

EGYPT ECONOMIC REPORT

GROWING HOPES FOR MACRO RECOVERY FOLLOWING TRANSITIONAL YEARS OF ECONOMIC SLUGGISHNESS

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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. Kansa
(961-1) 977470
fadi.kansa@banqueaudi.com

Sarah F. Borgi
(961-1) 964763
sarah.borgi@banqueaudi.com

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

- **A promising political changeover raising recovery hopes**
Egypt's second revolution in mid 2013 has opened a fresh chapter in the country's troubled political transition and resumed hopes for economic recovery after nearly three years of heavy losses. The grounds for optimism are easy to identify. The regime changeover has triggered the release of aid from Gulf states that had long been skeptical before. Recent developments have led international reference sources to strengthen their growth forecasts for Egypt though at a relatively moderate pace because of the disruptions in the manufacturing and tourism sectors. IMF expects growth to rise from 1.8% in 2013 to 2.8% in 2014 and to 4% thereafter.
- **Higher inflows foster improvement in external accounts**
Egypt's external accounts witnessed an overall improvement over the first nine months of 2013, as per the latest statistics of the Central Bank. Exports increased over the period while imports slightly contracted, and the subsequent improvement at the level of the trade balance was coupled with higher official transfers to the country and inflows in the form of subscription to bonds to result in an overall surplus of the balance of payments. The latter moved from a deficit of US\$ 3.8 billion in the first nine months of calendar 2012 to a surplus of US\$ 4.5 billion over the corresponding 2013 period.
- **Growing needs for structural reforms in the face of an aggravating fiscal conundrum**
At the fiscal level, Egypt's fiscal deficit soared by 44% in local currency terms to reach the equivalent of US\$ 37.2 billion in FY 2013, accounting for nearly 13.7% of GDP. Deficit financing has pushed general government debt to almost 90% of GDP. The Egyptian government targets a decline in the overall budget deficit to 9.1% of GDP in FY 2014. Preliminary budget results for the first seven months of FY 2014 reveal an overall budget deficit of US\$ 17.3 billion at end-January 2014, which represents circa 11% of GDP, noting that an irregular revenue is observed and is related to the Ministry of Finance's deposit at the Central Bank and the grants received from the GCC countries.
- **Inflation stuck at a significant two-digit level**
Annual inflation reached a rate of 11.7% in December 2013, mainly reflecting rising food prices amidst disruptions in supply chains. An increase in the minimum wage of public sector employees from LE 730 (US\$ 106) per month to LE 1,200 (US\$ 171), a 64% rise, was announced in September 2013 to go into effect in January 2014. The announcement immediately put pressure on private sector employers to follow suit, especially given that the average wage in the private sector is only about two-thirds of that in the public sector. After depreciating by 10.4% during the first half of 2013, the Egyptian Pound has slightly appreciated by 0.9% during the second half of 2013, amidst the injection of confidence given by the GCC aid.
- **Banking activity growth accelerates coupled with growing sovereign exposure**
Egypt's banking sector witnessed throughout 2013 a healthy activity growth, with the aggregated assets of banks operating in Egypt rising by 16.9% in local currency terms in 2013 (6.9% in US Dollar terms due to local currency depreciation during 2013) as per the latest available Central Bank statistics. Total bank assets reached the equivalent of US\$ 242.2 billion at end-December 2013, against US\$ 226.6 billion at end-December 2012. The growth was mainly favored by accrued funding on the back of rising deposits and ensuing increased investments in local government securities amidst considerable public sector financing needs.
- **Significant rebound in equity and bond prices during the second half of 2013 and early 2014**
Egypt's capital markets saw a pick-up in prices during the second half of the year 2013, mainly supported by an aid package pledged by three GCC countries, an interest rate cut by the Central Bank of Egypt, and a stimulus package announced by the interim government to prop up the economy. This allowed the Egyptian Exchange to close the year 2013 with significant price increases relative to the previous year, while Egyptian debt papers registered yearly price declines in 2013 despite the significant rise in prices during the second half of the year. Egypt's stock market rose by 42.7% in the second half of 2013, while its 5-year CDS spread contracted by 277 basis points over the same period to close the year at 605 basis points.

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

Egypt's second revolution in mid 2013 has opened a fresh chapter in the country's troubled political transition and raised hopes for economic recovery after nearly three years of heavy losses. The new, military-led regime has also laid out a timetable for a return to democracy. Polls suggest that the regime commands considerable popular support. A referendum on an amended constitution mid-January 2014 was widely backed by voters, and is set to pave the way for Parliamentary and Presidential elections.

The grounds for optimism are easy to identify. The regime changeover has triggered the release of aid from Gulf states that had long been skeptical before. This has led to some considerable financial stabilization. Egypt's foreign reserves reached US\$ 17.1 billion at end-December 2013, up by US\$ 2.1 billion since year-end 2012. The country has received US\$ 7 billion out of US\$ 13.9 billion pledged by Kuwait, Saudi Arabia and the UAE. The influx of Gulf aid and the resultant stabilization of the Egyptian Pound prompted the Central Bank to lower key interest rates three times during the second half of 2013 by a total of 150 bps in an attempt to boost growth. After depreciating by 10.4% during the first half of 2013, the Egyptian Pound has slightly appreciated by 0.9% during the second half of 2013, amidst the injection of confidence given by the pledge of US\$ 13.9 billion in GCC aid. In parallel, Egypt's stock market rose by 42.7% in the second half of 2013, while its 5-year CDS spread contracted by 277 basis points over the same period to close the year at 605 basis points.

Having said that, the interim government has adhered to a limited mandate and a populist policy stance, while deferring any action on fundamental economic reforms. The government has been focusing on creating employment through the activation of projects in the public sector, on improving security, and on reducing policy uncertainty to help spur private sector investment. It announced a stimulus package of US\$ 4.3 billion, equivalent to 1.6% of GDP. This would focus on accelerating construction in a low-cost housing program, reactivating infrastructure projects delayed by events or lack of finance, expanding public transport, and providing financial assistance to public enterprises to raise capacity utilization that had been reduced or shut down by shortages during the turmoil.

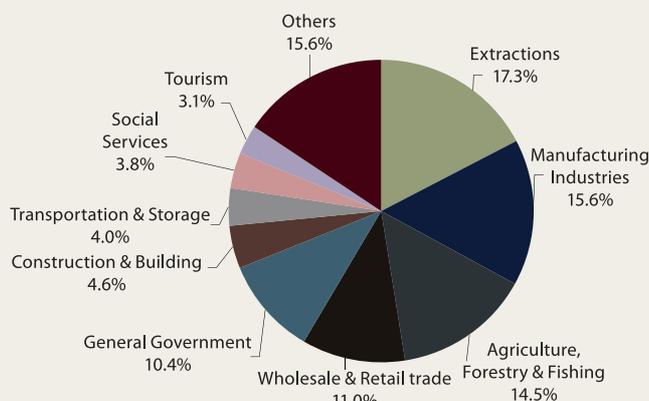
At the fiscal level, Egypt's fiscal deficit soared by 44% in local currency terms to reach the equivalent of US\$ 37.2 billion in FY 2013, accounting for nearly 13.7% of GDP. Deficit financing has pushed general government debt to almost 90% of GDP. Annual inflation reached a rate of 11.7% in December 2013, mainly reflecting rising food prices amidst disruptions in supply chains. An increase in the minimum wage of public sector employees from LE 730 (US\$ 106) per month to LE 1,200 (US\$ 171), a 64% rise, was announced in September 2013 to go into effect in January 2014. The announcement immediately put pressure on private sector employers to follow suit, especially given that the average wage in the private sector is only about two-thirds of that in the public sector.

EGYPT'S GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2013)



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

At the external level, last year's performances were mixed. Exports increased by 5.5% in 9M2013 as price competitiveness improved amidst the depreciation of the Egyptian Pound. Net FDI into Egypt has dropped by 29% in 9M2013, while remittances declined but remained a major contributor to inflows, benefiting from transfers of expatriates mainly in the GCC. Egypt's revenues from tourism reached US\$ 5.1 billion in 9M2013, down by a yearly 27%. Ernst & Young indicated a 15% decrease in hotel occupancy in Cairo in 2013 to reach 24.0%.

At the banking sector level, banking activity was favorable in 2013. Banks operating in Egypt posted an activity growth of 16.9% in local currency terms between end-2012 and end-2013 (+6.9% in US\$ terms). Deposits and loans were up by 20.6% and 6.5% respectively (+10.4% and -2.6% respectively in US\$ terms). Deposits in foreign currency increased by 17.6% during 2013 compared to a growth of 21.6% in local currency deposits over the same period, which shows that banks have been witnessing conversions in favor of local currency along with the appreciation in the Egyptian Pound recently. The aggregated net profits of eight listed banks of the sector rose by 19.8% in US\$ terms during the first nine months of 2013, suggesting a reinforcement of banking sector profitability at large.

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

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture

Flat growth for the second consecutive year

The primary sector maintained its pace of activity by growing at a rate of 3.0% in fiscal year (FY) 2013, slightly up from a rate of 2.9% reported in FY 2012. The trend seems to continue throughout FY 2014, with growth registered between July and September 2013 at a rate of 2.9% compared to a similar one registered in the first quarter of FY 2013. At the same time, the agricultural sector maintained almost the same share in Egypt's GDP at 14.5%.

As the agricultural output is almost totally driven by private entities' activity, investment within the sector grew by a significant 53.5%, reaching around US\$ 1.19 billion in FY 2013. Such a surge in investment was mainly driven by higher appetite from the side of the private sector, with the contribution of the latter more than doubling and reaching US\$ 780.9 million in FY 2013. Despite insignificant output contribution, investments implemented by the Egyptian government are substantial. They stood at US\$ 397.4 million in FY 2013 compared to US\$ 365.6 million in FY 2012.

The previous government, whose mandate overlapped with FY 2013, took a decision to dramatically reduce wheat imports. The decision was spurred by the lack of money and an over-optimistic attempt at making Egypt self-sufficient. In fact, Egypt has been the world's largest importer of wheat, bringing in about 10 million tons a year to meet its needs of over 18 million tons. In addition, with a quarter of the country's population living below the poverty line, millions depend on the subsidized bread program, with the latter requiring 9 million tons of wheat per annum.

Following the decision to reduce purchases of foreign wheat, the Egyptian government imported, during FY 2013, 6.66 million tons compared to 10 million tons in the previous fiscal year. Accordingly, the wheat stock was hurt, leaving the country with only 3.5 million tons in July 2013, compared to 4.9 million tons in July 2012. While the ousted government left the country with a stock covering its needs just until November 25, the new government imported, by July, 480,000 tons, covering the country's needs until end-2013.

OUTPUT OF MAIN CROPS

	Productivity unit	FY 2010		FY 2011		FY 2012		FY 2013e	
		Production (000s tons)	Area (000s Feddans)						
Vegetables	ton	17,510	1,496	21,514	1,903	22,548	2,070	21,956	2,080
Sugar cane	ton	15,482	317	15,709	321	15,550	326	15,900	320
Sugar beet	ton	7,840	386	7,486	362	7,013	339	9,920	435
Fruits	ton	10,073	1,511	8,370	1,376	9,518	1,542	9,546	1,501
Wheat	Ardeb	7,169	3,001	8,367	3,048	8,458	3,182	9,598	3,350
Maize	Ardeb	5,365	1,691	5,365	1,690	6,217	1,839	7,830	2,350
Rice	ton	4,330	1,094	4,329	1,095	5,912	1,477	5,125	1,250
Onion	ton	2,246	134	2,590	172	1,964	142	2,960	169
Millet	Ardeb	774	333	691	329	751	337	841	373
Cotton (seeds)	m. c.	281	284	431	370	473	400	533	410

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

It is worth noting that wheat production increased by 13.5% year-on-year, reaching 9.6 million tons in FY 2013. During the same period, the production of two of the country's main crops, namely maize and sugar, witnessed increases of 25.9% and 14.4%, respectively.

On a different note, last November, Egypt suspended rice exports only a week after issuing licenses to sell the grain abroad. The suspension aimed at meeting all domestic needs for the government subsidy program in addition to keeping prices in the local market stable. The decision came despite the fact that the country enjoyed an exportable amount of 800,000 tons beyond its local consumption needs of 4 million tons a year.

1.1.2. Industry

Manufacturing industries displayed a significant improvement

During the FY 2013, Egypt's manufacturing industries and the extracted ones reported contrasting trends. While both were influenced by a difficult environment restraining business sentiment, the manufacturing industries displayed an improvement from the levels witnessed in FY 2012. The industries of extractions, on the other hand, continued to face difficulties and could not renew with their upward path.

More specifically, extractive industries contracted by 2.7% in FY 2013 compared to a 0.1% expansion in the previous fiscal year. When broken down by type, petroleum industries contracted by 1.2% in FY 2013 against a 1% expansion in FY 2012. The gas industries witnessed a real contraction of 4.0% compared to a 0.7% contraction in FY 2013. On a positive note, the growth at the level of other extractions increased from 2.3% in FY 2012 to 2.9% in FY 2013.

With regards to the manufacturing industries, they significantly improved from the 2012 levels. Their growth accelerated to 2.3% in FY 2013 from 0.7% in the previous fiscal year. A breakdown by type shows that growth in manufacturing industries was mainly supported by the petroleum industries alongside other manufacturing industries. Petroleum industries reported a growth of 2.7% in FY 2013 against a contraction of 4.7% in the previous fiscal year. As to other manufacturing industries, they achieved a growth of 2.2% in FY 2013, against a 1.0% growth in FY 2012. The weakening of the Egyptian Pound is set to contribute to manufacturing exports and stronger services, which would be further assisted by a strengthening of global economic sentiment more generally.

Furthermore, implemented investments in crude oil projects are estimated to have risen more than twofold in FY 2013 from the previous fiscal year, compared to a contraction of 34% in FY 2012. In contrast, implemented investments in natural gas declined by 28.5% in FY 2013, relative to a 66.8% expansion in FY 2012. An improvement in the business environment should see a number of long-delayed projects get under way, including notably in the electricity and hydrocarbons sectors. Within this context, General Electric Co. and Egyptian private company Carbon Holdings signed a US\$ 500 million agreement to provide support in the building of the world's largest liquid cracker at a petrochemicals complex on the Gulf of Suez. The new plant would have an annual production capacity of 1,360,000 tons of ethylene and polyethylene and "significant quantities of propylene, benzene, butadiene and linear alpha olefins."

1.1.3. Construction

Noticeable improvement from the previous year

Although Egypt's construction and building activity was affected by the country's difficult conditions in FY 2013, the sector reported a noticeable improvement from the previous fiscal year. The sector attained a 5.9% growth in FY 2013, against 3.3% in FY 2012.

The value of implemented investments rose by approximately 93% in local currency terms in FY 2013, following a decline of 71% in FY 2012, as per Central Bank data. It is important to note that the significant increase in implemented investments mostly comes from a stronger appetite in the private sector. The share of the private sector's investment out of total investment in the construction and building sector reached 73.2% in FY 2013, up from 52.4% in FY 2012. Consequently, the share of the construction sector's investment out of total investment rose from 0.7% in FY 2012 to 1.4% in FY 2013.

Having said that, construction companies working in Egypt actually suffered as a result of the Ministry of Finance's deteriorating ability to compensate them for work completed due to the country's deteriorating financial situation. As of June 2013, the ministry owed contractors over LE 13 billion in back pay. Despite these issues, the Egyptian building and construction sector is expected to attract investments of around US\$ 7.3 billion by 2015.

Despite the importance of residential construction in Egypt, the bulk of spending in the construction sector is still directed toward non-residential building activities with construction expenditure standing at US\$ 6.2 billion and expected to increase to US\$ 7.3 billion in 2015. Within this context, Dubai retail developer Majid Al-Futtaim (MAF) plans to expand its investments in Egypt by around LE 16.5 billion (US\$ 2.3 billion) over the next five years. As a matter of fact, the company intends to build four shopping malls in Cairo, Giza and Alexandria, a project worth LE 11.3 billion (US\$ 1.6 billion) which would create roughly 38,000 job opportunities. The plan also includes establishing 32 hypermarkets in Egypt, worth LE 5.2 billion (US\$ 0.7 billion) and creating 4,500 jobs at large.

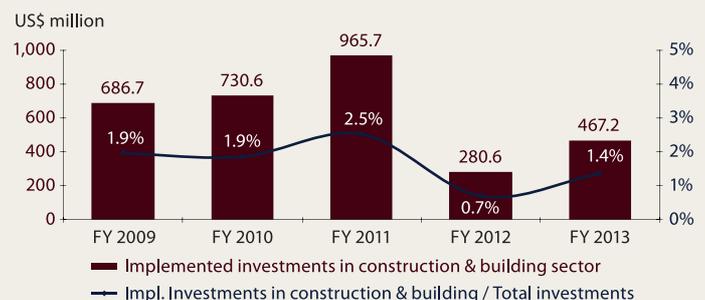
In order to realize Egypt's full potential in the infrastructure and construction sector, the government must work to create an environment that encourages long-term planning and investment and reduce lingering risks. The most significant threat to progress in the construction industry is the possibility of private investment drying up in the face of heightened political risk. In addition to falling levels of investment, construction activities are also vulnerable to labor unrest and supply chain disruptions. Notwithstanding continuous changes in governance that have resulted in a fragmented sector without a strong sense of purpose or continuity.

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

1.1.4. Tourism

A year of volatile performance

After tourism initiated the year 2013 on a positive note with rising promises of a slowly rejuvenating activity, things took on a downturn within the context of political turmoil and consequently issued travel warnings. Only few months after European countries relaxed the bans in September, a blast in Sinai knocked back the country's foreseen tourism recovery.

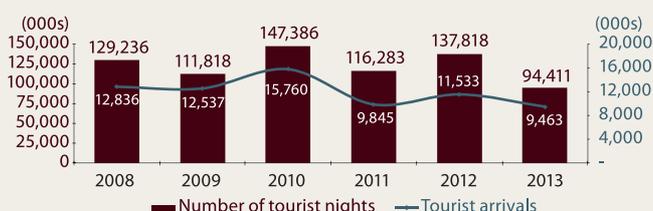
Accordingly, the performance of the sector in 2013 can be divided into three phases. The first two quarters were characterized by a relatively revived activity. The third quarter was characterized by a slump in tourist numbers due to Western issued travel warnings, while the fourth quarter was marking the beginning of a slow pick-up of activity following the easing of the above mentioned warnings.

In fact, the tourism sector, which accounts for around 3.1% of Egypt's GDP, reported a real growth of 6.6% in the fiscal year (FY) 2013, ending in June, following a lower growth of 2.3% in FY 2012. On the other hand, published data for the first three months of FY 2014 (July to September 2013) reflects the effect of the political events with negative growth reported at a rate of 28.3%.

Figures on the number of tourists for the year 2013 are in line with the stated pattern of activity. In fact, 5.9 million tourists visited Egypt in the first six months of 2013, compared to 5.2 million tourists in the equivalent period of 2012. In parallel, in the second half of 2013, only 3.5 million tourists visited the country, down from a total of 6.3 million in the equivalent period of 2012. Overall, the number of incoming foreigners dropped by 17.9% on an annual basis, from a total of 11.5 million tourists in 2012 to 9.5 million in 2013, a record low in seven years.

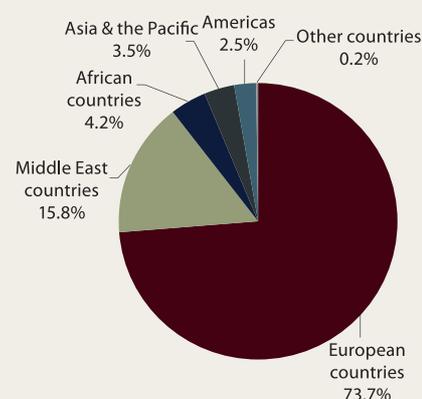
As to tourists' nights, they recorded a contraction of 31.5% in 2013, while the average stay per tourist reached 10 days compared to an average of 12 days in 2012. Furthermore, according to Ernst & Young, the occupancy rates in four and five star hotels within Sharm El Shaikh, Hurghada, and Cairo went down throughout the year, moving from 75%, 73%, and 39% in 2012 to 64%, 63%, and 24%, respectively in 2013. At the same time, average room rates slightly increased from their low base of 2012, by 10.6% for Sharm El Shaikh, 12.5% for Hurghada, and 1.2% for Cairo. Looking forward, the Ministry of Tourism is to offer incentives for European tourism in hopes of reaching an agreement to lift tour warnings and to encourage visitors to fly to Egypt.

EVOLUTION OF TOURISM ACTIVITY



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

TOURISTS BREAKDOWN BY REGION (2013)



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

1.2. EXTERNAL SECTOR

Lower trade deficit and higher inflows foster improvement in external accounts

Egypt's external accounts witnessed an overall improvement over the first nine months of 2013, as per the latest statistics of the Central Bank. Exports increased over the period while imports slightly contracted, and the subsequent improvement at the level of the trade balance was coupled with higher official transfers to the country and inflows in the form of subscription to bonds to result in an overall surplus of the balance of payments. The latter moved from a deficit of US\$ 3.8 billion in the first nine months of calendar 2012 to a surplus of US\$ 4.5 billion over the corresponding 2013 period.

In details, exports rose by 5.5% over the first nine months of 2013 to reach US\$ 18.5 billion, yet amidst a relative gain in competitiveness as the local currency actually depreciated by 13% between 9M2012 and 9M2013. Petroleum exports, mostly consisting of crude oil, rose by 20.7% in US Dollar terms year-on-year to account for 45% of total exports.

On the other hand, other exports declined by 4.4% over the covered period, driven by lower exports of cotton, dairy products, eggs and honey, carbon, organic and inorganic chemicals, soap, pharmaceuticals, fertilizers and ready made clothes, while those of iron and steel and cotton textiles managed to increase. A look at the exports distribution by geography shows that those to the European Union favored the moderate total exports increase.

Imports declined by 6.0% year-on-year to reach US\$ 40.9 billion in the first nine months of 2013, within the context of a slowdown in domestic consumption in a low growth environment and lingering uncertainties and a weaker local currency pushing up the cost of purchases from abroad. Petroleum imports dropped by 6.0% over the covered period and imports of other items, accounting for about 80% of the total, decreased at the same pace.

In the latter category, imports of raw materials, intermediate, investment and consumer goods all contributed to lower purchases from abroad. Imports from major trading partners such as the EU and other European countries and Asian countries declined over the first nine months of 2013, whereas those from Arab countries increased, especially during the third quarter of 2013.

As a result, the export-to-import coverage ratio improved, moving from 40.2% in 9M2012 to 45.1% in 9M2013. Similarly, the trade deficit narrowed by 13.8% in the covered period of 2013, moving from US\$ 26.0 billion in 9M2012 to US\$ 22.4 billion in 9M2013 and thus easing the pressure on the current account balance.

In contrast, the services balance remained in surplus but the latter narrowed by 30% to US\$ 2.9 billion. This is mostly due to lower receipts, particularly from the travel sector. Indeed, tourism revenues declined by 27% due to the lingering politico-security uncertainties in Egypt, while Suez canal dues almost maintained their 9M2012 levels.

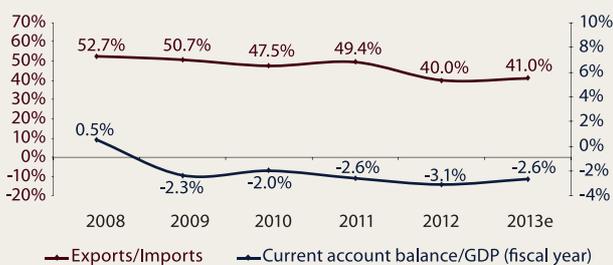
Another contributor to the improvement of external accounts proved to be the transfers balance, which posted a higher surplus of US\$ 17.8 billion (+19%) in the first nine months of 2013. While the remittances from Egyptian workers abroad to their homeland slightly declined though remaining a major contributor to inflows, official transfers soared over the covered period. They moved from US\$ 150.1 million in the first nine months of 2012 to a high of US\$ 4.5 billion in the corresponding period of calendar 2013. This actually reflects the receipt of US\$ 4.3 billion worth of funds in the third quarter of the year, notably from GCC States pledging funds to help Egypt in the after month of its second revolution.

With the trade balance deficit narrowing and the transfers balance surplus widening consistently, the current account deficit shrank considerably by 75% to reach US\$ 1.8 billion in the first nine months of 2013. It is worth noting that the receipt of funds from Gulf States in the third quarter of the year helped the current account balance to post a surplus of US\$ 757.0 million during that quarter, the first one in more than five years.

Along the same lines, the capital and financial account surplus more than doubled to reach US\$ 9.4 billion in 9M2013. This was notably due to higher portfolio investments in Egypt, most particularly in the form of bonds in the second and third quarters of 2013. However, net FDI in Egypt plummeted by 29% year-on-year to US\$ 3.9 billion in 9M2013 on account of weaker inflows of FDI from the European Union.

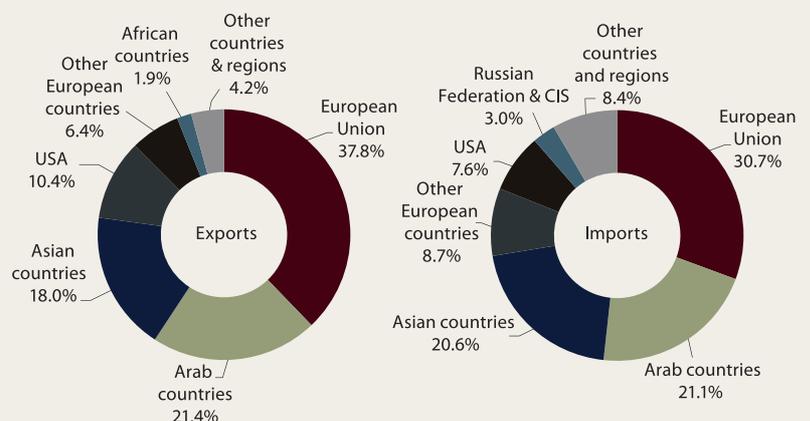
All in all, Egypt's overall balance of payments moved from a deficit of US\$ 3.8 billion in 9M2012 to a surplus of US\$ 4.5 billion in 9M2013, after registering two consistent surpluses in the second and third quarters of 2013. But while the country's external accounts ameliorated noticeably in recent months and GCC funds have avoided acute short-term pressures, the expected pick-up in imports once economic conditions improve sustainably are likely to weigh on the balance of payments and come to the fore once again as a structural pressure factor to Egypt's external accounts.

EGYPT'S FOREIGN SECTOR INDICATORS



Sources: IMF, EIU, Bank Audi's Group Research Department

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (9M 2013)



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

1.3. PUBLIC SECTOR

Growing needs for structural reforms in the face of an aggravating fiscal conundrum

During FY 2013, Egypt's fiscal accounts witnessed significant increases in domestic and external debt, while the overall budget deficit reached a historical high level of 13.7% of GDP, which prompted the interim government that took office in July 2013 to adopt fiscal reforms to raise revenues and rationalize expenditures.

The gross domestic debt surged by 23.4% in local currency terms in FY 2013 to reach the equivalent of US\$ 218 billion at end-June 2013, mainly driven by a significant growth in Treasury bills and Treasury bonds with the Central Bank of Egypt, within the context of sovereign debt sale aiming at funding the country's widening fiscal deficit. Accordingly, the total domestic debt to GDP went up from 78.6% in FY 2012 to 87.1% in FY 2013, as per the CBE. In FY 2014, the gross domestic debt expanded by 4.3% in local currency terms during the first quarter of the year to reach US\$ 231.2 billion at end-September 2013.

In parallel, the total external debt expanded by 25.7% in FY 2013 to reach US\$ 43.2 billion at end-June 2013, partly driven by a growth in long-term deposits and short-term debt in the aftermath of a Qatari and Libyan support to Egypt after the country's first revolution. Within this context, the total external debt rose from 13.2% of GDP at end-June 2012 to 17.3% at end-June 2013. In the first quarter of FY 2014, Egypt's external debt reached US\$ 47.0 billion.

As to public finances, total budget revenues grew by 15.4% in local currency terms in FY 2013 to reach the equivalent of US\$ 54.4 billion at end-June 2013, while total budget expenditures increased by 24.9% in local currency terms to hit the equivalent of US\$ 91.4 billion at end-June 2013. This resulted into a 43.8% expansion in the overall budget deficit in local currency terms in FY 2013 to reach the equivalent of US\$ 37.2 billion at end-June and account for 13.7% of GDP, which is its high level in more than a decade.

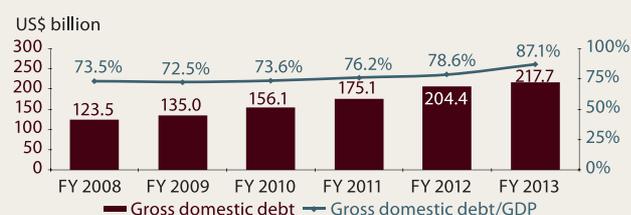
On the backdrop of wide budget deficit and large public debt, dwindling external receipts, weak international reserves, high unemployment, and rising poverty, the broad strategy of the interim government that took office in July 2013 was to inject fresh resources into the economy and to undertake fiscal reforms, relying on the availability of untapped Ministry of Finance deposit at the CBE and the Gulf financial support. To put this into effect, the interim government launched two stimulus packages over the first eight months of FY 2014. The first package of LE 29.7 billion was financed by half of a deposit that has been held by MoF at the CBE since 1991, with most of the spending allocated to infrastructure projects. The second package amounting to LE 33.9 billion includes LE 20 billion in additional infrastructure spending. The rest covers commitments made by the government to raise the minimum wage for government employees and salaries of teachers and medical professionals. The second package would be financed by a grant from the UAE, which is part of larger support package received from the Gulf countries.

SELECTED PUBLIC FINANCE INDICATORS

US\$ billion	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013e
Total budget revenues	51.2	48.5	45.6	50.5	54.4
Total budget revenues/GDP	27.1%	22.2%	19.3%	19.7%	20.0%
Total budget expenditures	63.7	66.2	69.1	78.4	91.4
Total budget expenditures/GDP	33.7%	30.3%	29.3%	30.5%	33.5%
Overall budget deficit	13.0	17.7	23.1	27.7	37.2
Overall budget deficit/GDP	6.9%	8.1%	9.8%	10.8%	13.7%

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

GOVERNMENT INDEBTEDNESS



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

Also, the government began in FY 2014 the implementation of a package of fiscal reforms to generate additional revenues and rationalize expenditures. On the revenues side, these measures include shifting from GST to VAT, implementing a new property tax, introducing a new mining law, settling outstanding tax arrears, widening the tax base through formalization, resolving cross-debt between public entities, and revising income tax law. All these reforms aim to widen the tax base and increase progressivity. On the expenditures side, reform measures encompass rationalizing energy subsidies, improving the efficiency of public investments and public debt management, introducing a new cash management system, completing Government Financial Management Information System (GFMS), strengthening internal auditing, and reviewing public procurement law.

The Egyptian government targets a decline in the overall budget deficit to 9.1% of GDP in FY 2014. Preliminary budget results for the first seven months of FY 2014 reveal an overall budget deficit of US\$ 17.3 billion at end-January 2014, which represents circa 11% of GDP, noting that an irregular revenue is observed and is related to the Ministry of Finance's deposit at the CBE and the grants received from the GCC countries.

Looking forward, expansionary fiscal and monetary policies are expected to generate higher economic growth in FY 2014, and the Egyptian authorities are set to move ahead with further reforms to contain Egypt's budget deficit and ensure sustainability.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

Pick-up in FX reserves coupled with currency stabilization

Egypt's monetary conditions witnessed a rebound so far in fiscal year 2014, with net international reserves registering growth following GCC aid package, and the local currency stabilizing against the US Dollar after previous depreciations, while inflation reached double-digit levels on average amidst loose monetary policy aiming at reviving the economy.

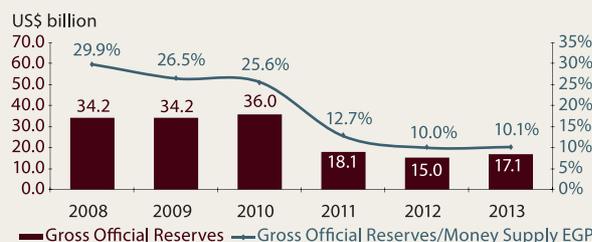
The decline in tourism revenue and drop in FDI inflows due to political instability had triggered a 15.9% depreciation in the Egyptian Pound in FY 2013, moving from LE/US\$ 6.06 at end-June 2012 to LE/US\$ 7.02 at end-June 2013. Yet, the inflows of Gulf aid following the June 2013 second Egyptian revolution and the relatively improved investor sentiment helped thwarting any further depreciation in the local currency, with the Egyptian Pound slightly moving up to LE/US\$ 6.96 at the time of the finalization of this report. Under these circumstances, the Central Bank of Egypt relaxed in January 2014 restrictions on foreign currency transfers abroad, allowing individuals to make a one-time transfer abroad of up to US\$ 100,000 in FY 2014, noting that this measure, which aims to facilitate bank dealing and meet customer needs, applies only to the fiscal year 2014.

BROAD MONEY AND INFLATION



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

EXCHANGE MARKET INDICATORS



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

The depreciation of the local currency against the US Dollar during the fiscal year 2013 and the extended rise in food and beverages prices over the year resulted into inflationary pressures. In fact, the Consumer Price Index for urban areas which include Cairo, Alexandria, urban Lower Egypt, urban Upper Egypt, Canal cities and frontier governorates rose by 6.9% on average in FY 2013 and reached a double-digit level of 10.8% on average during the first eight months of FY 2014, according to the Central Bank of Egypt. This more or less coincides with the IMF estimates of inflation for all areas during the fiscal year 2014, which is expected at 10.3%, given some episodes of unrest in the country that are set to cause periodic disruptions to supply chains, January's introduction of a 70% increase in minimum wage, the loose monetary policy adopted during the first half of FY 2014, and the Central Bank financing of the budget deficit.

The Central Bank of Egypt's net international reserves bounced back during the first eight months of FY 2014 following contractions in FY 2013, mainly buttressed by a US\$ 12 billion aid package pledged by Saudi Arabia, the UAE and Kuwait in July 2013, with nearly US\$ 10.5 billion disbursed during the first half of FY 2014 (US\$ 6 billion of which in the form of deposits at the CBE). Within this context, the Central Bank's net international reserves grew by circa US\$ 2.4 billion during the first eight months of FY 2014 to hit US\$ 17.3 billion at end-February 2014. The government also expects to receive US\$ 5.8 billion in additional aid from Saudi Arabia and the UAE in the form of Central Bank deposits and petroleum products, which would provide further support to the CBE's net international reserves.

The influx of Gulf aid after the interim government took over in July 2013 and the resultant stabilization of the Egyptian Pound prompted the Central Bank of Egypt to lower key interest rates three times during the first half of FY 2014 by a total of 150 basis points, despite rising inflation rate in the aim of supporting growth and reducing the costs of financing the fiscal deficit. In details, the CBE's overnight deposit rate was cut from 9.75% in June 2013 to 8.25% in December 2013. Also, the Central Bank's lending rate was reduced from 10.75% in June 2013 to 9.25% in December 2013. The discount rate was also reduced from 10.25% to 8.75%. The accommodative monetary policy adopted by the Central Bank of Egypt came along a heavy government spending aiming to revive an ailing economy and to boost tepid growth.

The broader money supply (M2) expanded moderately by 8.8% in US\$ terms during 2013, the equivalent of US\$ 16.1 billion, moving up from US\$ 183.5 billion at end-2012 to US\$ 199.6 billion at end-December 2013. This compared to a slightly lower growth of 6.6% in 2012. Money supply in its narrow sense (M1) widened by 18.6% in 2013, following a slower growth of 7.1% in 2012, to hit US\$ 53.7 billion at end-December 2013.

Looking forward, a sustained expansionary monetary policy along with the continuous influx of aid from oil-rich GCC states could help the government to generate output growth and maintain macroeconomic stability.

1.4.2. Banking Activity

Activity growth accelerates but sovereign exposure and asset quality are looming challenges

Egypt's banking sector witnessed a healthy activity growth throughout 2013, with the aggregated assets of banks operating in Egypt rising by 16.9% in local currency terms in 2013 (6.9% in US Dollar terms due to local currency depreciation during 2013) as per Central Bank statistics. Total bank assets reached the equivalent of US\$ 242.2 billion at end-December 2013, against US\$ 226.6 billion at end-December 2012. The growth was mainly favored by accrued liquidity on the back of rising deposits and ensuing increased investments in local government securities amidst considerable public sector financing needs.

The banking sector's deposits remain the cornerstone of the local banking sector activity, accounting for about three quarters of total balance sheets and thus constituting the main source of funding for Egyptian banks. Total deposits rose by 20.6% in local currency terms in 2013 (10.4% in US Dollar terms) to reach the equivalent of US\$ 189.2 billion at end-December. It is worth noting that the growth in local currency terms is more than twice higher than that registered during the previous year.

While government deposits and foreign currency private sector deposits increased during 2013, the progression in bank deposits over 2013 is mostly attributed to growing private sector deposits in local currencies on behalf of mainly the household sector and corporates. Within this context, the deposit dollarization ratio reached 23.8% at end-December 2013, against a slightly higher 24.4% at end-December 2012.

The Central Bank recently attributed the banks' rising deposit base to the increase in the confidence of Egyptians in the economic outlook. Bank deposits are actually supported by remittances from Egyptians working abroad, notably in the oil-rich Gulf region, noting that retail deposits account for the bulk (around 70%) of sector deposits. The strength and steadiness of the sector's deposit base means that market funding refinancing risks are quite limited, especially as wholesale funding (bonds and long-term loans) barely represent 1.7% of total balance sheets.

Increasing liquidity benefiting to Egyptian banks has yet not translated into a similar growth pace at the level of private sector lending. Egyptian banks have notable deposits, but are continuing to have difficulty in channeling those funds into private sector lending opportunities amidst weakness in the real economy and lingering political uncertainties. As a matter of fact, total credit facilities to the private sector rose by 5.6% in local currency terms over 2013 (slight negative growth in US Dollar terms) to reach the equivalent of US\$ 73.2 billion at end-December. This compares to a more or less similar growth in local currency terms over 2012. In parallel, credit facilities to the government increased by 18.3% during 2013, which falls in line with ongoing public sector financing needs. As a result, total credit facilities extended by banks grew by 6.5% in local currency terms over the covered period to reach US\$ 79.1 billion at end-December 2013.

Anyhow, the rising private sector lending volumes during 2013 are attributed to a 4.4% increase in local currency credit facilities (mostly to individuals) and to a 9.0% progression in foreign currency credit facilities (mostly industrial and services sectors) amidst a 9.3% currency depreciation over the year. It is worth noting that the Central Bank of Egypt recently unveiled a mortgage initiative by offering LE 10 billion to banks at discounted prices to stimulate the mortgage sector. Under this new plan, the Central Bank would lend banks operating in Egypt LE 10 billion for 20 years to the benefit of low and average income earners for them to acquire lodging in new residential areas. The initiative is believed to help promote the real estate sector and related industries as well.

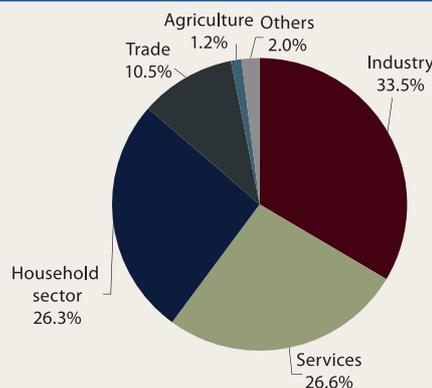
With deposits rising at a faster pace than credit facilities, the Egyptian banking sector's loans-to-deposits ratio declined from 47.4% at end-December 2012 to 41.8% at end-December 2013. Similarly, banks' core liquidity, defined as the ratio of readily available liquid assets (cash and balances with banks in Egypt and abroad) to customer deposits, reached 21% at end-December 2013, against a slightly lower 18% at end-December 2012. The increase in the core liquidity ratio is primarily owed to higher volumes of funds

BANKING SECTOR INDICATORS

US\$ million	2008	2009	2010	2011	2012	2013
Banking Activity						
Assets	189,987	209,953	221,047	216,740	226,556	242,209
Deposits	140,991	156,634	164,053	163,948	171,486	189,242
Credit Facilities	77,983	78,862	78,928	81,148	81,248	79,134
Capital + Reserves	9,987	11,585	13,794	13,530	15,834	16,296
Growth rates						
Assets	2.7%	10.5%	5.3%	-1.9%	4.5%	6.9%
Deposits	9.6%	11.1%	4.7%	-0.1%	4.6%	10.4%
Credit Facilities	12.7%	1.1%	0.1%	2.8%	0.1%	-2.6%
Capital + Reserves	20.7%	16.0%	19.1%	-1.9%	17.0%	2.9%

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

BANK LOAN BREAKDOWN BY ECONOMIC ACTIVITY*



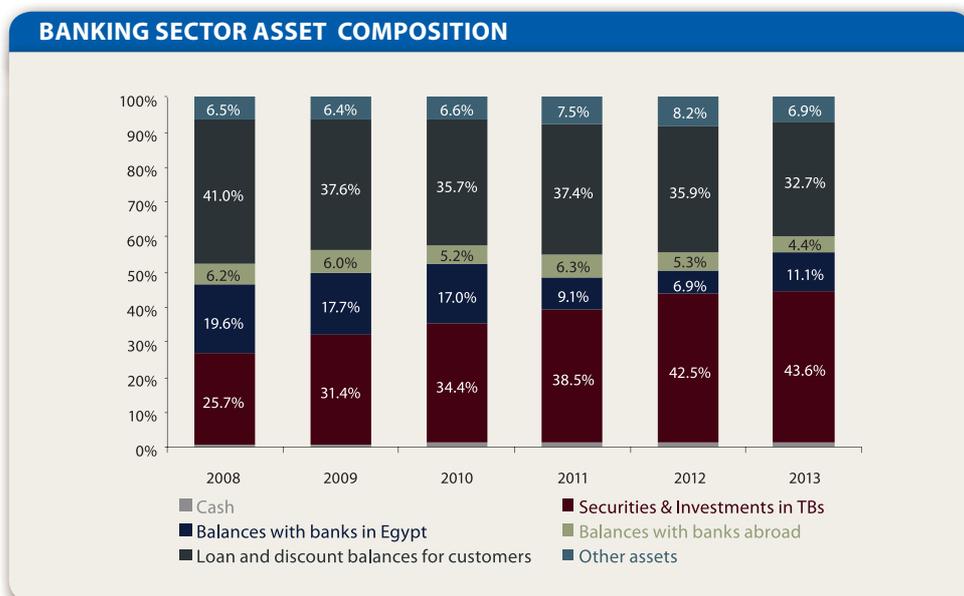
* As at end-December 2013

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

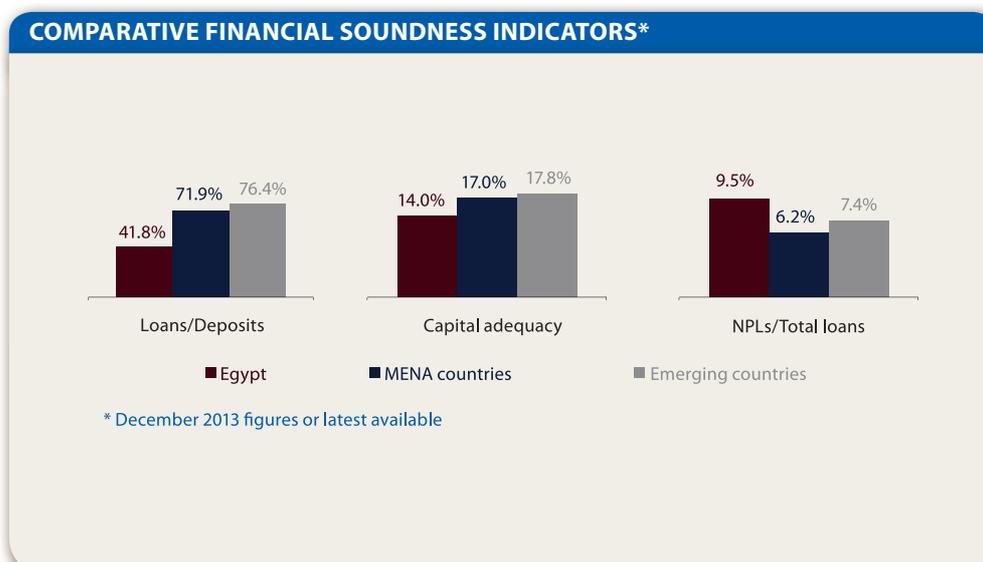
parked at banks in Egypt during the year 2013, yet remains much lower than that at end-2010, i.e. prior to the popular uprisings in Egypt, when it exceeded the 30% mark.

The liquidity position of banks in Egypt remains constrained by their increasing investments in local government securities in order to help plug the gap in the domestic public finances. Egypt's persistent fiscal deficits have been financed by domestic banks that are using part of their liquidity to invest in lucrative government debt instruments. As a matter of fact, around 44% of total assets were accounted for by securities and investments in Treasury bills at end-December 2013. This is almost the same level as end-December 2012 but still higher than the pre-uprisings level of 34% and the pre-global crisis level of less than 20%.

A closer look at banks' securities portfolio reveals that more than 90% of it consists of government securities. The latter grew by 22.1% in local currency terms over 2013. Government securities in local currency, accounting for 88% of total government securities held by banks, progressed by 17.6% over the covered period, while those in foreign currencies grew by 1.7x. Banks' exposure to the government



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



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

reached 5.9x capital and reserves as at end-December 2013. Banks' increasing holdings of Egyptian government debt instruments actually reflect the growing ties between their solvency and that of the sovereign.

At the level of profitability, and in the absence of consolidated sector figures, we resorted to the aggregation of eight listed banks' bottom lines, which gives some indication of sector-wide trends. Those banks' net profits rose by 19.8% year-on-year in US Dollar terms over the first nine months of 2013.

While the consistent investment in government securities has boosted banks' net profits in 2012 and throughout most of last year, the relatively lower yields over the course of the second half of 2013 and the lack of lending opportunities are likely to leave their imprints on full-year net profits for the sector.

At the level of asset quality, Egyptian banks have been reporting an improvement at the level of non-performing loans. As a percentage of total loans, they decreased to 9.5% at end-September 2013 as per the latest Central Bank statistics. This compared to a slightly higher 10.0% at end-December 2012 and 10.9% at end-December 2011. According to the Central Bank of Egypt, this recent amelioration comes after one bank executed one of its distressed debt portfolios.

It is worth noting that after the popular uprising in early 2011, the Central Bank issued a directive allowing banks to permit borrowers to defer the installments of regular retail and tourism sector loans for the first three and six months of the year, respectively, while urging them to carry out discretionary loan restructurings. In March 2013, it issued another directive granting them a one-year grace period before classifying loans in the hard-hit tourism sector as non-performing, and this was extended until the end of December 2014. Anyhow, while the NPL ratio remains relatively higher than regional and global peers, the provisioning coverage ratio has increased to a high of 99.5% at end-September 2013, against 97.1% at end-December 2012 and 94.6% at end-December 2011. The Central Bank asks banks to provision the loans of various sectors in addition to their clients' allocations.

At the level of capital adequacy, banks are following all the Basel committee specifications by keeping the capital adequacy ratio higher than the recommended 10%. The latter ratio, calculated according to Basle II regulations, reached 14.0% at end-September 2013, of which 84% consists of Tier 1 capital. It is yet worthy to recall that rising sovereign exposure, perhaps not quite reflected in the former ratio, renders banks on the overall more susceptible to possible sovereign refinancing pressures. As matter of fact, Egyptian banks' capital and reserves to total assets ratio attained a relatively low 6.7% level at end-December 2013, bearing in mind though that privately owned banks display relatively higher capital to assets ratios than the sector-wide average.

1.4.3. Equity and Bond Markets

Significant rebound in equity and bond prices during the second half of 2013 extended to early 2014

Egyptian capital markets saw a pick-up in prices during the second half of the year 2013, mainly supported by an aid package pledged by three GCC countries, an interest rate cut by the Central Bank of Egypt, and a stimulus package announced by the interim government to prop up the economy. This allowed the Egyptian Exchange to close the year 2013 with significant price increases relative to the previous year, while Egyptian debt papers registered yearly price declines in 2013 despite the significant rise in prices during the second half of the year.

The Egyptian Exchange managed to end the year 2013 on a positive note, with the bourse main benchmark index (EGX 30) registering a 24.2% rise in local currency terms annually, mainly supported by a strong rebound in prices during the second half of the year after an interim government took office in July 2013; Saudi Arabia, the UAE and Kuwait pledged a US\$ 12 billion aid package to Egypt; the government unveiled a LE 29.7 billion stimulus package to boost tepid growth; and the Central Bank of Egypt cut key interest rates three times over the second half of the year to stimulate growth. Within this context, EGX 30 jumped by 42.7% during the second half of 2013, sweeping price contractions of 13.0% observed during the first half of the year. As to the breakdown by sector, most sectors witnessed a favorable performance in 2013 with the food and beverage sector surging by 78%, followed by the

basic resources sector (+46%), the banking sector (+33%), the real estate sector and the chemicals sector (+26% each), the telecommunications sector (+22%), the industrial goods, services and automobiles sector (+21%), the personal and household products sector (+17%), the construction and material sector (+16%), the travel and leisure sector (+15%), and the healthcare and pharmaceuticals sector (+7%), while the financial services sector excluding banks registered price drops of 11%.

Price increases registered over the year 2013 were extended to early-2014 after an amended constitution has been widely backed by voters in a referendum mid-January, paving the way for further progress on the government's political roadmap; Egypt's Defense Minister announced that he will run in the Presidential elections due to take place by mid-year; the Egyptian interim government unveiled its second stimulus package; and the Central Bank of Egypt launched a new initiative that aims at promoting the mortgage sector, by lending banks LE 10 billion for 20 years to be lent to people of low and average income. Within this environment, EGX 30 pursued its upward trend during the first two months of 2014, closing up by 19.8% at end-February.

The significant rise in prices over the year 2013 was coupled with a small decline in the number of listed companies on the Egyptian Exchange from 213 at end-2012 to 212 at end-2013. Accordingly, the market capitalization rose by 3.9% year-on-year in foreign currency terms, moving up from US\$ 59.0 billion at end-2012 to US\$ 61.4 billion at end-2013. The ratio of market capitalization to GDP increased from 23.0% at end-2012 to 23.4% at end-2013, noting that the Egyptian bourse's contribution in the economy remained relatively low in comparison with the higher market capitalization to GDP registered in the MENA region (around 50%).

The total volume of traded securities dropped from 34,261 million shares in 2012 to 29,190 million shares in 2013, down by 14.8%. The total number of transactions went down from 6.2 million in 2012 to 4.8 million in 2013. The total trading value fell from US\$ 29.1 billion in 2012 to US\$ 23.3 billion in 2013, down by 19.9%. Within this context, the turnover ratio, measured by total trading value to market capitalization, declined from 49.3% in 2012 to 37.9% in 2013.

In parallel, Egyptian debt papers witnessed price increases during the second half of 2013 following the formation of an interim government, a large aid package pledged by Saudi Arabia, the UAE and Kuwait, and a rebound in the Central Bank's net international reserves. Yet, Egyptian bond prices at end-2013 fell short of high levels recorded at end-2012, with sovereigns maturing in 2020 and 2040 closing down by 4.00 pts and 1.00 pt respectively in 2013, and National Bank of Egypt'15 trading down by 0.75 pt over the year.

So far in 2014, Egyptian bond prices extended the upward trend that they have started during the second half of the year 2013, with Egypt'20 and '40 trading up by 6.50 pts and 7.00 pts respectively and National Bank of Egypt'15 closing up by 1.00 pt, on boosted investor sentiment after Egypt's amended constitution was widely approved by voters in a referendum held mid-January 2014 and on expectation of additional

CAPITAL MARKETS INDICATORS

	2008	2009	2010	2011	2012	2013
Market capitalization (US\$ billion)	86.1	91.1	84.1	48.6	59.0	61.4
Total value traded (listed & unlisted securities, US\$ million)	96,232	81,688	55,371	24,561	29,080	23,279
Non-Arab foreign participation as % of total value traded	19.5%	12.7%	16.5%	23.6%	14.9%	14.3%
Total volume of traded securities (million)	25,556	36,602	33,414	18,491	34,261	29,190
Total number of transactions (000s)	13,456	14,628	10,201	5,590	6,234	4,790
No. of listed companies	373	306	213	213	213	212
No. of traded companies	322	289	211	204	204	204
% Change in price index (EGX 30)	-56.4%	35.1%	13.8%	-49.3%	50.8%	24.2%
P/E ratio	9.9	12.1	14.7	10.5	12.4	15.2
Dividend yield	8.8%	7.0%	7.1%	10.4%	8.6%	6.5%

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

GCC support. As to the cost of insuring debt, Egypt's five-year CDS spread saw significant contractions of 277 bps during the second half of 2013 closing at 605 bps at end-2013, yet remained well above the end-2012's CDS level of 510 bps. So far in 2014, Egypt's five-year CDS spread contracted by 140 bps, reaching 465 bps at the time of the finalization of this report, mainly supported by rising investors' confidence in the authorities' commitment to a rapid transition, which eased fears that the timetable could drift, in addition to prospects of less local political instability.

Under these favorable circumstances, Egypt's local currency borrowing costs fell in 2013 and early 2014, with the 12-month average yield dropping from 13.54% at end-2012 to 11.21% at end-2013 and pursuing its decline to 10.84% at the time of this report.

As to credit rating changes, international rating agencies took several actions in 2013 and early-2014. In fact, Moody's downgraded Egypt's government bond ratings by a total of two notches in February and March 2013 from "B2" to "Caa1", and affirmed Egypt's "Caa1" government bond rating with "Negative" outlook in July 2013, citing the substantial boost in Egypt's international liquidity provided by the US\$ 12 billion external financial support package from the governments of Saudi Arabia, Kuwait, and the UAE; the road map laid out by the interim government for a return to democracy by early 2014; and the recent containment of the government's debt-financing costs, below post-revolution peaks. The maintenance of the "Negative" outlook is driven by Moody's view of the country's considerable economic and political challenges.

Also, Fitch had downgraded Egypt's long-term foreign and local currency issuer default ratings by one level in July 2013 from "B" to "B-", with "Negative" outlook. Yet, the international rating agency revised in early-January 2014 the outlook on Egypt's long-term foreign and local currency Issuer Default Ratings to "Stable" from "Negative". The revision of the outlook reflects the significant financial assistance from Kuwait, Saudi Arabia and the UAE that has eased the pressure on reserves, the exchange rate and the budget, and boosted business confidence; the political scene that has been calmed through a tough crackdown on the Muslim Brotherhood and restrictions on protests; and the reduced political disruption and greater availability of foreign exchange which, combined with fiscal and monetary stimulus, supported a tentative improvement in the economy. It is worth noting that Fitch said in its latest report released in February 2014 that Egypt's ratings have stabilized on tentative political and economic improvements, but rapid upgrades are unlikely.

Finally, Standard & Poor's raised in November 2013 Egypt's long-term and short-term foreign and local currency sovereign credit ratings from "CCC+/C" to "B-/B" with "Stable" outlook, following a downgrade in May 2013. The upgrade reflects S&P's view that the Egyptian authorities have secured sufficient foreign currency funding to manage Egypt's short-term fiscal and external financing needs. The "stable" outlook reflects S&P's view of Egypt's difficult political landscape and significant external financing pressures against relatively generous support from bilateral donors.



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

2. CONCLUDING REMARKS

The approval of a new constitution in a referendum early this year has paved the way for presidential elections before the end of the first half-year. Parliamentary elections will then follow, bringing a democratically-elected government to power. But the country remains deeply polarised, with significant political violence including attacks on security forces, raising growing fears of security drifts. Though the political situation has improved somewhat, it is still adversely affecting tourism, investment and economic confidence more generally, leaving the economy heavily dependent on Gulf aid and a promised fiscal stimulus package.

Still, recent developments have led international reference sources to strengthen their growth forecasts for Egypt though at a relatively moderate pace because of the disruptions in the manufacturing and tourism sectors. IMF expects growth to rise from 1.8% in 2013 to 2.8% in 2014 and to 4% thereafter. IIF sees growth increasing from 2.1% in 2013 to 2.3% in 2014. Having said that, the growth rates projected will only begin to reverse the losses of the past three years. A return to pre-2011 levels of economic activity will require full political normalization – which will likely be a lengthy and challenging process given the weakness Egypt's political institutions have shown and the relative support the Muslim Brotherhood likely still commands.

Inflationary pressures are likely to remain significant, especially that a relative uptick is expected when the public minimum wage is implemented in January. The minimum wage of public sector employees has been raised from US\$ 106 per month to US\$ 171, a 64% rise, to go into effect in January 2014. Inflation pressures reflect persistent supply-side bottlenecks and continued money expansion. IMF foresees inflation to hover around the 10% rate over the next couple of years. It is widely believed that unemployment, inflation, and critically, poverty, will remain high and, in the absence of a clear and credible strategy to deal with them, could stoke popular frustration and discontent.

At the monetary level, major international reference sources have improved their forecast for Egyptian Pound but modestly. They are actually conscious that the challenges remain pronounced. Even after recent gains, reserves still cover less than 4 months of imports, and there is little appetite at the Central Bank to remove, or reduce, extensive controls on FX. It is believed that the underlying forces of the Egyptian Pound, namely the balance of payments, remain in a critically weak position.

The main risk is that heightened political uncertainty and further escalation of violence would reduce confidence and increase external and budgetary pressures. Also, higher food and energy prices would place an additional burden on the budget and worsen the external position. While the pledged financial support from Kuwait, Saudi Arabia, and UAE would help Egypt meet its financing needs during the next year or so, the budget deficit will remain elevated, unless the authorities move ahead quickly with their plans to reform subsidies and implement other fiscal measures. All international institutions see the budget deficit revolving within the 13%-14% range in FY 2013/2014 while public debt is set to exceed the threshold of 90% of GDP.

Beyond the near term, the prospects for the Egyptian economy hinge on the achievement of political stability and structural reforms. Risks to the outlook remain high. Unemployment, the most pressing issue, increased from 9% in 2010 to 13.6% in 2013, with youth unemployment exceeding 30%. Egypt needs to create 700,000 new jobs annually to avoid a further increase in unemployment. However, this would require a revival of private sector investment and an improved business climate to generate a much higher growth rate than all current growth projections. Modest growth may not fully satisfy the popular expectations of fundamental change to create meaningful employment, sharply reduce poverty, and secure personal welfare and human rights at large.

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