EGYPT ECONOMIC REPORT

FAST AND AMBITIOUS REFORM PROCESS DRIVING THE IMPROVED MACROECONOMIC OUTLOOK

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CONTACTS

Research

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

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

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

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

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

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

Anthony Badr
(961-1) 964714
anthony.badr@banqueaudi.com

- Improving real sector activity momentum

Egypt's real economic growth is picking up, though moderately. Benefits are becoming apparent across the whole economy reinforcing the investment aggregate, but the consumer remains quite challenged. Egypt's Gross Domestic Product registered a strong real growth of 4.2% during 2017, as a result of the growth in several sectors, including communication, tourism and manufacturing and supported by the gradual implementation of business climate reforms and improved competitiveness. Looking ahead growth is expected to gain further momentum, driven by a recovery in consumption and private investment and a continued positive contribution from net exports.

- Current account deficit cut by half yielding noticeable balance of payments surplus

Egypt's external position has witnessed a relative improvement in the first nine months of 2017 when compared to the previous year's performance, as the current account deficit has been cut by half, mainly on the back of a surge in services balance and a decline in trade deficit supported by a contraction in non-oil imports within the context of a weak Egyptian pound against the US dollar and improved export competitiveness. Accordingly, Egypt's balance of payments registered a significant surplus of US$ 11.8 billion in the first nine months 2017, compared to a smaller surplus of US$ 2.5 billion during the previous year's corresponding period.

- Narrowing fiscal deficit ratio on the back of a firm commitment to fiscal reforms

The fiscal position has benefitted from a firm commitment by the government to fiscal reforms under the IMF program, such as the introduction of the value-added tax, subsidy reforms, and government wage reforms. As such, the general government fiscal deficit reached 10.9% of GDP in FY 2017, compared with 12.5% in FY 2016. Total budget revenues went up by a solid 34.1% in local currency terms while budget expenditures were up by 26.2%. Egypt's Parliament subsequently passed the State budget for the FY 2018 with an ambitious budget deficit target of 9.0% of GDP.

- FX reserves at record high and inflation gradually receding though remaining

Following the November 2016 currency floatation, Egypt's monetary conditions were marked by inflationary pressures that started recently to moderate in the second half of 2017 due to base effects closing the year at 21.9%, while the Egyptian Pound has shown very modest appreciation following devaluation. Within this context, monetary authorities maintained a tight monetary policy throughout the year, before cutting rates by 100 bps in February 2018 as inflation eased. The Central Bank of Egypt, which benefited from strong inflows tied to improving fundamentals and the US$ 12 billion loan accord with the IMF, was able to replenish its FX reserves to reach currently a historical high level of US$ 37 billion at year-end 2017.

- Banking activity weathering the currency floatation spillovers

Egypt's banking sector witnessed strong performances in the year 2017, despite the currency depreciation repercussions and ensuing uncertainties. Measured by the aggregated assets of banks operating in Egypt, banking sector activity grew by a noticeable 21.0% in the first ten months of 2017 (+24.1% in US dollar terms) to reach the equivalent of US$ 271.4 billion at end-October 2017. The sector continues to display good financial soundness indicators, with an NPLs/total loans ratio of 5.3%, a loan provisioning coverage of 98.8%, a capital adequacy ratio of 14.7% with 80% of capital being common Tier 1 capital, and a ROAA of 2.0% and a ROAE of 30.9% as at September 2017.

- Strong price gains in Egypt's capital markets for the second consecutive year

Egyptian capital markets were at the mirror of an improving domestic economy. The Egyptian Exchange continued to report double-digit price gains (21.7% in 2017) amid a strong activity skewed to the buy side, mainly supported by increased investor confidence and rising capital inflows following the implementation of economic reforms, the liberalization of the exchange regime and the stabilisation of the Egyptian Pound. In parallel, the fixed income market registered healthy price increases for the second consecutive year, and the cost of insuring debt continued to register significant contractions (134 bps in 2017), reflecting a noticeable improvement in the market perception of sovereign risks at large.

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

Egypt's reform process has accelerated over the past year, with further subsidy reductions, VAT increases and interest rate hikes. The fruits of this challenging reform are becoming evident, with real economic activity picking up, foreign currency reserves improving to their highest level on record, tourist arrivals recovering from low levels and the capital markets performing solidly, with parallel improvement in banking activity at large.

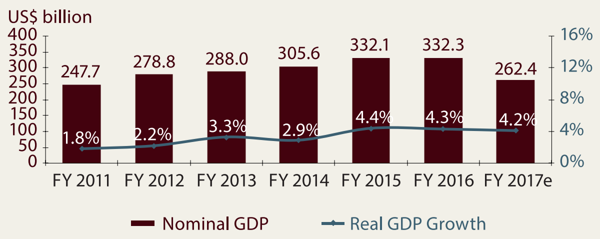
At the real sector level, growth is picking up, though moderately. Benefits are becoming apparent across the whole economy reinforcing the investment aggregate, but the consumer remains quite challenged. Egypt's Gross Domestic Product registered a strong real growth of 4.2% during 2017, as a result of the growth in several sectors, including communication, tourism and manufacturing and supported by the gradual implementation of business climate reforms and improved competitiveness.

At the monetary level, FX reserves increased significantly over the past year to reach US$ 37.0 billion in December, their highest level on record. As such, Egypt's reserves have now risen by US$ 17 billion since it began its IMF-backed reform program mid last year. The exchange market mirrored the improvement in the economy, as the Egyptian pound slightly appreciated against the US$ to reach 17.80 LE/US$ today as compared to LE 18.12 end-December 2016. The main challenge remains inflation, with headline inflation remaining high by year-end. Egypt's core inflation rose by a yearly 19.9% up to December following fuel and energy subsidy cuts as part of the IMF-backed reforms.

A net improvement in the external sector is indeed being reported. Tourist arrivals jumped by 54.7% in the first eleven months of 2017 from a year earlier, as announced by the Ministry of Tourism, marking the sector's revival from its sharp contraction since 2011. The current account deficit recorded its lowest deficit since 2014 on the back of higher exports, declining non-oil imports and recovering receipts from tourism and workers' remittances. Egypt's current account recorded in the FY 2016/17 (Jul-Jun) fiscal year a deficit of US$ 15.6 billion down from US$ 19.8 billion a year before. Having said that, the latest external data continue to show significant positive gains, Egypt's shortfall is still large and the adjustment still has some way to go. The trade deficit remains high at 10% of GDP. The challenge for Egypt going forward will be to continue growing its more sustainable sources of foreign inflows, particularly FDI and tourism receipts.

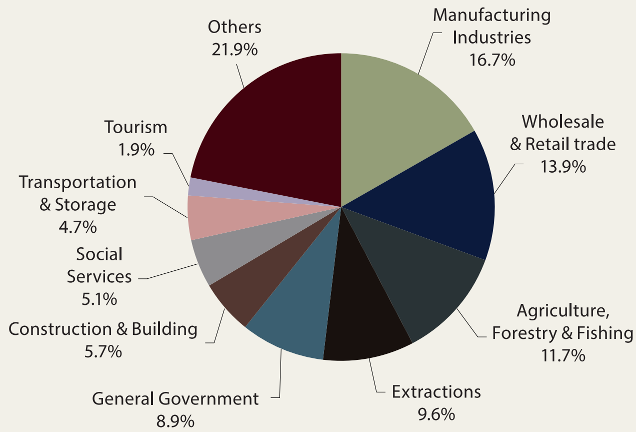
At the fiscal level, Egypt has reported a relative improvement in 2017, with fiscal deficit retreating from 12.5% of GDP in 2016 to 10.9% of GDP in 2017. Egypt has started its new fiscal year in July with the passing of an ambitious budget that plans to reduce the deficit to around 9% of GDP in 2017/18. The budget, if achieved, would give the government its first single-digit deficit in seven years, and first primary surplus in 11 years.

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2017)



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

Capital markets mirrored to a large extent the improving economy. At the stock market level, the stock market index reported a rise in prices of 21.7% over the year amid a recovering economy, favorable corporate financial results and opportunistic buying. At the fixed income market's level, Egypt's CDS spreads reported a yearly contraction of 134 bps to reach a sound level of 316 bps by year-end 2017.

Within this environment, banking activity continues to show resilience. Over the first ten months of 2017, bank assets grew by 21% when expressed in Egyptian pounds, while deposits grew by 17% over the period. In parallel, bank loans to the private sector grew by 7% over the period. Given the stability of the exchange rate over the period, banking aggregates growth rates in US$ terms are almost the same as those in the Egyptian pound. The growth in banking aggregates is not recorded at the detriment of financial standing, as financial soundness indicators continue to show solid performance at the level of liquidity, capital adequacy, asset quality 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 near term macro outlook looking forward.

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture

Slight downtick in the activity of the primary sector in line with a number of challenges

The primary sector remained the third largest contributor to the Egypt's GDP with a share of 11.7% in FY 2017, edging marginally down from 11.9% registered in the previous year. It maintained its pace of activity by growing at a rate of 3.2% in FY 2017.

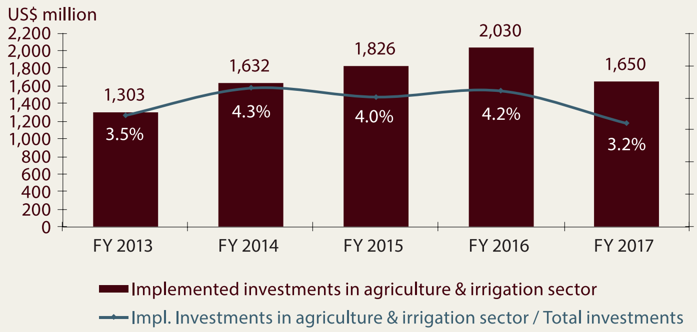
In parallel, the bank loans to the sector accounted for a mere 1.0% of the total bank loans at end-October 2017, down from 1.4% at end-October 2016. Egypt's implemented investments in the agriculture and irrigation sectors declined by 18.7% from US$ 2.0 billion in FY 2016 to US$ 1.7 billion in FY 2017. The falling trend took over the share of implemented investments in agriculture and irrigation in total investments as well, which declined from 4.2% in 2016 to 3.2% in 2017.

In a detailed look at the crops, wheat production registered 8.1 million tons in 2017, unchanged from its 2016 level, following a decrease of 2.4% posted in 2016. Corn production was also constant in 2017. It stood at 6.0 million tons in 2017. This came after a growth of 0.7% registered in 2016. As for the rice production, this stood at 4.8 million tons in 2017, a yearly increase of 20%. However, rice production will remain under pressure due to a shortage of available land and a desperate government bid to conserve water. Sugar production rose by a yearly 6.8% to 2.3 million tons in 2017. Sugar production will strengthen modestly as the government is keen to expand sugar output and reduce import dependency in the country.

The sector faced a number of challenges as farmers refused to sell rice to the government for the mandated price of LE 2,400, referring it to the low price. In this sense, the government would import rice to meet local demand.

The Egyptian agricultural sector continued to faces the threat of prolonged droughts and diminishing water supply for irrigation purposes, a challenge that looms large on the long-term horizon. Following the increased water efficiency method is of importance to the survival of the Egyptian agricultural sector and new methods of using mechanized raised beds are proving to be essential. It is worth noting that raised bed farming technology appears promising as it can save up to 75% of water compared to traditional irrigation techniques, along with providing the added benefit of reduced farming costs and promoting higher yields.

IMPLEMENTED INVESTMENTS IN AGRICULTURE & IRRIGATION SECTOR



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

In sum, the agricultural sector maintained its position as one of the biggest contributors to the country's GDP, with a nearly unchanged real growth, despite the numerous challenges facing the sector in terms of natural and environmental factors or other strategic performances.

1.1.2. Industry

Egypt's manufacturing and extractive industries witness robust recovery

In FY 2017, Egypt's manufacturing and extractive industries witnessed a robust recovery. Despite economic pressures impacting the business environment with high inflation rates dominating the scene, the country's extractive and manufacturing industries still managed to grow.

To begin with, Egypt's manufacturing industries maintained a positive growth trajectory over the previous six fiscal years. Manufacturing industries expanded by 2.1% in the past fiscal year relative to 0.8% in FY 2016. Manufacturing industries consist of petroleum refining and other manufacturing sub-sectors. Egypt's petroleum industries contracted by 3.1% in FY 2017, compared to a growth of 2.5% in the previous fiscal year. Other manufacturing industries posted an increase of 3.7% in FY 2017, compared to a 0.2% rise in FY 2016.

Egypt's extractive industries mildly contracted by 1.8% in FY 2017 compared to a 5.3% drop in the previous fiscal year. It is worth noting that extractive industries comprise petroleum industries, gas industries, and other extractions. Petroleum industries witnessed a negative growth of 6.5% in FY 2017 against a 1.5% contraction in FY 2016. On the other hand, gas industries saw a recovery, expanding by 2.1% in the past fiscal year relative to an 11.0% contraction in the previous fiscal year. Other extractions, the third sub-sector of extractive industries, grew by 3.4% in the past fiscal year against a 3.3% growth in FY 2016.

Moving on to implemented investments, Egypt's crude oil, natural gas and other manufacturing industries were on a positive trend in FY 2017. In fact, implemented investments in crude oil projects strongly increased by 123.7% in the past fiscal year, compared to an expansion of 83.0% in FY 2016. Similarly, implemented investments in natural gas expanded by 56.2% in FY 2017, adding to an expansion of 33% in the previous fiscal year. Other manufacturing industries contracted by 0.5% in the past fiscal year.

The main constraint on the growth of the industrial sector was high inflation, which dampened consumer sentiment. Nevertheless, inflation has gradually eased since the devaluation of the Egyptian pound, despite remaining at high levels, and this is expected to provide a much-needed boost to business sentiment and help attract foreign investors.

The country's weak exchange rate also put raw materials importing firms under pressure. But Egyptian companies could take advantage of the weak exchange rate environment as they can outperform international firms, since 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 government continued its support to the industrial sector by investing into industrial projects as a means of broadening the country's economic base. The country's Ministry of Petroleum plans to invest US$ 6.8 billion for the construction of a petrochemical complex near Ain Sokhna Port in Suez Governorate. Also, the Egyptian cabinet also recently approved a draft law to establish an authority for the Upper Egypt Development, with the latter taking the lion's share of the industrial development in various fields under the current administration. The government's investments in northern Upper Egypt reached LE 6.9 billion during the current fiscal year 2017/18. In parallel, the country plans to develop 11 projects in natural gas fields with investments amounting to US$ 17.5 billion, with the projects expected to produce 1.9 billion cubic feet of gas per day and 50,000 barrels of condensates between 2018 and 2023.

Last but not least, with inflation expected to ease, consumer and investment sentiment is expected to improve and the latter would have positive spillover effects on Egypt's industrial sectors. The country's extractive and manufacturing industries would also benefit from the government's notable initiatives and industrial investment projects in the near future.

1.1.3. Construction

Construction & building sector witnessing solid performances in the past fiscal year

The Egyptian construction and building sector witnessed solid performances in FY 2017, contributing to 5.7% of Egypt's GDP. The sector grew by 9.5% in the past fiscal year, against a growth rate of 11.2% in FY 2016.

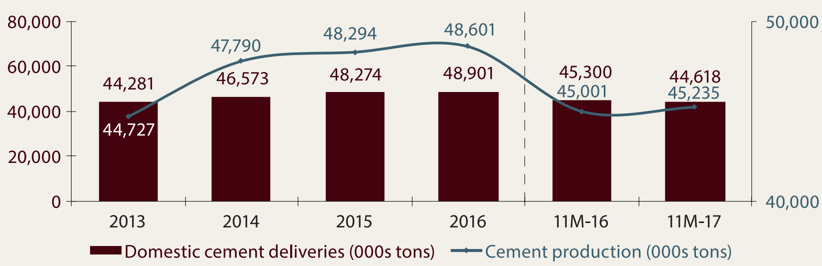
Moreover, the value of investments in the country's construction sector was on an expansionary trend, rising by 8.6%, in local currency terms, to attain LE 12.7 billion in FY 2017, following a rise of 198.6% in FY 2016, as per Central Bank data. The share of investment in construction out of total investments in Egypt stood at 2.3% in FY 2017.

Also, the lion's share of investments in Egypt's construction sector came from the private sector, with its share out of total investment rising to 90.7% in the past fiscal year from 60.0% in FY 2016.

It is worth noting that several developments took place in 2017 that benefited Egypt's construction industry. One of these developments was the approval of executive regulations for the country's new investment law. The new law, which would simplify procedures for businesses and introduce various tax incentives, would support a pick-up in fixed investment in the country and have a positive impact on the construction sector.

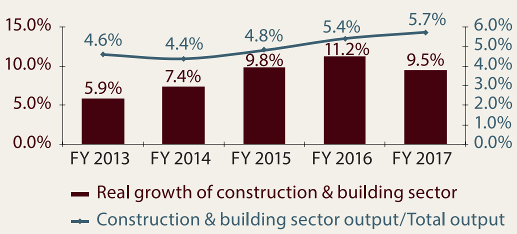
Furthermore, multilateral development agencies played a crucial role in promoting infrastructure investment in the country. A consortium led by the International Finance Corporation (IFC) completed a US$ 653 million debt package to fund the construction of 13 solar power plants, generating up to 752 MW of power, near Aswan. The funding would support six groups of private power firms to build and operate the plants.

CEMENT PRODUCTION AND DELIVERIES



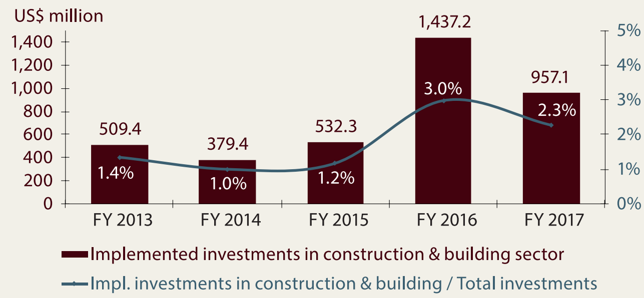
Sources: Central Bank of Egypt, Bank Audi's Group Research Department

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

Additionally, the recent IMF agreement, which would disburse US$ 12 billion over the next three years, would help keep vital infrastructure projects afloat. Egypt would also be able to rely upon a Public Private Partnership model in attracting private capital into its infrastructure market, with the latter rendered more attractive on a relative basis by the continued weakness of the pound.

It is expected that a young and increasingly urban population ensures robust demand for additional housing projects. In order to meet this demand, the Prime Minister unveiled plans for a US$ 1.58 billion project to develop the Sinai, Portsaid, Ismailia and Suez governorates in the country. The Sinai Development Authority, together with the Ministry of Housing, plans to build 5,000 houses.

In conclusion, Egypt's construction industry is expected to be one of the best performing markets in the near future. The sector's growth would be broadbased, with the country's non-residential building and power segments to outperform on the back of economic diversification efforts and robust structural demand.

1.1.4. Tourism

Tourism recovers from the downturn encountered in the previous year

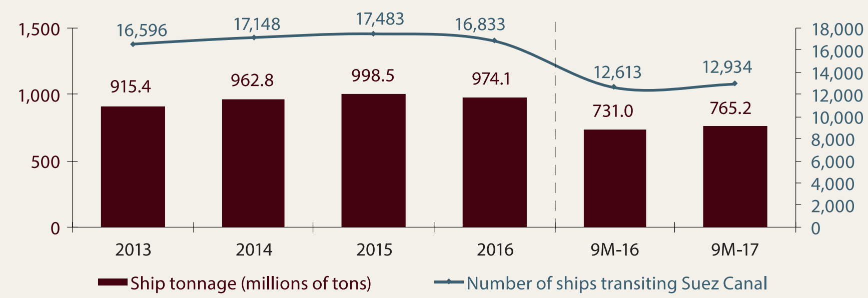
Following a downturn in 2016, the past year encountered a significant increase in tourist arrivals in addition to the number of tourist nights. Egypt actually remains a touristic hub for tourists from different source markets across Europe, Africa, Middle East and North America.

In a look at the numbers, tourist arrivals registered an increase of 54.5% year-on-year, from 4.3 million in the first ten months of 2016 to 6.7 million in the corresponding period of 2017. Moreover, the number of tourist nights improved as well from 26.0 million in the first ten months of 2016 to 68.0 million in the same period of 2017.

In details, tourists from European countries ranked first within all tourists with 55.1% in the first ten months of 2017. Tourists from the Middle East got a share of 24.7% in the same period of 2017. African tourists took over a share of 8.0% in the first ten months of 2017. Asia and the Pacific took over a share of 7.6% and the share of the Americas was 4.3%.

Looking at the performance of four and five stars hotels, the 11M2017 hotel benchmark survey issued by Ernst & Young showed that the hospitality sector in Cairo adopted a positive path whereby hotel occupancy rose by 5.1% from 63.1% in 11M2016 to 68.2% in the same period of 2017. 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 75.0% to stand at US$ 84 in 11M2017 and the latter increasing by 87.1% year-on-year to register US$ 58 in 11M2017. This comes along to highlight the importance of the capital as a touristic destination, in addition to other touristic areas in the country.

EVOLUTION OF SUEZ CANAL ACTIVITY



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

It is worth noting that Egypt's tourism infrastructure is well developed, particularly with regards to hotels, in established tourism destinations. The increase in the flow of tourists, the performance of hotels, the support of the government to the sector and the variety of holiday options, from beach holidays through to cultural and wildlife tourism strengthen the position of the sector and make it a significant contributor to the country's economy.

1.2. EXTERNAL SECTOR

Current account deficit cut by half over the first nine months of 2017

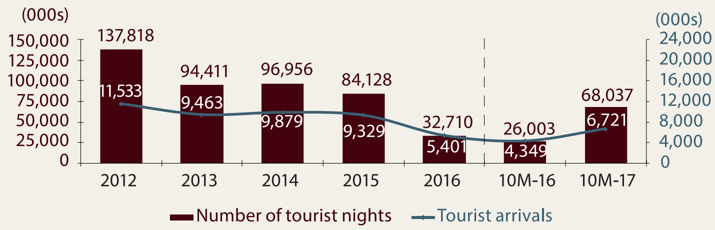
Egypt's external position has witnessed a relative improvement in 2017 when compared to the previous year's performance, as the current account deficit has been cut by half, from a deficit of US$ 15.2 billion in the first nine months of 2016 to a deficit of US$ 7.6 billion in the first nine months of 2017, mainly on the back of a surge in services balance and a decline in trade deficit supported by a contraction in non-oil imports within the context of a weak Egyptian pound against the US dollar and improved export competitiveness.

In details, Egypt's foreign trade activity showed a tiny rise in total imports by 1.2% alongside a 15.1% rise in exports during the first nine months of 2017 compared to the same period of 2016, contributing to a 6.1% decrease in the foreign trade deficit, according to the Central Bank of Egypt. In fact, Egypt's trade deficit contracted from US$ 28.2 billion during the first nine months of 2016 to US$ 26.5 billion during the same period of 2017. As such, Egypt's foreign trade activity posted a net rise in terms of volume, as the sum of exports and imports went up by 4.8% moving from US$ 57.9 billion to US$ 60.7 billion during the same period. Subsequently, the exports to imports coverage ratio rose from 34.5% to 39.2%.

In parallel, total imports reached US$ 43.6 billion during the first nine months of 2017, compared to US$ 43.1 billion during the first nine months of 2016, yet non-oil imports (representing 80% of total imports) witnessed a drop of 4.8% within the context of a sharp depreciation in exchange rate during the same period. As such, the breakdown of imports by product suggests that the most significant decline among the major categories was reported by imports of consumer goods with a decline of 15.2% year-on-year to make up 20.9% of total imports during the first nine months of 2017 (from 24.9% over the same period of 2016). The breakdown of imports by geographic distribution shows that most of the inward merchandise during the first nine months of 2017 came from the European Union with 27.7% of the total, followed by Asian countries (excluding Arab countries) with 18.5% of the total, and Arab countries with 12.8% of the total.

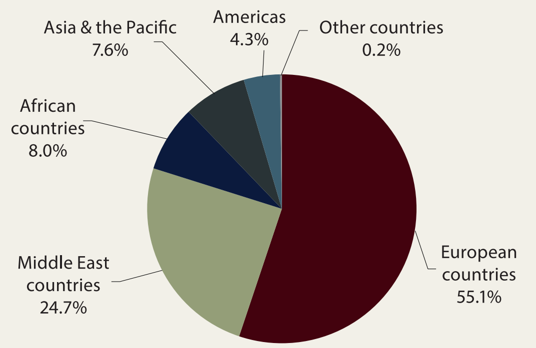
At the level of exports, a total of US$ 17.1 billion was registered during the first nine months 2017, compared to US$ 14.8 billion during the same period of 2016, on the back of the currency depreciation by 108% during the same period, which has strengthened external competitiveness and therefore

EVOLUTION OF TOURISM ACTIVITY



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

TOURISTS BREAKDOWN BY REGION (10M-17)



Sources: *Central Bank of Egypt, Bank Audi's Group Research Department* supported exports. In parallel, the breakdown of exports by product suggests that the most significant increase among the major categories was reported by fuel and mineral oils with a rise of 32.8% year-on-year to make up 32.6% of total exports during the first nine months of 2017 (from 28.2% over the same period of 2016). The geographic distribution of exports indicates that 35.2% of total exports went to the European Union, followed by the Arab countries with 25.9% of the total, and Asian countries (excluding Arab countries) with 9.3%.

Within this context, the current account deficit narrowed by 50.4% during the first nine months of 2017 relative to the same period of 2016. This drop in the current account deficit was mainly attributed to a significant hike in services balance from US$ 3.3 billion to US$ 7.2 billion over the same period, supported by a surge in tourism receipts from US$ 1.8 billion to US$ 5.5 billion, on the back of a tangible recovery in tourism activity from its sharp contraction since 2011. In addition, current transfers went up by 20.0% as a result of a 19.2% rise in remittances from Egyptian workers abroad to their homeland. In parallel, the capital and financial account has declined by 20.7% during the first nine months of 2016, moving down from US$ 22.3 billion to US$ 17.6 billion, which is attributed to a sharp drop in other investments account from a surplus of US$ 17.2 billion to a deficit of US$ 10.7 billion. Accordingly, Egypt's balance of payments registered a significant surplus of US$ 11.8 billion in the first nine months 2017, compared to a smaller surplus of US$ 2.5 billion during the previous year's corresponding period.

1.3. PUBLIC SECTOR

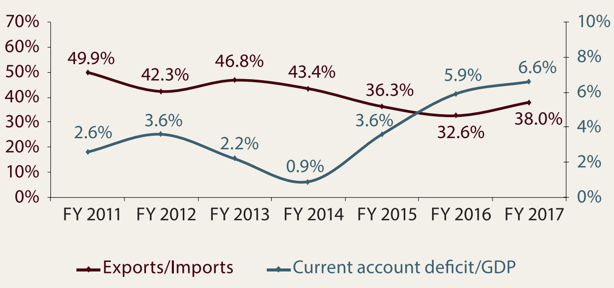
Narrowing fiscal deficit ratio on the back of a firm commitment to fiscal reforms

The fiscal position has benefitted from a firm commitment by the government to fiscal reforms under the IMF program, such as the introduction of the value-added tax, subsidy reforms, and government wage reforms. As such, the general government fiscal deficit reached 10.9% of GDP in FY 2017, compared with 12.5% in FY 2016.

In details, total budget revenues went up by a solid 34.1% in local currency terms during FY 2017 as compared with FY 2016, to reach LE 659 billion or 19.0% of GDP, according to preliminary actual figures issued by the IMF. The significant rise in budget revenues was due to a hike in tax revenues by 31.1%, boosted by tax policy reforms mainly through the introduction of the VAT and better tax administration. In parallel, non-tax revenues grew by 32.4% during FY 2017 relative to FY 2016.

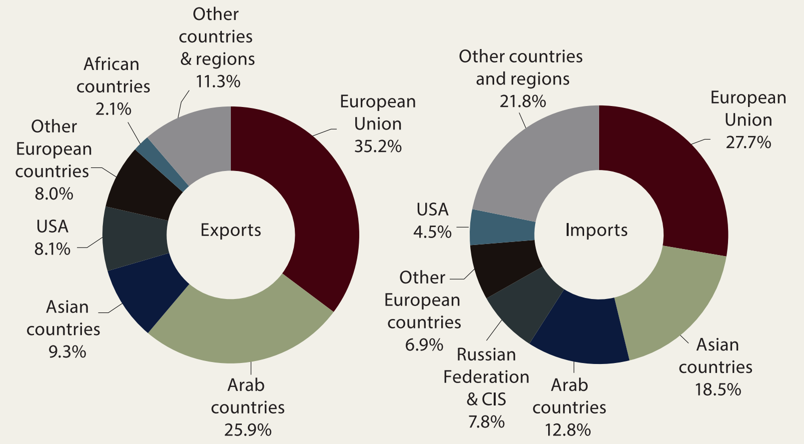
With regards to total budget expenditures, they were up by 26.2% in local currency terms during FY 2017 relative to FY 2016, to reach LE 1,032 billion or 29.7% of GDP. The rise in public expenditures was to a significant extent the result of an increase in interest payments on external and domestic debt by 30.0% (representing 30.7% of total expenditures) on the back of higher borrowing costs within the context of the

FOREIGN SECTOR INDICATORS



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

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (9M 2017)



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

CBE's policy rate hikes. In addition, subsidies, grants and social benefits increased significantly by 37.7%, as the fuel subsidy bill has also increased over the last year, owing to the larger currency depreciation and higher oil prices. In parallel, workers' wages and compensations grew by a moderate 5.5% (compared to a 6.4% rise in FY 2016). As such, this resulted into a moderate expansion in the overall deficit in local currency terms of 11.8% in FY 2017, to reach the equivalent of LE 380 billion and accounting for 10.9% of GDP in FY 2017, down from 12.5% of GDP in FY 2016 given the government initiatives toward fiscal consolidation.

Accordingly, Egypt's gross domestic debt rose by 20.6% in local currency terms in FY 2017 following a 23.8% expansion in FY 2016, to reach the equivalent of LE 3,161 billion at end-June 2017. This was mainly triggered by a 32.0% growth in the balances of bonds and bills, within the context of sovereign debt sale aiming at funding the country's fiscal deficit. As such, the gross domestic debt to GDP went down from 96.7% as at end-June 2016 to 91.1% as at end-June 2017, as per the Central Bank of Egypt. In parallel, the external debt almost doubled to 33.6% of GDP in FY 2017 from 16.6% the year before, to reach US$ 79.0 billion at end-June 2017, as the government resorted to borrowing in an effort to provide the necessary liquidity for its current expenditures and to increase foreign exchange reserves which was largely the result of debt-creating inflows.

Last but not least, Egypt's Parliament passed the State budget for the FY 2018 with a budget deficit target of 9.0% of GDP (from 10.9% in FY 2017). Total revenues are expected to reach LE 835 billion (up from LE 659 billion in FY 2017), as tax revenues are expected to reach LE 604 billion (up from LE 462 billion) and other revenues will amount to LE 230 billion (up from LE 180 billion). Total expenditures in the FY 2018 budget are expected to reach LE 1,207 billion compared to the LE 1,032 billion in FY 2017, as a result of the currency floatation, the rise in oil prices, and the increase in the cost of debt and interest on government loans raising the burden of the debt service. Within this context, the authorities' fiscal consolidation path aims to improve the primary balance by about 4% of GDP over the next two years (from a realised deficit of 1.8% of GDP in FY 2017 and a budgeted deficit of 0.2% in FY 2018), which, in combination with strong growth in nominal GDP, would reduce general government debt to 87% of GDP in FY 2019.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

FX reserves at record high level amid improving fundamentals

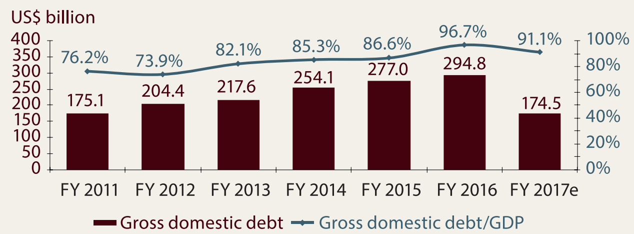
Following the November 2016 currency floatation, Egypt's monetary conditions were marked by rising inflationary pressures that started recently to moderate due to base effects, while the Egyptian Pound has shown very modest appreciation following devaluation. Within this context, monetary authorities maintained a tight monetary policy throughout the year, before cutting rates by 100 bps in February 2018 as inflation eased. The Central Bank of Egypt, which benefited from strong inflows tied to improving fundamentals and the US$ 12 billion loan accord with the IMF, was able to replenish its FX reserves to reach currently a historical high level.

SELECTED PUBLIC FINANCE INDICATORS

LE billion	FY 2013	FY 2014	FY 2015	FY 2016	Prel. FY 2017
Total budget revenues	350.3	456.8	465.2	491.5	659.2
Total budget revenues/GDP	18.8%	21.4%	19.0%	18.1%	19.0%
Total budget expenditures	588.2	701.5	733.4	817.8	1,031.9
Total budget expenditures/GDP	31.6%	32.9%	30.0%	30.2%	29.7%
Overall budget deficit	239.7	255.4	279.4	339.5	379.6
Overall budget deficit/GDP	12.9%	12.0%	11.4%	12.5%	10.9%

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

GOVERNMENT INDEBTEDNESS



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

In details, inflation peaked at 33.0% in July 2017, reflecting the pass-through from the devaluation of the Egyptian pound on November 3, 2016, the subsidy cuts and the increased VAT rate. However, annual inflation receded to 21.9% in December 2017, mainly as the initial inflation spike from the November 2016 devaluation fell out of the series. Within this context, it is worth mentioning that the Central Bank of Egypt announced for the first time in May 2017 an inflation target of 13% by the fourth quarter of fiscal year 2018 and single digits thereafter.

With the purpose of containing the inflationary impact of the currency devaluation, the Central Bank of Egypt maintained a tight monetary policy in FY 2017 and during the first half of FY 2018, while signalling in December 2017 that it "will only reconsider its stance conditional upon data confirming the moderation of underlying inflationary pressures". Within this context, the CBE raised each of the overnight deposit rate, the overnight lending rate and the rate of CBE's main operation by 500 bps in FY 2017 and by an additional 200 bps during the first half of FY 2018 to reach 18.75% and 19.75% and 19.25% respectively at end-December 2017. In February 2018, the Central Bank lowered those rates by 100 bps to 17.75%, 18.75% and 18.25% respectively.

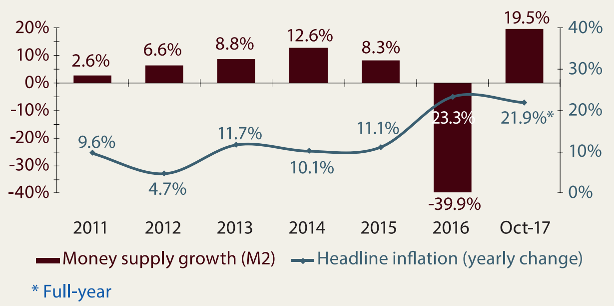
The exchange market mirrored the improvement in the economy, as the Egyptian pound slightly appreciated by 2.0% against the US dollar during the first half of FY 2018 to reach LE/US$ 17.80 at end-December 2017 as compared to LE/US$ 18.12 at end-June 2017 and end-December 2016. Within this context, it is worth mentioning that since June 2017, the CBE has not intervened in the FX market directly. However, it has supplied foreign exchange at market exchange rates to State-owned enterprises and portfolio investors through the repatriation mechanism, which guarantees the availability of FX for repatriation to investors that choose to sell FX to the CBE at the time of entry at prevailing exchange rates. The repatriation mechanism has diverted FX liquidity from the interbank market and prevented the appreciation of the currency in response to portfolio inflows.

The floatation of the exchange rate regime and the interest rate differential against major funding currencies have attracted healthy portfolio inflows, and the Central Bank was able to build up reserves. Accordingly, the CBE's gross official reserves reached a record high level of US$ 37.0 billion at end-December 2017, covering 27.0% of local currency money supply. This compared to a lower coverage ratio of 22.1% at end-December 2016.

The broader money supply (M2) expanded significantly by 19.5% in US$ terms during the first ten months of 2017, moving up from US$ 146.2 billion at end-2016 to US$ 174.8 billion at end-October 2017 amid rising capital inflows. This followed a large contraction of 39.9% in 2016. Money supply in its narrow sense (M1) widened in US$ terms by 18.8% during the first ten months of 2017, following a large contraction of 48.0% in 2016, to hit US$ 41.0 billion at end-October 2017.

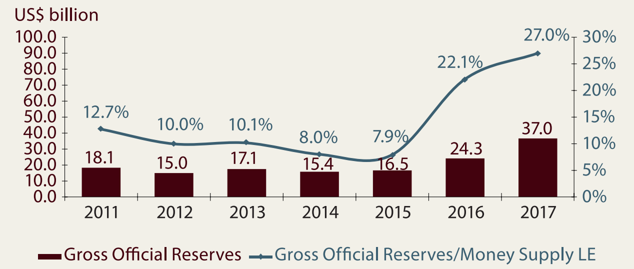
Looking forward, inflation is expected to gradually continue to decline from its July peak, as second-round effects from the depreciation of the pound and fuel price and VAT rate hikes appear to be contained, as per the IMF. Within this context, the Fund recommends a gradual easing of policy interest rates only once the monetary authorities are confident that demand pressures and inflation expectations remain contained, while warning against any premature monetary easing.

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

1.4.2. Banking Activity

Weathering the currency depreciation spillovers rather well and boasting solid financial standing

Egypt's banking sector witnessed strong performances in the year 2017, despite the currency depreciation repercussions and ensuing uncertainties. The growth of major banking activity indicators came as Egypt renewed with positive economic activity momentum post political/security situation stabilization and IMF program implementation boosting economic prospects and confidence across the board. Measured by the aggregated assets of banks operating in Egypt, banking sector activity grew by a noticeable 21.0% in the first ten months of 2017 as per the latest Central Bank statistics available (+24.1% in US dollar terms given the slight FX appreciation over the covered period) to reach the equivalent of US$ 271.4 billion at end-October 2017.

A quick glance at banks' balance sheets shows that the bulk of activity growth over the first ten months of 2017 stems from the core retail deposit base. As a matter of fact, banks have high levels of retail customer deposits accounting for two thirds of total deposits which in turn account for two thirds of total balance sheets. Increased confidence and higher inflows (notably remittance inflows) into the country along with improving macroeconomic activity, financial inclusion progress and high interest rates mostly explain higher deposit levels at banks in Egypt. Total deposits actually grew by 16.6% in local currency terms to reach the equivalent of US$ 182.2 billion at end-October 2017, with the growth in volume accounting for more than half of total balance sheet growth in the first ten months.

Government deposit growth accounted for 10% of total deposit growth, leaving the bulk to the private sector. In currency terms, foreign currency deposits contracted but only due to lower FC deposits on behalf of the government, leading the deposit dollarization ratio to decline from 31.2% at end-December 2016 to 24.2% at end-October 2017.

In parallel, government-owned banks have increased their market funding in the past couple of years, and this is showing in aggregated balance sheets, yet noting that this funding is mainly secured from regional/multilateral development banks and thus associated with lower refinancing risks.

On the asset utilization side, part of the additional liquidity at hand was channeled unto lending to the economy, with credit facilities extended by banks growing by 10.2% between December 2016 and October 2017 to reach the equivalent of US$ 81.1 billion. Around 45% of this growth in volume is owed to more money lent to the government amidst the development of infrastructure projects, with a slight advantage to lending in local currency to the government, while the remainder went to the private sector. More specifically, lending to the private sector in foreign currencies retreated by 14.5% while loans in Egyptian pounds rose by 21.0% in the first ten months of 2017 (mostly to the services sector, followed by industry and retail sectors). As such, loan dollarization also went down from 43.6% at end-December 2016 to 37.4% at end-October 2017.

The Egyptian authorities pursued their supportive policies towards the private sector when it comes to lending, as they recently extended their initiative to support the tourism sector and workers in the tourism sector through retail loans until end-December 2018. The Central Bank also complemented its initiative to support financing to MSMEs and which included requiring banks to allocate 20% of their total lending portfolios to financing such companies until end-2020. In fact, it agreed late in 2017 to issue a LE 2 billion guarantee to the credit guarantee company (CGC) for the latter to issue guarantees to banks to cover part of the risks associated with lending to such companies.

While lending activity progressed last year, the bulk of balance sheet growth on the asset side could be attributed to banks increasing their liquidity levels and parking more funds at banks in Egypt and abroad. As a matter of fact, the increase in deposits at banks domestically and abroad accounted for slightly more than 60% of total balance sheet growth. As such, while banks deployed some excess liquidity to provide loans, they strived to maintain and actually reinforce their solid liquidity buffers. Egyptian banks have increased access to the hard currency and thus reduced their net foreign liability position by augmenting their dollar liquidity placed outside the country.

The banking sector's liquidity coverage ratio (LCR) is higher than 200% for both local currency and foreign currencies and thus way above the 80% regulatory minimum for 2017 which is expected to rise to 100% by 2019. The LCR is particularly high in the local currency where most of banks' investments in government bonds are held, noting that a good chunk of the latter is in short-dated Tbs. In parallel, the net stable funding ratio (NSFR) is also high at more than 200% on aggregate at end-September as per the latest Central Bank data.

As mentioned here above, Egyptian banks invested massively in recent years in government papers to fund the budget deficit and as yields on debt papers remain lucrative. Banks' investments in government sector securities accounted for 31% of their total balance sheets and more than 4x their capital and reserves, thus shedding light on their high exposure to sovereign risk. On a more positive note, such holdings have slightly retreated during 10M2017 (-1.1%) owing to less investments in foreign currency papers and a slight uptick in investments in local currency papers.

Asset quality metrics were not that affected by currency depreciation due to regulations prohibiting lending in foreign currencies to borrowers who do not have sufficient FX revenues, noting that loan books remain broadly diversified by sectors (notwithstanding increasing sovereign exposure) and that some corporates operating in Egypt are benefiting from government initiatives to help the tourism sector and importers. The NPLs/total loans ratio reached 5.3% at end-September 2017 and 5.8% at end-December 2016, remaining slightly below emerging market and international averages. Loan provisioning covers almost all NPLs (coverage ratio at 98.8%), buffering banking institutions against potential losses.

Furthermore, the IMF recently stressed that in the absence of new shocks, lending quality is expected to remain sound. This is owed to: CBE restrictions on FX lending to borrowers without sufficient FX revenues; the cash collateral requirement for import-linked trade finance lending in the same currency; banks' focus on multinational corporates, local blue chips and wealthy retail clients; the relatively low debt levels of Egyptian corporates and households; resilient revenues of large corporate borrowers in most sectors; and the generally favorable growth outlook.

Egyptian banks benefit from adequate capitalization ratios providing them with buffers against potential pressures on their capital base. The sector's aggregate capital adequacy ratio strengthened further to reach 14.7% at end-September 2017, against 14.1% at end-December 2016, following the regulator's decision to allow banks to include current-year profits in the capital adequacy ratio calculation and prohibit dividend payment for all banks. More than 80% of capital is common Tier 1 capital. The IMF lately said that the banking sector is resilient to moderate shocks, with a bank-by-bank assessment suggesting that capital and operating profits are sufficient to absorb potential loan impairments.

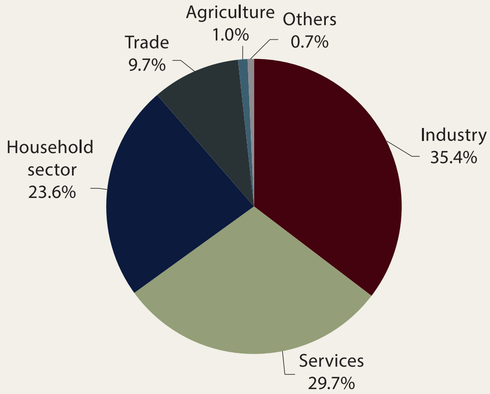
Last but not least, banks operating in Egypt have been able to derive healthy income from the government's need to borrow funds. Despite a small drop in the high net interest margins, this along

BANKING SECTOR INDICATORS

US$ million	2012	2013	2014	2015	2016	Oct-17
Banking Activity						
Assets	226,556	242,209	275,375	317,393	218,738	271,415
Deposits	171,486	189,242	218,210	244,484	152,411	182,165
Credit Facilities	81,248	79,134	88,028	101,073	71,773	81,116
Capital + Reserves	15,834	16,296	17,174	18,033	13,985	17,847
Growth rates						
Assets	4.5%	6.9%	13.7%	15.3%	-31.1%	24.1%
Deposits	4.6%	10.4%	15.3%	12.0%	-37.7%	19.5%
Credit Facilities	0.1%	-2.6%	11.2%	14.8%	-29.0%	13.0%
Capital + Reserves	17.0%	2.9%	5.4%	5.0%	-22.4%	27.6%

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

BANK CREDIT FACILITIES BY ECONOMIC ACTIVITY*



* As at end-October 2017

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

with fees and commissions and a positive quantity-effect owing to growing lending activity managed to support pre-provision income of banks. In the absence of recent consolidated sector statistics, we resorted to the aggregation of Egyptian banks' results based on Bureau Van Dijk data which show a 38.5% yearly rise in aggregated net profits in local currency terms for the first nine months of 2017 for 15 banks that published 9M2017 results.

1.4.3. Equity and Bond Markets

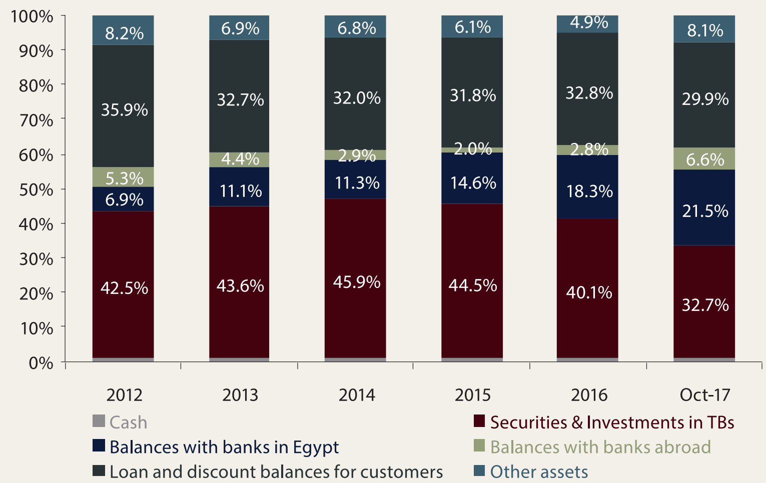
Strong price gains in Egypt's capital markets for the second consecutive year

Egyptian capital markets were at the mirror image of the improving domestic economy in 2017. The Egyptian Exchange continued to report double-digit price gains amid a strong activity skewed to the buy side, mainly supported by increased investor confidence and rising capital inflows following the implementation of economic reforms, the liberalization of the exchange regime and the stabilization of the Egyptian Pound. Also, the fixed income market registered healthy price increases for the second consecutive year, and the cost of insuring debt continued to register significant contractions.

In details, the Egyptian Exchange saw a strong price rally in 2017 and was the best performer in the MENA region. This was mainly driven by several favourable market-specific factors. First, foreign funds showed an increased appetite to add the Egyptian stocks to their holdings in order to benefit from a weak Egyptian Pound following the liberalization of the exchange regime on November 3, 2016. This was reflected by a 27% jump in in the number of new foreign institutions and funds entering the market over the year. Second, Egypt showed signs of economic recovery in 2017. In fact, GDP growth recorded a solid 4.2% in FY 2017, and is projected to strengthen further to 4.8% in FY 2018, as per the IMF. Third, Egypt issued in 2017 a long-delayed investment law aimed at easing doing business and creating incentives to lure back investors after years of turmoil.

That being said, the bourse main benchmark index (EGX 30) reached a record high level of 15,019 at end-2017, surging by 21.7% relative to end-2016. The breakdown of the index by sector shows that all sectors posted price gains in 2017. The personal and household products sector led the advance, surging by 116%, followed by the chemicals sector (+84%), the travel and leisure sector (+79%), the healthcare and pharmaceuticals sector (+77%), the industrial goods, services and automobiles sector (+68%), the food and beverage sector (+62%), the basic resources sector (+43%), the construction and material sector (+31%), the real estate sector (+17%), the banking sector (+11%), the financial services sector excluding banks (+9%), and the telecommunications sector (+3%).

BANKING SECTOR ASSET COMPOSITION



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

Alongside the significant rise in equity prices in 2017, the number of listed companies on the Egyptian Exchange stood unchanged at 222 at the end of the year, while 48 existing companies raised their capital by circa LE 10 billion, which marks a 100% surge when compared to capital increases recorded in the previous year. Accordingly, the average company size rose from LE 2,709 million in 2016 to LE 3,716 million in 2017, up by 37.2%. That being said, the market capitalization exceeded in 2017 the LE 800 billion threshold for the first time in nine years to reach LE 824.9 billion at the end of the year, up by 37.1% in local currency terms relative to end-2016, which is equivalent to LE 223 billion. As a result, the ratio of market capitalization to GDP increased from 25% at end-2016 to 30% at end-2017, according to the Egyptian Exchange.

On the back of improved investor sentiment, the total volume of traded shares surged from 68,559 million shares in 2016 to 77,946 million shares in 2017. The total number of transactions rose by 17.1%, moving from circa 6.0 million transactions in 2016 to circa 7.0 million transactions in 2017. Higher equity prices coupled with increased number of traded shares led to a rise in the total trading value from LE 284.5 billion in 2016 to LE 332.2 billion in 2017, moving up by 16.7%. The average daily trading value rose from LE 820 million in 2016 to LE 1,183 million in 2017, marking an increase of 44.3%.

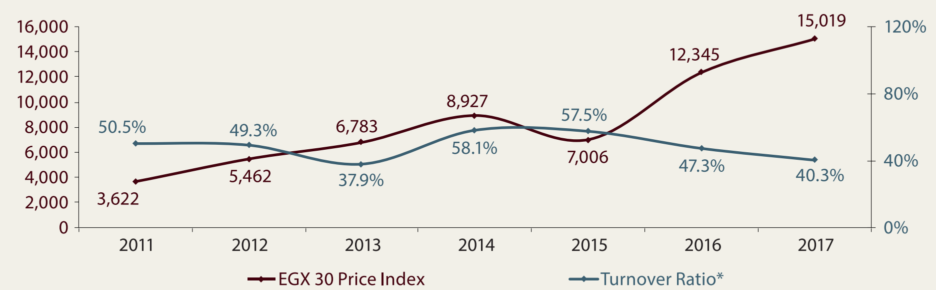
Individuals captured 65% of activity in 2017, while institutional investors accounted for the remaining 35%, noting that the latter were net buyers for the second consecutive year, recording net inflows of LE 4.6 billion in 2017 as compared to net inflows of LE 2 billion in 2016. Foreigners accounted for about 28% of the total value traded in 2017, of which 18% was captured by non-Arab foreign investors, while the

CAPITAL MARKETS INDICATORS

	2012	2013	2014	2015	2016	2017
Market capitalization (US$ billion)	59.0	61.4	69.9	54.9	33.2	46.4
Total value traded (US$ million)	30,473	23,555	41,044	32,091	30,389	18,640
Non-Arab foreign participation as % of total value traded	14.9%	14.3%	9.7%	11.1%	11.5%	17.7%
Total volume of traded securities (million)	34,261	29,190	57,230	45,078	68,559	77,946
Total number of transactions (000s)	6,234	4,790	7,328	4,875	6,008	7,034
No. of listed companies	213	212	214	221	222	222
No. of traded companies	204	204	206	209	209	213
% Change in price index (EGX 30)	50.8%	24.2%	31.6%	-21.5%	76.2%	21.7%
P/E ratio (times)	12.4	15.2	20.2	13.6	26.6	18.8
Dividend yield	8.6%	6.5%	9.3%	7.7%	9.0%	5.8%
CDS spreads (bps)	510	605	282	531	450	316

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

STOCK MARKET PERFORMANCE



* Denominated in Egyptian pounds

Sources: Egypt Stock Exchange, Bank Audi's Group Research Department remaining 10% was captured by Arab investors. Within this context, the turnover ratio, measured by total trading value to market capitalization in local currency terms, declined from 47.3% in 2016 to 40.3% in 2017.

In parallel, Egyptian sovereign debt papers continued to trace healthy price gains for the second consecutive year, with Z-spreads contracting significantly, mainly supported by strengthening growth alongside the implementation of ambitious economic reforms, a recovery in foreign reserves from low levels, and a revised outlook by Standard & Poor's.

In details, S&P Global Ratings revised in November 2017 its outlook on Egypt to "positive" from "stable" and affirmed the "B-/B" long-term and short-term foreign and local currency sovereign credit ratings. The positive outlook reflects, as per S&P, a potential upgrade in 2018 if Egypt continues to implement structural reforms to support investment and growth, if external weaknesses abate, and if further progress is made in improving the effectiveness of the monetary framework. S&P's long-term rating on Egypt remained at "B-", reflecting wide fiscal and external deficits, high public debt and low income levels, as per the credit rating agency.

Within this context, Egypt'20 closed up by 4.01 pts in 2017, recording a 227 bps contraction in Z-spreads. Prices of Egypt'25 rose by 10.63 pts in 2017, posting a 180 bps contraction in Z-spreads. Egypt'40 traded up by 14.34 pts, registering a 138 bps contraction in Z-spreads. Also, the US$ 4 billion triple-tranche US dollar-denominated bond issued late January 2017 registered decent price increases over the year. In details, the five-year US$ 1.75 billion notes maturing in January 2022 recorded price gains of 4.69 pts. The US$ 1 billion 10-year notes maturing in January 2027 were up by 10.81 pts. Prices of the US$ 1.25 billion 30-year securities rose by 14.54 pts over the year 2017.

Regarding new issues, Egypt raised mid-February 2018 US$ 4 billion through the sale of US$ 1.25 billion five-year notes at a yield of 5.58%, US$ 1.25 billion 10-year notes at 6.59%, and US$ 1.5 billion 30-year notes at 7.90%, noting that the order book size reached US$ 12 billion. The proceeds of the sale would be used to finance the budget deficit and bolster foreign reserves. Within this context, it is worth mentioning that Egypt would soon approach investment banks for a planned Euro-denominated bond issue. As to the cost of insuring debt, Egypt's five-year CDS spreads contracted by 136 bps in 2017 to reach 316 bps at end-December, and contracted further by 56 bps in January 2018 to reach 260 bps, in a sign of improved market perception of country risk.

2. CONCLUDING REMARKS

Looking ahead, Egypt is amid a multi-year rally, supported by broad structural reforms with multiple catalysts lying ahead, of which we mention the falling interest rates, some currency appreciation and recovery in real wages, continued recovery in tourism and growing gas output. Growth is expected to gain momentum, driven by a recovery in consumption and private investment and a continued positive contribution from net exports.

At the monetary level, there is a wide belief that difficult conditions – namely high inflation – will ease gradually from 2018 as Egypt adjusts to the new, more flexible currency regime. Inflation should start to ease from end-2017 as the base effect of the currency depreciation a year earlier starts to drop out of the calculation. Inflation will yet still remain somewhat high at double digits, forecasted at 11.7% in full-year 2018 as per the IMF, sustained by the impact of currency liberalization, continued supply bottlenecks, poor government supervision of markets, notwithstanding the recent imposition of the VAT and its subsequent rise.

Having said that, after a period of tightening to curb inflation, monetary policy should loosen gradually from 2018 in a bid to support economic growth and lending to the private sector. Despite macroeconomic improvements, the resulting greater stability of the domestic currency and dampened inflationary expectations will allow the Central Bank to ease monetary policy from 2018 which should decrease borrowing costs for the private and public sectors at large.

At the fiscal level, the economic reform program tailored with the International Monetary Fund will ensure progress in fiscal consolidation, although business related structural reforms will proceed slowly owing to opposition from vested interests within State bodies. The country's fiscal deficit is forecasted by the IMF at 7.3% of GDP in the year ahead.

At the external sector level, it is expected that the current account deficit would narrow further in 2018-2019, assuming a stable trade deficit in US dollar terms and further growth, albeit much more moderate, in tourism and remittances. Among factors helping the trade deficit is the impact of rising gas production on Egypt's hydrocarbons trade balance. The government estimates that Egypt will no longer need to import gas starting the second half of 2018, with full year impact set to be felt in 2019, given higher output from existing gas fields and the start of production at the giant Zohr gas field.

When assessing the near and medium term outlook of the Egyptian economy, we need to look at key strengths and underlying challenges at the horizon. Among key strengths, we mention the large and diversified economy, the external donor support that buffers the external payments position and the large domestic funding base for government debt. At the level of challenges, we mention the sizeable fiscal deficits, high public debt and very large financing requirements, the social pressures from high unemployment and high inflation and the susceptibility to political event risks. Having said that, we believe strengths outpace weaknesses and opportunities outpace threats at the horizon.

In its recent IMF Article IV Consultation report issued last month, the Fund commended the Central Bank for maintaining a prudent monetary policy stance, urging the Bank to remain vigilant and welcoming the intention to consider a gradual easing of policy interest rates once the authorities are confident that demand pressures and inflation expectations remain contained. The IMF finally advocates structural reforms to support private sector led growth, including the need to further improve Egypt's public finances, the need to build on recent efforts to better integrate women in the labor force, in addition to strengthening competition and addressing corruption in order to achieve greater economic efficiency 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@banqueaudi.com