt's trade deficit lessened last year, the current account deficit widened by 30.3% during the first nine months of 2016 relative to the same period of 2015. The rise in current account deficit was mainly attributed to a significant drop in services balance by 48.3%, on the back of a decline in tourism receipts by 64.2% due to an overall decelerated tourism activity. In addition, current transfers declined by 16.1% as a result of a 15.7% drop in remittances from Egyptian workers abroad to their homeland. As a percentage of GDP, the current account deficit widened from 3.6% in FY 2015 to 5.9% in FY 2016.

- Fiscal reforms to materialize into declining public finance deficit

There are signs that the government will consolidate its austerity drive in the current fiscal year. As such, the FY 2017 budget registers ambitious target, the government targeting to collect LE 670 billion of revenues, mainly driven by the impact of higher real GDP growth rates on tax revenue. Public expenditures are expected to reach LE 975 billion in FY 2017, on the back of an expected further rise in interest payments. Accordingly, the fiscal deficit is expected to decrease both in absolute terms and as a percentage of GDP in FY 2017, as it is expected to reach LE 319.5 billion (a decline of 6.0%), and consequently to narrow from 12.3% of GDP in FY 2016 to 9.8% of GDP in FY 2017.

- Shift to floating exchange rate regime dictates further monetary policy tightening

The fiscal year 2017 witnessed the historical shift from a fixed exchange rate regime to a flexible one, in a move aimed at removing the significant overvaluation of the Egyptian Pound and rebuilding international reserves, while pursuing an extended monetary tightening policy in order to anchor inflation expectations and contain domestic and external demand pressures. The CBE's gross official reserves grew by a significant 38.1% during the first half of FY 2017 to reach US$ 24.3 billion at end-December 2016, and extended their upward trajectory to reach US$ 26.4 billion at end-January 2017, their highest level since the eruption of Egypt's first revolution in January 2011.

- Steady banking activity growth along with improving asset quality

The banking sector has weathered well the repercussions of the political and security situation the country witnessed in the last few years. A 26.1% growth in bank assets was recorded in the first ten months of 2016 (+11.1% in US dollar terms) to reach the equivalent of US$ 352 billion at end-October. Total deposits rose by 16.2% in the same period to reach the equivalent of around US$ 250 billion at end-October. Credit facilities surged by 24.0% between December 2015 and October 2016 to reach the equivalent of US$ 110 billion. Banks' asset quality has improved as well, with the stock of non-performing loans declining to reach 5.9% of total loans as at end-September 2016 (6.8% at end-2015), somewhat in line with international averages.

- Adjustment program real opportunity for Egypt looking ahead

The adjustment program followed by Egypt is attempting to tackle three interlinked problems, namely an urgent balance of payments problem, rising public debt and the long term issue of low growth and high unemployment. While domestic and external risks do exist, the program is an opportunity in the meaning that Egypt is apt to move in a new economic direction that will put an end to the economic turbulence of the post-revolution period within the context of the targeted restoration of macroeconomic stability at large.

The Egypt Economic Report can be accessed via internet at the following web address: http://www.bankaudigroup.com

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The year 2016 was mixed for the Egyptian economy which is facing both opportunities and challenges. The country is going through large structural reforms which are set to secure sound growth in the economy in the medium term. However, such reforms carry intermediate costs, mainly at the level of monetary and exchange pressures that add to geopolitical and security threats with considerable burden on the real sectors of the economy.

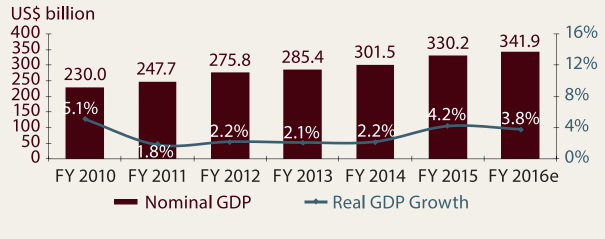
As a matter of fact, the Egyptian economy reported a real GDP growth of 3.8% in 2016, slightly lower than the 4.2% registered in the previous year, but still outpacing overall population growth. The real sector slowdown comes within the context of shrinking foreign demand amid lower touristic receipts and financial inflows, while domestic demand continues to grow satisfactorily. Reflecting the sluggish touristic performance, the number of tourists was down by 45% over the first eleven months of 2016 relative to the previous year's same period. The balance of payments figures for FY 2015/16 indicate a record current account deficit of US$ 18.7 billion, compared to US$ 12.1 billion in the previous year.

Within this environment, Egypt adopted significant structural measures including a currency floatation, increases in fuel and power prices, a new value-added tax and increases in custom duties. The reforms had already contributed to a rise in Egypt's core inflation, tough inflationary pressures are expected to relatively ease in the second half of 2017. Core inflation jumped to 24.3% in December, an eight-year high. The rise in inflation has adverse effects on real income which adversely impacts consumption.

Linked to this is the recent monetary drift. The Egyptian Pound exchange rate reached 18.11 Pounds per dollar by year-end 2016, against 7.83 at year-end 2015, following the decision on November 3 to move from a fixed exchange rate system to a floating exchange rate regime. The large depreciation of the exchange rate comes despite reinforced Central Bank reserves that exceeded US$ 24.3 billion at year-end 2016 (against US$ 16.5 billion at year-end 2015), following the IMF deal and the stream of financing agreements with the World Bank and African Development Bank and others. It is still worth bearing in mind that a net appreciation of the national currency was reported in the first couple of months of 2017, representing a 14% correction from the overdone depreciation of the past year.

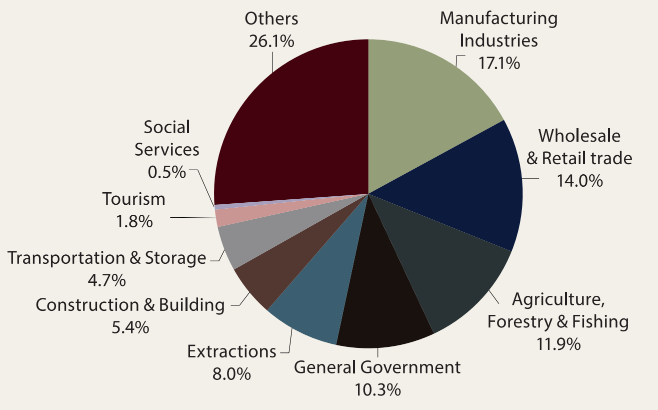
At the public finance level, a slight deterioration was reported in the past fiscal year. The public finance deficit to GDP ratio went up from 11.5% to 12.0%, as budget revenues to GDP contracted from 21.9% to 20.3%, thus slightly outpacing the drop in public expenditures to GDP from 33.5% to 32.4%. Corollarily, the domestic debt to GDP ratio rose from 89.0% to 94.6%. It is within this context that the State launched a number of ambitious fiscal reforms aimed at containing the most important economic vulnerability of Egypt, namely that of its public finances.

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2016)



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

At the banking sector level, the banking system has been relatively resilient to the macro/monetary pressures amidst a tough operating environment. In details, over the first ten months of 2016, bank assets grew by 26.1% when expressed in Egyptian Pound, while deposits grew by 16.2% over the period. In parallel, bank loans to the private sector grew by 24.0%, suggesting growing lending opportunities in an economy operating below potential. Net profits for ten listed banks reported a yearly growth of 37% over the first nine months of 2016 relative to the corresponding period of 2015. Financial soundness indicators remain satisfactory, with a non-performing loan ratio of 5.9% of total loans along with a provisioning ratio of 99.0% of non-performing loans, a capital adequacy ratio of 14.1% and a return on average assets of 1.5% and a return on average equity of 24.4%. Within this environment, banking activity in Egypt continues to be sound amid a strictly regulated environment, with opportunities outpacing challenges for operating banks at large.

As to capital markets, a net improvement in activity was reported for both equity and fixed income markets. Stock market prices rose by 76.2% in 2016 on the back of an active trading on securities, with the total number of market transactions rising from 4,875 thousands to 6,008 thousands. Consequently, the market valuation ratios rose significantly over the past year. The P/E ratio increased from 13.6x in 2015 to 26.6x in 2016 and the dividend yield increased from 7.7% to 9.0%. At the fixed income level, an improvement in the market perception of sovereign risk was actually reported. The 5-year CDS spreads contracted from 478 basis points at end-2015 to 450 basis points at end-2016.

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 near term macro outlook looking forward.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture

Stability in the performance of the primary sector

The agricultural sector, which is the third largest contributor to the Egyptian economy's GDP, maintained its pace of activity by growing at a rate of 3.1% in FY 2016. The primary sector took over a share of 11.9% in Egypt's GDP in FY 2016, up from 11.2% in FY 2015. In parallel, the bank loans to the sector accounted for a mere 1.4% of the total bank loans at end-October 2016, nearly unchanged from the previous year.

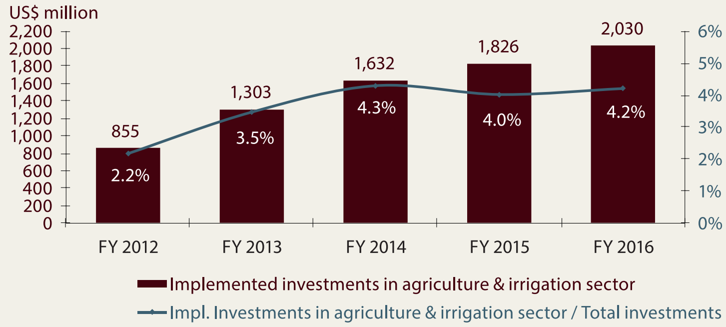
Egypt's implemented investments in the agriculture and irrigation sectors grew by 11.2% from US$ 1.8 billion in FY 2015 to US$ 2.0 billion in FY 2016. The growing trend took over the share of implemented investments in agriculture and irrigation in total investments as well. The latter registered 4.3%, 4.0% and 4.2% in FY 2014, FY 2015 and FY 2016.

In a detailed look at the crops, wheat production registered 8.1 million tons in 2016, down by 2.4% from 8.3 million tons, following a slight increase of 0.6% posted in 2015. Corn production increased in 2016, however at a slower pace from the previous year. It grew by a yearly 0.7% from 5.96 million tons in 2015 to 6.0 million tons in 2016. This came after a growth of 2.8% registered in 2015. As for the rice production, this stood at 4.0 million tons in 2016, a yearly decrease of 11.7%, following the decrease of 4.6% registered a year earlier. It is worth noting that the government is restricting the areas of rice farming as Egypt is suffering from severe water shortage. However, the Egyptian government's decision to re-allow rice exports following the November 2013 ban would play a positive role in reinforcing output. Sugar production rose by a yearly 2.8% to 2.1 million tons in 2016. This came after a nearly similar growth in 2015.

In a forward look, the Egyptian primary sector faces the threat of prolonged droughts and decreasing water supply for irrigation purposes, a challenging factor in the long-term. It is worth noting that the promotion of increased water efficiency is critical to the health of the Egyptian agricultural sector.

In brief, the country's agricultural sector continued to have a nearly constant contribution to the country's economy in 2016, with a stable real growth. The different branches of crop production registered different trends of growth depending on various regulatory and environmental conditions.

IMPLEMENTED INVESTMENTS IN AGRICULTURE & IRRIGATION SECTOR



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

1.1.2. Industry

Egypt's manufacturing and extractive industries witness mixed trends

During the past fiscal year, Egypt's manufacturing and extractive industries witnessed contrasting trends. Although both remained under the influence of a difficult environment to different extents, extractive industries faced structural problems, which restrained growth, while manufacturing industries grew on the overall.

As a matter of fact, extractive industries contracted by 5.3% in FY 2016 compared to a 4.1% drop in growth in the previous fiscal year. Egypt's extractive industries consist of petroleum industries, gas industries, and other extractions. The growth of the petroleum industries declined by 1.5% in FY 2016 against a 1.7% expansion in FY 2015. Gas industries contracted by 11.0% in FY 2016 relative to a 10.4% contraction in the previous year. Other extractions, the third sub-sector of extractive industries, expanded by 3.3% in FY 2016 against a 2.7% growth in the previous fiscal year.

Moving on to Egypt's manufacturing industries, the latter slightly grew over the past fiscal year, retaining its positive trend over the previous five fiscal years. In fact, manufacturing industries expanded by 0.8% in FY 2016 relative to 3.1% in FY 2015. Manufacturing industries comprise petroleum refining and other manufacturing sub-sectors. The growth of the country's petroleum industries fell by 2.5% in the past fiscal year, compared to a growth of 3.3% in FY 2015. Other manufacturing industries posted an expansion of 0.2% in the past fiscal year, compared to a 5.2% rise in the FY 2015.

As for implemented investments, Egypt's crude oil, natural gas and other manufacturing industries witnessed divergent trends in the past fiscal year. For instance, crude oil projects implemented investments fell by 83% in FY 2016, compared to an expansion of 33% in FY 2015. On the other hand, implemented investments in natural gas expanded by 33% in FY 2016, adding to an expansion of 32% in the previous fiscal year. Other manufacturing industries also grew by 14.3% in FY 2016.

Despite slightly growing over the past fiscal year, the industrial sector's growth capacity was constrained by scarcity of foreign currencies in Egypt. This negatively affected the industrial base as firms struggled to obtain dollars to import raw materials. After the Central Bank announced that it would free float the pound and raised key interest rates by three percentage points as part of a set of reforms aimed at alleviating a dollar shortage, a considerable rise in the prices of domestically produced and imported goods was seen. As a result, consumer purchasing power declined, with this having a drag on the industrial sector.

However, it is worth noting that this could create opportunities for local companies to outperform multinationals, as price would be the key consideration over quality for the majority of households. Thus, local producers could reap the benefits from operating in such an environment over the short term.

On another note, the Egyptian authorities have taken constructive steps to support the country's industrial sectors. The Egyptian Industrial Development Authority (IDA) inaugurated 605 new factories during 2016 with investments estimated at LE 9.3 billion (US$ 513.0 million), providing 21,000 job opportunities and encouraging local production. The Ministry of Trade and Industry also announced that it targets an industrial growth rate of 8% by 2020. It also plans to increase the participation of the industrial sector in Egypt to 21% of GDP by 2020, as per the same source. Additionally, Cairo Cotton Group announced that it would be investing US$ 100 million into expanding its operations, with the funds to be earmarked to open its second phase in Obour City.

In conclusion, while the falling currency would support the country's industrial sectors within the context of improving their competitiveness, it also makes local production costlier as the industry also relies on imports. Therefore, the extractive and manufacturing industries could face headwinds over the current fiscal year, as the government needs to take to stronger initiatives to support the local industries.

1.1.3. Construction

Construction & building sector posts strong performances in FY 2016

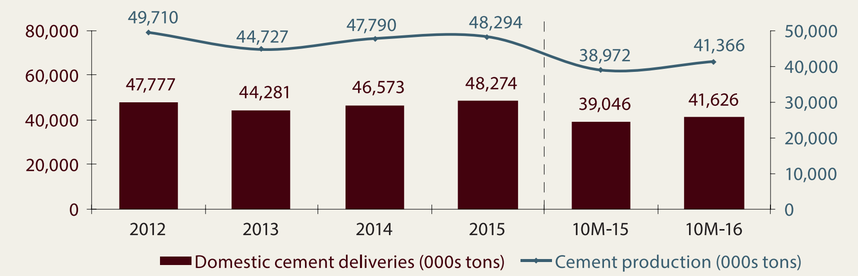
The country's construction and building sector posted strong performances in 2016, while accounting for 5.4% of Egypt's GDP. The sector further expanded by 11.2% in the FY 2016, compared to a growth rate of 9.8% in FY 2015.

Furthermore, the value of investments in Egypt's construction sector almost tripled, rising by 198.6%, in local currency terms, to attain LE 11.7 billion in the past fiscal year, following a rise of 43.2% in FY 2015, as per Central Bank data. The share of investment in construction out of total investments in the country rose from 1.2% in the previous fiscal year to 3.0% in FY 2016.

As a matter of fact, the majority of investments in the construction sector came from the private sector, with a noticeable rise in public sector investments. As a result, the private sector's share out of total investment in the construction and building sector fell to 60% in FY 2016 year from 71.6% in the previous fiscal year.

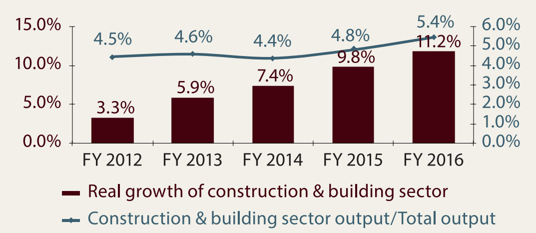
Although Egypt is expected to run a considerable fiscal deficit in the current fiscal year, the recent IMF agreement helped keep important infrastructure projects afloat. The country was able to depend on a proven Public Private Partnership (PPP) model in attracting capital into its infrastructure market, a market that became more attractive on a relative basis by the continued weakness of the pound. The country's Public Private Partnership Central Unit, an agency within the Ministry of Finance charged with guaranteeing the transparency of the tendering process, acts as an essential element in attracting investment. It oversees, implements and communicates Egypt's PPP laws. It also coordinates funding and partner selection across the government.

CEMENT PRODUCTION AND DELIVERIES



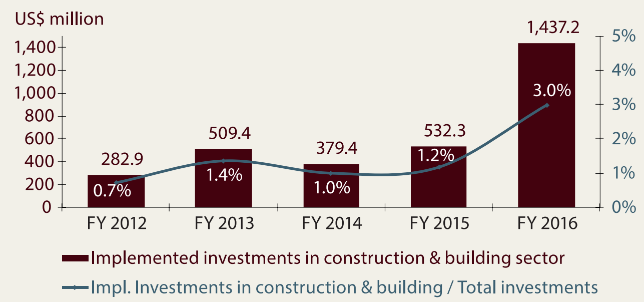
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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

Within the context of investments in the sector, in December 2016, Egypt granted an 80-hectare area in Port Said to a consortium of Russian firms that would design and construct a US$ 4.6 billion industrial port facility. Moreover, China Fortune Land Development (CFLD) signed a US$ 20 billion deal with the Egyptian government in October 2016 to develop and manage 57 square km as part of phase two of the country's new administrative capital development.

Additionally, the construction industry was supported by an increasingly competitive landscape, particularly with the growing Chinese market share, in the wake of the sharp devaluation of the Egyptian pound. Another factor that comforted the construction sector was resilient structural demand, where the government prioritized infrastructure investment across a variety of sectors, as it sought to address a persistent infrastructure deficit exacerbated by a growing population. For example, the governorate of Cairo plans to provide 7,380 housing units to the population in Mokattam district by early 2017, as part of the third phase in Al Asmarat project.

In conclusion, real growth in Egypt's construction sector could decelerate in 2017 relative to the preceding two fiscal years, as the reduction of energy subsidies and a de-pegging of the Egyptian pound could present difficulties to the construction industry output in the form of higher building material costs. Nonetheless, the sector would remain on a positive path due to strong fundamentals, which consist of a robust structural demand, a strong project pipeline, and an increasingly competitive investment environment.

1.1.4. Tourism

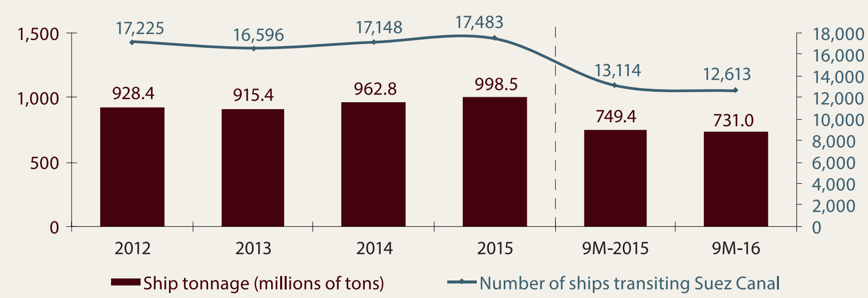
Unstable regional geopolitical situation challenges the sector

Egypt's tourism sector faced challenges in 2016, in the era of several terrorist attacks and as regional security concerns continue to limit visitors. Terror attacks contributed to a decrease in the perception of the country as a safe destination in a volatile region. In fact, the tourists arrivals fell by a yearly 45.4% in the first 11 months of 2016.

In details, tourist arrivals fell from 8,889 thousands in the first 11 months of 2015, to 4,849 thousands in the corresponding period of 2016. The number of tourist nights was on a declining path as well, decreasing by an annual 64.1% from 81.7 million tourist nights in the first 11 months of 2015 to 29.3 million in the same period of 2016. Moreover, the average stay per tourist decelerated to 6.0 days in the first 11 months of 2016, from 9.2 days in the same period of 2015.

Looking at the tourist breakdown by region, tourists from European countries took over the lion's share with 47.4% in the first 11 months of 2016 (down from 73.8% in the first 11 months of 2015). Tourists from the Middle East got a share of 29.8% in the same period of 2016 (up from 14.7% in the first 11 months of 2015). African tourists registered a share of 9.4% in the first 11 months of 2016 (compared to 4.3% in the

EVOLUTION OF SUEZ CANAL ACTIVITY



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

same period of 2015). Asia and the Pacific took over a share of 5.1% (up from 3.8%) and the share of the Americas was 8.0%, up from 3.0%.

On a more positive note, the 2016 hotel benchmark survey issued by Ernst & Young showed that the hospitality sector in Cairo, though ranking low amongst Middle Eastern peers, revealed improving trends whereby hotel occupancy rose by 14.0% from 49% in 2015 to 63% in 2016. Furthermore, both the average room rate and the rooms' yield in Cairo's four and five star hotels registered double-digit increases with the former rising by a yearly 26.3% to stand at US$ 142 in 2016 and the latter increasing by 62.7% year-on-year to register US$ 90 in 2016. It is yet worth finally mentioning that such a relative improvement in the capital's hotel performance in 2016 at large comes from a considerably low base in 2015.

1.2. EXTERNAL SECTOR

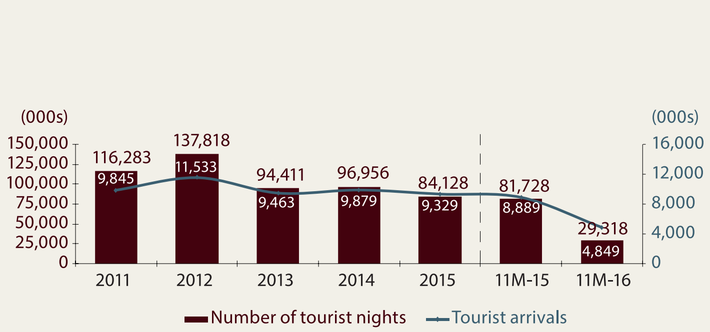
Widening current account deficit despite contracting trade deficit

Within the context of currency depreciation and geopolitical and security concerns, Egypt's foreign trade activity showed a contraction in imports by 2.3% alongside a 1.4% rise in exports during the first nine months of 2016 compared to the same period of 2015, contributing to a 4.2% decrease in the foreign trade deficit, according to the Central Bank of Egypt. In fact, Egypt's trade deficit contracted from US$ 28.7 billion during the first nine months of 2015 to US$ 27.5 billion during the same period of 2016. As such, Egypt's foreign trade activity posted a net contraction in terms of volume, as the sum of exports and imports went down by 1.4% moving from US$ 57.9 billion to US$ 57.1 billion during the same period, and consequently, the exports to imports coverage ratio rose from 33.8% to 35.1%.

Going further into details, imports reached US$ 42.3 billion during the first nine months of 2016, compared to US$ 43.3 billion during the first nine months of 2015, on the back of the low oil prices impacting petroleum imports and within the context of the sharp rise in customs duties on more than 300 goods to encourage domestic production and curb a ballooning trade deficit. As such, the breakdown of imports by product suggests that the most significant decline among the major categories was reported by fuel and mineral products with a decline of 20.8% year-on-year to make up 15.7% of total imports during the first nine months of 2016 (from 19.3% over the same period of 2015). The breakdown of imports by geographical distribution shows that most of the inward merchandise during the first nine months of 2016 came from the European Union with 30.2% of the total, followed by Asian countries (excluding Arab countries) with 19.7% of the total, and Arab countries with 17.4% of the total.

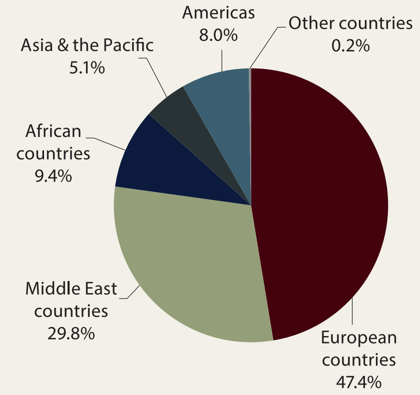
At the level of exports, a total of US$ 14.8 billion was registered during the first nine months 2016, compared to US$ 14.6 billion during the same period of 2015, on the back of the currency depreciation during the period and that has somehow strengthened external competitiveness and supported exports. In parallel, the breakdown of exports by product suggests that the most significant increase among

EVOLUTION OF TOURISM ACTIVITY



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

TOURISTS BREAKDOWN BY REGION (11M-16)



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

the major categories was reported by gold with a rise of 223.8% year-on-year to make up 9.7% of total exports during the first nine months of 2016 (from 3.0% over the same period of 2015). The geographical distribution of exports indicates that 32.0% of total exports went to Arab countries, followed by the European Union with 30.4% of the total, and Asian countries (excluding Arab countries) with 10.5%.

Although the pressures on Egypt's trade deficit lessened last year, the current account deficit widened by 30.3% during the first nine months of 2016 relative to the same period of 2015 to reach the equivalent of US$ 15.4 billion, as per the latest available statistics. The rise in current account deficit was mainly attributed to a significant drop in services balance by 48.3%, on the back of a decline in tourism receipts by 64.2% due to an overall decelerated tourism activity. In addition, current transfers declined by 16.1% as a result of a 15.7% drop in remittances from Egyptian workers abroad to their homeland. Within this context, the current account deficit widened from 3.6% of GDP in FY2015 to 5.9% in FY2016, as per the Central Bank of Egypt, yet the deficit is expected to narrow gradually in the coming years as export recovery is based on competitiveness gains from real depreciation of the pound, growth-friendly reforms, and on exploration of new gas fields.

In parallel, the capital and financial account balance has risen by 17.7% during the first nine months of 2016, moving up from US$ 18.8 billion to US$ 22.1 billion, which is attributed to a surge in other investments account from US$ 13.7 billion to US$ 17.1 billion, alongside a rise in net direct investment by 10.1% from US$ 5.2 billion to US$ 5.7 billion during the same period. Accordingly, Egypt's balance of payments registered a surplus of US$ 2.5 billion in the first nine months 2016, compared to a smaller surplus of US$ 1.1 billion during the previous year's corresponding period.

1.3. PUBLIC SECTOR

Fiscal reforms to materialize into declining public finance deficit

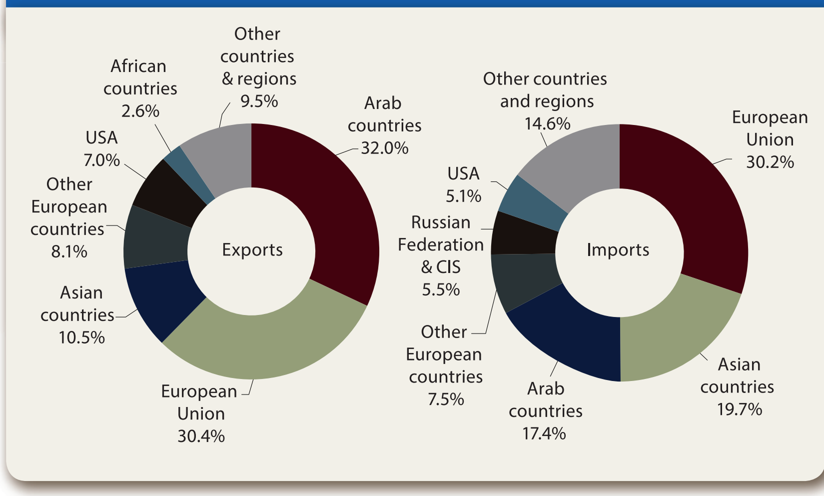
The Egyptian government took positive steps towards reducing fiscal deficits considerably, however these reforms have yet to materialize to put the fiscal deficit on a declining path. Having said, the overall budget deficit has expanded slightly in the FY 2016 according to the Ministry of Finance, mainly driven by higher debt servicing and slow growth.

Going further into details, total budget revenues grew by 5.6% in local currency terms during FY 2016 relative to FY 2015, to reach LE 491.5 billion (or US$ 60.2 billion) at end-June 2016 or 17.7% of GDP, according to pre-actual figures issued by the Ministry of Finance. The rise in budget revenues was due to an increase in tax revenues by 15.2% that came in line with the five-year program (introduced in 2014) to improve tax buoyancy and widen the tax base. However, the increase in tax revenues was offset by a

FOREIGN SECTOR INDICATORS

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

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (9M 2016)



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

retreat in non-tax revenues by 12.6%, as a result of a sharp decline in external grants from US$ 3.5 billion in FY 2015 to US$ 433 million in FY 2016.

Total budget expenditures were up by 11.5% in local currency terms during FY 2016 relative to FY 2015 (compared to a 4.5% hike during FY 2015), to reach LE 817.8 billion (or US$ 100.1 billion and 29.5% of GDP) at end-June 2016. Public outlays were to a significant extent the result of an increase in interest payments by 26.2% (compared to a 11.5% rise in FY 2015) representing 29.8% of total expenditures. However, the government should be able to reduce the budget allocation to debt service payments because the projected deficit in 2016-2017 would be financed almost completely through IMF funds and other multilateral and bilateral loans at favorable rates, in the range of 1%-2%, compared to rates of above 15% on borrowing from local banks. In addition, compensation of employees increased by 7.7%, while subsidies, grants and social benefits increased by slight 1.2% in line with the plan to phase out energy subsidies.

As such, this resulted into an expansion in the overall deficit in local currency terms of 21.5% in FY 2016 to reach LE 339.5 billion, the equivalent of US$ 41.5 billion, accounting for 12.3% of GDP in FY 2016, up from 11.5% of GDP in FY 2015 given the government initiatives towards fiscal consolidation.

The gross domestic debt rose by 23.8% in local currency terms in FY 2016 following a 16.5% expansion in FY 2015, to reach the equivalent of US$ 295 billion at end-June 2016. This was mainly triggered by a 33.0% growth in the balances of bonds and bills, within the context of sovereign debt sale aiming at funding the country's fiscal deficit. Within this context, the total domestic debt to GDP went up from 86.6% in FY 2015 to 96.7% in FY 2016, as per the Central Bank of Egypt. In parallel, the total external debt increased by 16.0% in FY 2016 compared to a 4.3% increase in FY 2015, to reach US$ 55.8 billion at end-June 2016. As such, total external debt rose from 14.8% of GDP at end-June 2015 to 18.1% at end-June 2016.

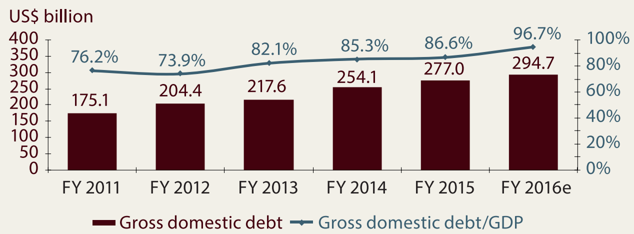
There are signs that the government will consolidate its austerity drive in the current fiscal year. As such, the FY 2017 budget registers ambitious target, the government targetting to collect LE 669.7 billion of revenues, mainly driven by the impact of higher real GDP growth rates on tax revenue. The main objective of the economic reform program is the reduction of public debt as a proportion of GDP by 10 percentage points over the three-year duration of the EFF, primarily by reducing budget expenditure and raising revenue. The projected deficit reduction would be supported by the implementation of VAT, although about 1% of GDP in fiscal savings would be dedicated to increasing food subsidies and boosting cash transfers to vulnerable groups. Public expenditures are expected to reach LE 974.8 billion in FY 2017, on the back of an expected further rise in interest payments. Accordingly, the fiscal deficit is expected to decrease both in absolute terms and as a percentage of GDP in FY 2017, as it is expected to reach LE 319.5 billion (a decline of 6.0%), and consequently to narrow from 12.3% of GDP in FY 2016 to 9.8% of GDP in FY 2017.

SELECTED PUBLIC FINANCE INDICATORS

LE billion	FY 2013	FY 2014	FY 2015	FY 2016e
Total budget revenues	350.3	456.8	465.2	491.5
Total budget revenues/GDP	19.0%	21.7%	19.1%	17.7%
Total budget expenditures	588.2	701.5	733.4	817.8
Total budget expenditures/GDP	31.9%	33.4%	30.2%	29.5%
Overall budget deficit	239.7	255.4	279.4	339.5
Overall budget deficit/GDP	13.0%	12.2%	11.5%	12.3%

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

GOVERNMENT INDEBTEDNESS



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

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Shift to floating exchange rate regime dictates further monetary policy tightening

The fiscal year 2017 witnessed the historical shift from a fixed exchange rate regime to a flexible one, in a move aimed at removing the significant overvaluation of the Egyptian Pound and rebuilding international reserves, while pursuing an extended monetary tightening policy in order to anchor inflation expectations and contain domestic and external demand pressures.

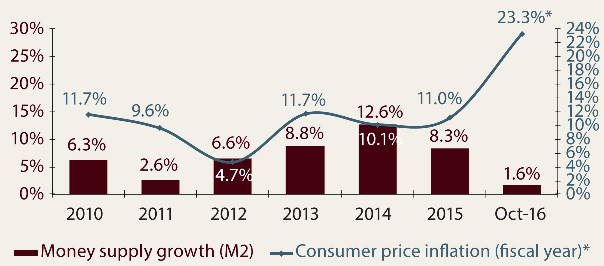
In details, the Central Bank of Egypt devalued the Egyptian Pound by 32.5% against the US dollar on November 3, 2016 following a 13% devaluation in March 2016, and allowed the exchange rate to float freely in the aim of quelling any distortions in the domestic foreign currency market, restoring confidence in the Egyptian economy and eliminating exchange shortages. Within this context, Moody's said that the floating and depreciation of the currency is credit positive for Egypt, as a market-based foreign exchange rate would relieve pressures on scarce foreign-currency reserves and support investment and overall growth.

The Egyptian Pound, which was estimated to be overvalued in real effective terms against the US dollar before the currency float, was quoted at LE/US$ 18.11 at end-December 2016 following the liberalization of the exchange rate system, against LE/US$ 8.88 at end-June 2016 and LE/US$ 7.83 at end-December 2015, yet the Egyptian Pound started to see mild appreciation towards mid-February 2017, hovering around LE/US$ 16.0 amid reduced forex exchange shortages and eased importers' demand for the greenback.

In conjunction with the currency float, the Central Bank of Egypt continued to pursue a tight monetary policy in FY 2017, raising key policy rates by 300 basis points on November 3, 2016, following a total interest rate hike of 300 bps in FY 2016, mainly in the purpose of containing the inflationary impact of the devaluation, while simultaneously sterilizing part of the large liquidity surplus that had built up in the system due to the prior accommodative stance by introducing longer-term deposit auctions. That being said, the overnight deposit rate was raised from 11.75% at end-2016 to a current 14.75%, and the overnight lending rate was lifted from 12.75% to 15.75%.

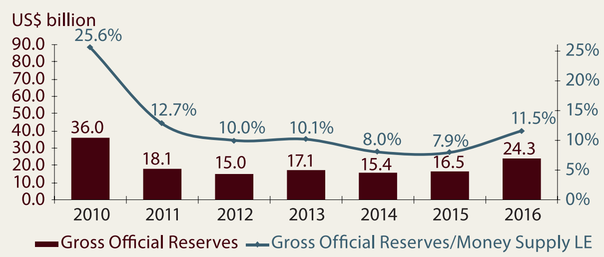
Following the liberalization of the exchange rate system, inflationary pressures intensified in Egypt. The Headline Consumer Price Index for urban areas which include Cairo, Alexandria, urban Lower Egypt, urban Upper Egypt, Canal cities and frontier governorates rose by 16.7% on average during the first half of FY 2017 and extended its upward trajectory till January 2017, surging by 28.1% year-on-year, according to the Central Bank of Egypt. Also, core CPI, which excludes the impact of temporary price shocks on inflation that could result from weather conditions, supply disruptions or infrequent resetting of prices by the government, giving better implications about future inflation trends, increased from 8.1% on average

BROAD MONEY AND INFLATION



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* in FY 2016 to 17.0% on average during the first half of FY 2017, and pursued its upward slope to rise by 30.9% year-on-year in January 2017.

The Egyptian government's reform program, the currency float, the release of the first tranche of a three-year US$ 12 billion IMF loan facility (US$ 2.75 billion) and the sale of US$ 4 billion international bonds allowed the Central Bank of Egypt to replenish its gross official reserves. In fact, the CBE's gross official reserves grew by a significant 38.1% during the first half of FY 2017 to reach US$ 24.3 billion at end-December 2016, and extended their upward trajectory to reach US$ 26.4 billion at end-January 2017, their highest level since the eruption of Egypt's first revolution in January 2011. Within this context, the Central Bank's gross official reserves covered 11.5% of local currency money supply at end-December 2016. This compared to lower coverage ratios of 8.8% at end-June 2016 and 7.9% at end-December 2015.

The broader money supply (M2) expanded by a shy 1.6% in US$ terms during the first ten months of 2016 given the 13% currency devaluation in March 2016, moving up from US$ 243.3 billion at end-2015 to US$ 247.3 billion at end-October 2016. This followed a higher growth of 8.3% in 2015. Money supply in its narrow sense (M1) widened in US$ terms by 3.8% during the first ten months of 2016, following a higher growth of 6.6% in 2015, to hit US$ 69.0 billion at end-October 2016.

Looking forward, the new exchange rate regime is projected to improve Egypt's competitiveness and allow for the deepening of foreign currency liquidity, while streamlining activity into the formal channels. Such activity is set to allow for the steady accumulation of foreign currency reserves through the increase of private transfers, trade competitiveness and foreign investments. Under these conditions, the monetary policy would be largely dictated by the need to ensure price stability following the currency float, and bring the inflation down to mid-single digits over the medium term, while maintaining an orderly foreign exchange market. For this purpose, the CBE said that it would closely monitor the amount of reserve money in the system and continue to rely on indirect monetary policy tools.

1.4.2. Banking Activity

Steady deposit growth utilized to finance public finances gaps and the private sector economy

The banking sector has weathered well the repercussions of the political and security situation the country witnessed in the last few years, and is now in growth mode despite the recent currency devaluation and ensuing floatation. The latest sector statistics disclosed by the Central Bank are as at end-October 2016, and show a 26.1% growth in bank assets in the first ten months of the year (+11.1% in US dollar terms) to reach the equivalent of US$ 352.5 billion at end-October.

The solid increase in banking sector activity was made possible by continuous deposit collection on the funding side, which was channeled unto public sector financing through the purchase of securities and unto lending activity growth on the asset utilization side.

On the funding side, banks benefit from a wide pool of deposits, mostly local currency retail deposits, which allows them to operate with little reliance on the often-volatile foreign funding market. Total deposits rose by 16.2% in the first ten months of 2016 to reach the equivalent of around US$ 250 billion at end-October, and the growth in deposits over the covered period accounted for close to half of total balance sheet growth. This compares rather well to a strong 20% rise in the corresponding period of the previous year.

The breakdown of bank deposits shows that the government sector accounted for less than 30% of total deposit growth over the covered period, thus leaving the bulk of growth to the private sector. Among the latter, the main deposit driver remained retail depositors, i.e. households, which accounted for the largest share in deposit growth, followed by the private corporate sector.

From a currency standpoint, local currency deposits were the ones to rise the most in the first ten months of last year, accounting for 78% of total deposit growth, leaving less than a quarter to foreign currency deposits and supporting the dominance of local currency funding for banks' activities at large.

Lately, the Central Bank said confidence in the system is growing, and that commercial lenders attracted US$ 9 billion in inflows since the pound was floated in November. Banks have seen a notable improvement in foreign currency inflows in the past few weeks.

Part of the continued rise in liquidity at hand for banks was channeled unto new loan waves to the economy, which accounted for 29% of total activity growth. As a matter of fact, total credit facilities surged by 24.0% between December 2015 and October 2016 to reach the equivalent of US$ 110.4 billion.

Credit facilities to the government accounted for 47% of total growth over the covered period, boosted by the financing of infrastructure projects, leaving slightly more than half to the private sector. Among the latter, the industrial sector, followed by the services sector and the household sector, were allocated the largest amounts of new loans in the first ten months of 2016. On the overall, local currency lending rose the most (+26.2%) while foreign currency lending increased by 18.8% from a lower base.

Authorities are continuing to support lending activity with the aim of financing the private sector needs. Earlier this year, the Central Bank allocated a LE 5 billion envelope for bank lending to hotel refurbishment and touristic transport fleet renovation/modernization, with loans extendable by banks for up to ten years. Furthermore, the Central Bank extended late last year the tourism sector support initiative until February 2018, and extended for six months until June 2017 the initiative consisting of extending retail loans to tourism sector staff.

The sector regulator is also working on diversifying further banks' loan portfolios, and to that effect, has issued guidelines in early 2016 to lower the maximum exposure to a single customer from 20% to 15% of bank capital and to a group of customers to 20% of capital. Banks operating the country were also asked to reduce aggregate exposure to their largest 50 customers in the next three years or face additional capital requirements.

Part of the excess liquidity at banks was placed with other banks in the country, thus boosting banks' liquid assets base. The overall increase in core liquidity (cash, balances with banks in Egypt and balances with banks abroad) accounted for 17% of total activity growth in the first ten months of 2016. Accordingly, the core liquidity ratio of banks, which we measure as the ratio of those liquid assets to customer deposits, reached 25% at end-October 2016, against slightly less than 23% at end-2015, in line with international benchmarks.

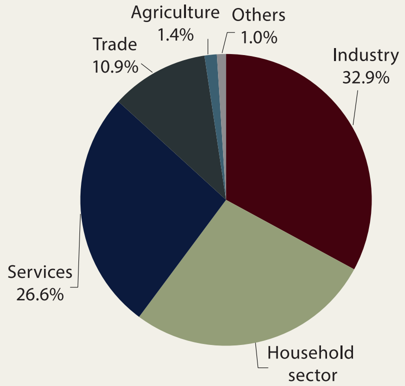
These liquid assets are complemented by growing investments in securities, a good chunk of which is short-term Treasury bills. Investments in securities grew by 22.4% in the covered period of 2016 to account for 38% of total asset growth over the same period, or 43% of the total asset base at end-October 2016. Given that 95% of the stock of such securities are issued by the government sector, the rise in investments in securities of banks is explained by their continued financing of government budget gaps

BANKING SECTOR INDICATORS

US$ million	2011	2012	2013	2014	2015	Oct-16
Banking Activity						
Assets	216,740	226,556	242,209	275,375	317,393	352,520
Deposits	163,948	171,486	189,242	218,210	244,484	250,215
Credit Facilities	81,148	81,248	79,134	88,028	101,073	110,380
Capital + Reserves	13,530	15,834	16,296	17,174	18,033	21,508
Growth rates						
Assets	-1.9%	4.5%	6.9%	13.7%	15.3%	11.1%
Deposits	-0.1%	4.6%	10.4%	15.3%	12.0%	2.3%
Credit Facilities	2.8%	0.1%	-2.6%	11.2%	14.8%	9.2%
Capital + Reserves	-1.9%	17.0%	2.9%	5.4%	5.0%	19.3%

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

BANK CREDIT FACILITIES BY ECONOMIC ACTIVITY*



* As at end-October 2016

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

in recent years. As such, with government securities investments accounting for close to 7x their own capital and reserves, Egyptian banks are highly exposed to the sovereign, over and above their lending exposures to the government.

It seems that banks have seen liquidity in local currency pile up recently after interest rates rose, but they are suffering from a lack of investment opportunities that can absorb that liquidity and cover its cost. Banks are waiting for the economy to improve once structural reform plans materialize in order to invest rather than just focus on government debt instruments.

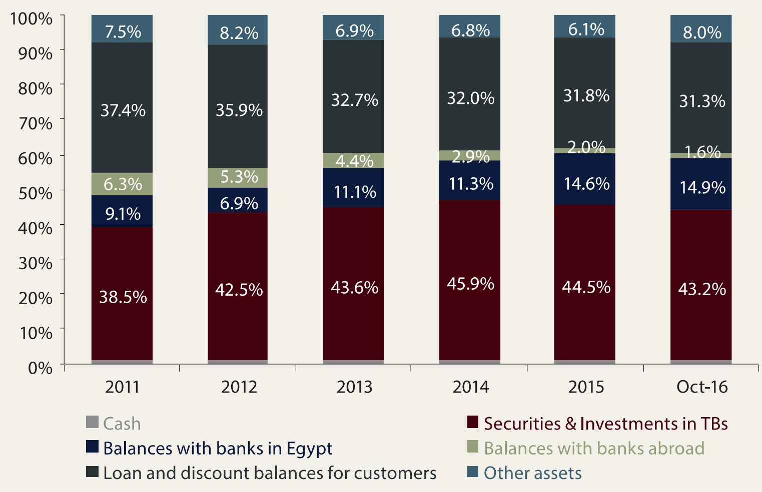
On a more positive note, banks' asset quality has improved lately, with the stock of non-performing loans declining to reach 5.9% of total loans as at end-September 2016 as per the latest Central Bank of Egypt figures (6.8% at end-2015), in line with international averages. This has been favored by the settlement of some legacy NPLs, noting that the largest two banks have managed to address better their legacy problem loans. In a similar fashion, provisioning coverage remained more than enough and stood at 99.0% of NPLs.

Along the same lines, capital adequacy is satisfactory, with banks' capital base to risk-weighted assets ratio at 14.1% at end-September 2016, against 13.7% at end-2015, well above the Basel-recommended floor and the CBE-mandated level. More than 80% of their capital base consists of Tier 1 capital.

The IMF lately said Egyptian authorities are confident that the banking system can weather the transition to the new FX regime. The Central Bank has conducted extensive stress tests prior to the devaluation to confirm that banks' capital and liquidity buffers were adequate to withstand devaluation and higher interest rates. The stress test results indicated that the banking system would remain sound, but also showed that a severe shock would push the capital adequacy ratio of a few small banks below the Basel-recommended 10.5%.

Finally, Egyptian banks benefited from the higher investments in government securities and increased lending activity to post a rise in their bottom lines. While detailed consolidated sector statistics are not available, we resorted to the analysis of results of ten listed banks, which show that bank net profits rose by a yearly 37% in local currency terms (+22% in US$ terms) in the first nine months of 2016.

BANKING SECTOR ASSET COMPOSITION



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

1.4.3. Equity and Bond Markets

Noticeable price rebound in Egypt's capital markets on the back of reforms and currency floatation

Egyptian capital markets saw a strong price rebound in 2016, mainly supported by the implementation of economic reform programs and the currency floatation, which cleared the way for a long-awaited US$ 12 billion IMF loan facility, and helped restoring investors' confidence and attracting healthy net foreign inflows. Within this context, the Egyptian Exchange registered a strong price rally in 2016, with all its indices posting decent gains relative to the previous year. Also, the fixed income market registered healthy price gains that swept out previous year's losses, and the cost of insuring debt contracted significantly.

In details, the Egyptian Exchange benefited from improved investor sentiment in 2016 after the government adopted a fiscal and monetary restructuring program, and the Central Bank of Egypt liberalized the exchange rate regime and allowed the Egyptian Pound to float freely on November 3, 2016, a key requisite for the IMF's US$ 12 billion loan facility and a move that is set to attract foreign investments, improve Egypt's external competitiveness, support exports and tourism, and resolve the country's hard currency shortages. These reforms combined with the Supreme Investment Council's decision to extend the suspension of capital gains tax on shares for three years helped spur activity on the Egyptian market. Within this context, the bourse attracted healthy net foreign inflows in 2016, with both non-Arab and Arab investors being net buyers.

That being said, the bourse main benchmark index (EGX 30) jumped by 76.2% year-on-year to reach a record high level of 12,345 at end-December 2016, yet slipped slightly by 3.3% over the first two months of 2017 on the back of some profit taking operations that were mainly triggered by currency appreciation. The breakdown of the index by sector shows that most sectors posted strong price gains in 2016. The telecommunications sector led the advance, surging by 138%, followed by the basic resources sector (+88%), the financial services sector excluding banks (+76%), the banking sector (+73%), the personal and household products sector (+70%), the industrial goods, services and automobiles sector (+58%), the chemicals sector (+52%), the real estate sector (+41%), the healthcare and pharmaceuticals sector (+30%), and the travel and leisure sector (+19%), while the food and beverage sector posted price drops of 19%, followed by the construction and material sector (-9%).

The significant rise in equity prices in 2016 was coupled by a shy increase in the number of listed companies on the Egyptian Exchange from 221 at end-2015 to 222 at end-2016. As such, the market capitalization surged by 40.0% in local currency terms, the equivalent of LE 172 billion, to reach LE 601.6 billion at end-December 2016, its highest level in eight years. As a result, the ratio of market capitalization to GDP increased from 22% at end-2015 to 25% at end-2016, as per the Egyptian Exchange.

On the back of improved investor sentiment, the total volume of traded shares surged from 45,078 million shares in 2015 to 68,559 million shares in 2016. The total number of transactions rose by 23.2%, moving from circa 4.9 million transactions in 2015 to circa 6.0 million transactions in 2016. Higher equity prices coupled with increased number of traded shares led to a rise in the total trading value from LE 247.2 billion in 2015 to LE 284.5 billion in 2016, moving up by 15.1%. Individuals captured 65% of activity in 2016, while institutional investors accounted for the remaining 35%, noting that the latter were net buyers after being net sellers in the previous year. Egyptians captured 74% of activity, while foreigners accounted for the remaining 26%. Within this context, the turnover ratio, measured by total trading value to market capitalization in local currency terms, declined from 57.5% in 2015 to 47.3% in 2016.

In parallel, Egyptian sovereign debt papers posted healthy price gains in 2016 that were extended to the first two months of 2017, with Z-spreads contracting significantly, mainly supported by the government's structural reforms and the authorities' shift to a more flexible exchange rate regime, which is considered a vital step toward alleviating the country's FX shortage.

In details, Egypt'20 closed up by 3.00 pts in 2016, recording a 103 bps contraction in Z-spreads, and extended its upward trajectory during the first two months of 2017 to register a year-to-date price rise of 2.5 pts at end-February 2017. Prices of Egypt'25 rose by 4.5 pts in 2016, posting an 81 bps contraction in Z-spreads, and increased by 7.25 pts during the first two months of 2017. Egypt'40 traded up by 5.38

pts, registering a 72 bps contraction in Z-spreads, and pursued its upward slope during the first two months of 2017, posting price rises of 7.38 pts. Regarding new bond issues, Egypt launched late January 2017 a US$ 4 billion triple-tranche US dollar-denominated benchmark bond issue that bore witness of higher borrowing costs. Egypt issued US$ 1 billion 10-year notes at 7.5%, as compared to a coupon rate of 5.875% for similar-maturity bonds in 2015. The government also sold five-year US$ 1.75 billion notes at a coupon rate of 6.125% and US$ 1.25 billion 30-year securities at a coupon rate of 8.5%. The order book size reached US$ 13.5 billion.

The newly issued sovereigns recorded decent price increases till end-February 2017. Egypt'22 closed up by 3.75 pts, posting an 82 bps contraction in Z-spreads. Egypt'27 was up by 6.38 pts, with an 82 bps contraction in Z-spreads. Prices of Egypt'47 rose by 7.63 pts, recording a 60 bps contraction in Z-spreads.

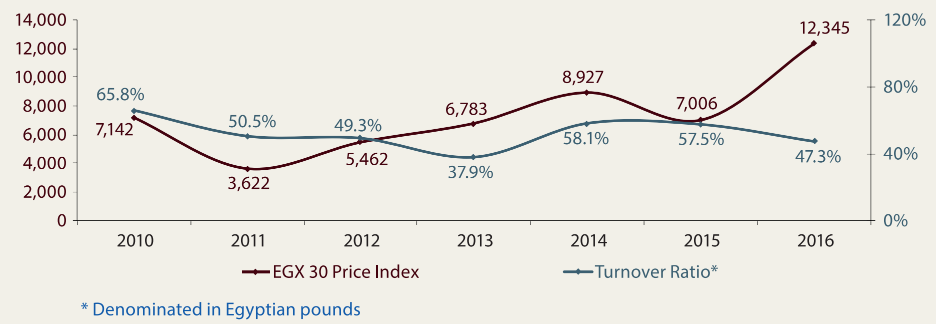
As to the cost of insuring debt, Egypt's five-year CDS spreads, a reflection of market perception of country risks, contracted by 28 bps in 2016 to close at 450 bps at end-2016, and shrank further by 115 bps during the first two months of 2017 amidst improved investor sentiment. Regarding credit rating changes, Standard & Poor's revised on November 11, 2016 its outlook on the long-term sovereign credit rating on the Arab Republic of Egypt to "stable" from "negative". At the same time, S&P affirmed its "B-" long-term and "B" short-term foreign and local currency sovereign credit ratings. The outlook's revision reflects the balance between Egypt's long-standing external and fiscal vulnerabilities and S&P's expectation that the IMF's EFF program would provide external financing to Egypt to meet its foreign exchange requirements over the coming 12 months.

CAPITAL MARKETS INDICATORS

	2011	2012	2013	2014	2015	2016
Market capitalization (US$ billion)	48.6	59.0	61.4	69.9	54.9	33.2
Total value traded (US$ million)	24,938	30,473	23,555	41,044	32,091	30,389
Non-Arab foreign participation as % of total value traded	23.6%	14.9%	14.3%	9.7%	11.1%	11.5%
Total volume of traded securities (million)	18,491	34,261	29,190	57,230	45,078	68,559
Total number of transactions (000s)	5,590	6,234	4,790	7,328	4,875	6,008
No. of listed companies	213	213	212	214	221	222
No. of traded companies	204	204	204	206	209	209
% Change in price index (EGX 30)	-49.3%	50.8%	24.2%	31.6%	-21.5%	76.2%
P/E ratio (times)	10.5	12.4	15.2	20.2	13.6	26.6
Dividend yield	10.4%	8.6%	6.5%	9.3%	7.7%	9.0%
CDS spreads (bps)	640	510	605	282	478	450

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

STOCK MARKET PERFORMANCE



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

2. CONCLUDING REMARKS

The large twin deficits and the high and persistent inflation along with the persistently high unemployment are key macroeconomic challenges facing Egypt. It is within this context that the authorities have adopted their new program, based on a significant policy adjustment, strengthening social safety nets, far reaching structural reforms and fresh external financing to close the financing gaps. Such a new macroeconomic direction aims at fundamentally addressing Egypt's macroeconomic vulnerabilities and promoting inclusive growth and job creation.

There is no doubt that the liberalization of the exchange rate regime, effectuated at the end of past year was a critical step toward restoring economic confidence at large. The decision to float the Egyptian Pound and to reign in energy subsidies should help increase investment, and improve the net export contribution to growth. But a slowdown in consumption could prevent a rapid growth rebound in the current fiscal year. Prolonged periods of FX shortages over the past few years, along with elevated socio political and security related risks, have severely undermined investment growth. Investment has dipped from 21% of GDP in 2010 to around 14% currently. In parallel, the erosion of competitiveness as a result of real appreciation of the EGP contributed to a sharp fall in exports by 25% over the same period.

Beyond helping to bridge Egypt's large external financing needs, the agreement with the IMF would send a strong signal to domestic and foreign investors that the authorities are committed to achieve macroeconomic stability and to improve the business environment. According to the IMF program, Egypt is set to decrease its total debt ratio to reach 88% of GDP by 2018/19 from its current level of around 98% and to turn its 3.5% primary deficit to GDP ratio to a surplus of 2%, which represent ambitious targets for the Egyptian State authorities in general.

As a result, growing confidence in the availability of the hard currency along with the stream of ambitious fiscal reforms would provide a noticeable boost to business sentiment and raise the attraction of foreign investment at large. At the real sector level, growth would pick up, though it might remain below the rates required to effect a sharp and swift reduction of unemployment looking ahead. It is within this context that real GDP growth would rise by an average of 5.2% over the next five years as per the recent IMF forecasts disclosed in the report released in the past month.

At the monetary level, monetary policy will be largely dictated by the need to anchor inflation expectations following the recent floatation of the Egyptian Pound. It is within this context that the Central Bank increased interest rates by 3% last November, the fourth increase in a year's time. The tighter monetary policy could prove counterproductive in terms of government efforts to encourage investment and boost demand for goods and services in the near term, which could lead ultimately the Central Bank to ease monetary policy in the year to come amid greater stability of the Pound and relatively dampened inflationary expectations.

Finally, the adjustment program followed by Egypt is attempting to tackle three interlinked problems, namely an urgent balance of payments problem, rising public debt and the long term issue of low growth and high unemployment. As risks to the program are considerable, much work remains to be done. Of these risks, we mention both internal and external risks such as the risk of erosion for a lengthy period of structural reforms, the spillover effects of terrorism, the performance of Egypt's main trading partners and global financial risks at large. Nevertheless, the program is an opportunity in the meaning that Egypt is apt to move in a new economic direction that will put an end to the economic turbulence of the post-revolution period within the context of the targeted restoration of macroeconomic stability at large.

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