EGYPT ECONOMIC REPORT

IN THE MIDST OF FISCAL CHALLENGES AND MONETARY CONCERNS

TABLE OF CONTENTS

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

Nathalie F. Ghorayeb
(961-1) 964047
nathalie.ghorayeb@banqueaudi.com

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

Marc P. Harb
(961-1) 959747
marc.harb@banqueaudi.com

- Slow economic recovery from a relatively low base

The Egyptian economy remain pressured by a multitude of economic and social challenges in addition to an acute political divide across the country on key national issues. But as the local macro environment has been slightly better than that seen in 2011, real GDP reported a growth of 2.0% in 2012, driven by resilient domestic consumption and growing public spending. In parallel, Egypt's inflation rate dropped to a single digit rate of 8.7% in 2012 as per the IMF, after five years of a double-digit growth in the consumer price index.

- Another year of external sector fragility despite relative improvement

Egypt's external accounts managed to report an improvement stemming from the low base seen in 2011, characterized by a staggering outflow of capital. Yet, the recovery of some of the external drivers was more or less offset by the weaker performance of others as they were still under the influence of the unsettled situation, thus leaving the balance of payments in the negative territory. The country's external accounts were still impacted by the protracted occasional instabilities coupled with an ongoing weaker demand from Egypt's main trade partner, debt-stricken Europe.

- Intensifying pressures on already worrisome public finances

Fiscal accounts remain at the forefront of the country's macroeconomic issues as the delay in reforms along with a weak economic growth and the expansion of subsidies exacerbated what was already a critical issue in Egypt. Public finances reported a shortfall of 11.1% of GDP in FY 2012, overshooting the target of nearly 8% to reach the highest contemporary level so far witnessed by the country and among the most significant in the MENA region. This has put upward pressure on the country's borrowing costs and its indebtedness ratio which accounted for 79.7% of GDP in FY 2012, compared with 76.4% of GDP in FY 2011.

- Foreign reserves depletion coupled with local currency depreciation

Monetary conditions in Egypt were marked by a continuous deterioration in gross official reserves 2012 and a further depreciation in the local currency against the US Dollar. International reserves closed the year at US$ 15.0 billion at end-December, reporting a yearly decline of US$ 3.1 billion after the drastic decline of the previous year. Reserves are equivalent to circa 10% of Egyptian Pound deposits and nearly 3.3 months of imports, i.e relatively vulnerable levels within the current managed exchange rate regime.

- Resilient banking sector but with rising sovereign exposure

Egypt's banking sector has sailed through a year of extended uncertainties rather well, recording a pick-up in activity growth and improved profitability from a lower base in the previous year, although the rising exposure to domestic government securities is somehow starting to weigh on banks' solvency/liquidity profile. Banks' total activity, measured by total assets of banks operating in the country, managed to pull out a rather satisfactory performance last year on the back of a resilient deposit base, posting a 10.2% increase in local currency terms (4.5% in US Dollar terms) in 2012.

- Sound recovery across capital markets in 2012 followed by trend reversal in early 2013

The year 2012 saw a rebound in Egyptian capital markets after the sharp drops observed in 2011, as a preliminary agreement between the IMF and the Egyptian authorities over a long-awaited credit facility, the conclusion of the Presidential elections in a peaceful way, and the relative improvement in Egypt's outlook triggered increases in equity and bonds prices and resulted in contractions in the cost of insuring debt. Yet, the Egyptian Exchange saw price declines and the bond market saw spread expansion so far this year, relatively bucking the trend that has prevailed over the previous year.

- Economic adjustment program critical for near term outlook

Looking ahead, the implementation of a new program paving the way for macroeconomic stability, faster growth and a stronger balance of payments and fiscal position would be positive for the country's risk outlook in the near term. On the other hand, the failure to secure a new IMF program or a serious delay in agreeing on a program, leading to unsustainable fiscal and external positions, would be adversely impacting risks and outlook. The main ultimate issue remains that of the turbulent transition coupled with considerable political volatility and sporadic outbursts of violence within the context of an overall fragile Egyptian economy at large.

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

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

Throughout 2012, the Egyptian economy has witnessed a slow recovery from a relatively low base in the previous year. The economy remained pressured by a multitude of economic and social challenges in addition to an acute political divide across the country on key national issues. But Egypt has managed to preserve macroeconomic stability in the period following the revolution on the overall. As the local macro environment has been slightly better than that seen in 2011, real GDP reported a growth of 2.0% in 2012, following an increase of 1.8% a year earlier. In parallel, Egypt's inflation rate dropped to a single digit rate of 8.7% in 2012, after five years of a double-digit growth in the consumer price index, as per the IMF.

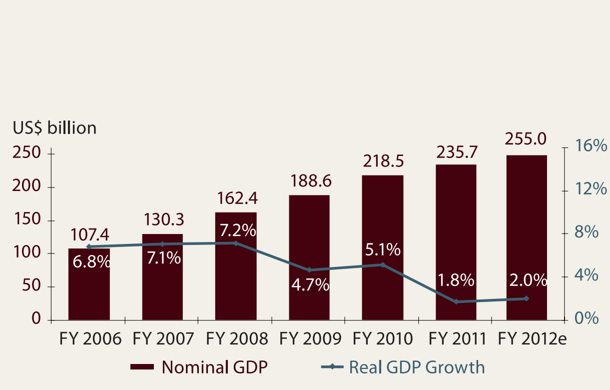
Domestic consumption has shown a considerable extent of resilience, especially on the back of elections-related expenditures and the government's spending on subsidies and wages which provided a support to private demand. Investment has picked up over the year, partly due to positive base effects. The value of implemented investment increased by 3.1% in FY 2012, following a decline of 1.2% in FY 2011. It likewise extended its rising streak so far in FY 2013 (+3.0% in the first quarter of FY 2013). In particular, FDI marked a net inflow of US$ 2.6 billion in 9M2012, depicting a relative improvement from a period highlighted by colossal instabilities.

At the sectoral level, manufacturing and tourism have shown signs of slow recovery as has the construction sector. The touristic sector has actually shown some pick up from its relatively low base in the previous year. In fact, Egypt recorded a 17% increase in the number of tourists in 2012 and revenues generated by the sector were up by 13%, as per the Ministry of Tourism. But as economic growth remained somehow anemic, the unemployment rate has risen to 12.6% in FY 2012, from about 9% before the revolution.

Within the context of a slow-moving global economy, Egypt's external growth drivers have been relatively sluggish on the overall. Activity within the Suez Canal has indeed slowed owing to weaker global demand particularly in the Euro zone. Likewise, exports decreased by 2.6% year-on-year in 2012, following an increase of 11.5% a year earlier, within the context of a weaker demand mainly from the EU coupled with some disruptions on the country's pipelines as well as halting gas exports to some countries.

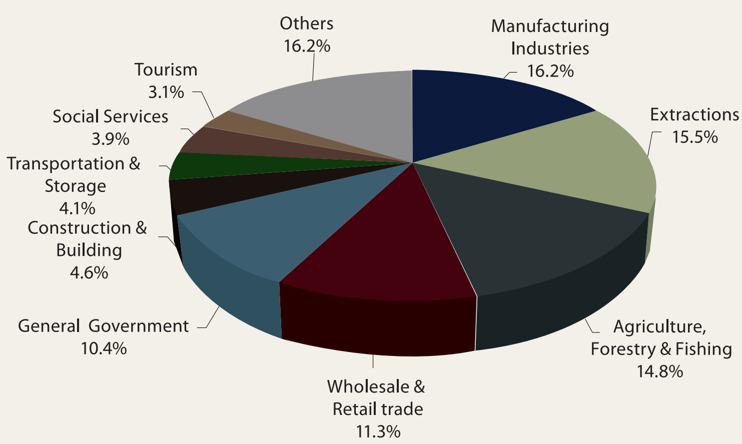
In parallel, Egypt's financial vulnerabilities have risen owing to a decline in international reserves and an increase in the fiscal deficit and domestic Treasury bills rates. International reserves closed the year at US$ 15.0 billion at end-2012, reporting a yearly decline of US$ 3.1 billion after the drastic decline of the previous year. Reserves are equivalent to circa 10% of Egyptian Pound deposits and nearly 3.3 months of imports, i.e relatively vulnerable levels within the current managed exchange rate regime. To prevent a further deterioration of reserves, the Central Bank adopted new currency measures according to which it started auctioning US$ 75 million a day for banks. It also put a limit on corporate cash withdrawals at US$

GROSS DOMESTIC PRODUCT



Sources: IMF, Bank Audi's Group Research Department

GDP BREAKDOWN BY ECONOMIC ACTIVITY (FY 2012)



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

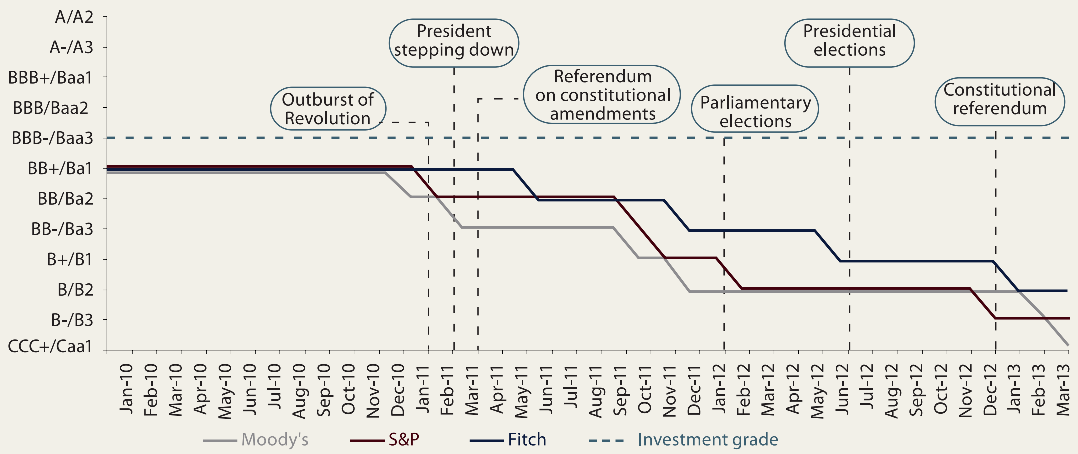
30,000 per day and placed a 2% administrative fee on individuals purchasing foreign currencies (slightly reduced thereafter). Still, the Egyptian Pound traded at its weakest level since eight years. It has closed the year at circa LE 6.36 per US$, compared with nearly LE 6.04 per US$ at the close of the previous year.

Weaker revenue collection and higher public expenditures driven by higher subsidies have widened the budget deficit, which reached 11.1% of GDP in FY 2011/2012, driving up Egypt's debt to GDP ratio from 76% to 80% over the period. Reliance on the domestic market to finance the deficit has actually contributed to a sharp increase in domestic Treasury bill rates, which peaked at nearly 16% in August before receding. The balance of payments also deteriorated in relative terms owing to portfolio capital outflows in addition to a widening current account deficit within the context of weakening net exports.

At the banking sector level, activity has been more or less faring well in a relatively cloudy economic environment, bearing witness to a relative resilience on the overall. Bank assets increased by 10.2% in local currency terms (4.5% in US$ terms) between end-2011 and end-2012 compared with a mild growth a year earlier. Deposits are up by 10.3% over the same period, against a mild 2.9% increase in 2011, while loans posted a 5.5% rise within the context of a still struggling economy. The growth in total deposits was driven by the rise of those in local currency that represented almost 70% of the total deposit growth and which increased by 9.2% between end-2011 and end-2012 while those in foreign currency went up by 13.7% over the same period. While operating conditions are still tough, banks' net profits underwent a relative recovery as the economy emerged gradually from the wider conflicts it had witnessed in 2011.

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 challenges facing the near term outlook.

EGYPT'S CREDIT RATING EVOLUTION



Sources: Rating Agencies, Bank Audi's Group Research Department

1. ECONOMIC CONDITIONS

1.1. REAL SECTOR

1.1.1. Agriculture

Activity on a standstill in the primary sector

The agricultural sector managed to somehow sustain its pace of activity by reporting a real growth of 2.9% in FY 2012 compared to a slightly lower one of 2.7% in FY 2011, a trend also seen so far in FY 2013 as the real growth moved from 3.1% in the first three months of FY 2012 to 3.0% in the same period of the current fiscal year. The sector which accounts for circa 14.8% of the country's GDP is almost totally driven by the production in the private sector.

While the private sector accounts for the bulk of total agriculture output, the value of implemented investments within the agricultural sector declined by 24.8% in FY 2012 following a rise of 1.3% a year earlier. Such a performance is linked to a weaker appetite from the private and the public sector. As a matter of fact, those stemming from the former entity reported a decline of 24.2% in FY 2012 after another one of 7.9% in FY 2011 and those from the latter also declined by 25.6% in FY 2012 against a rise of 13.8% in FY 2011, as per Central Bank data.

Regarding the production of wheat, although wheat cultivated areas make up the highest share of the country's agricultural land, Egypt remains the top global importer of the product, as local production satisfies less than half the country's consumption. It is worth noting in this context that wheat cultivated areas accounted for more than 3 million Feddans in 2012, exceeding those of the year before, after a governmental announcement of a plan to raise the purchasing price to 400 pounds per Ardeb. In parallel, Egypt was facing additional risks to inflation due to unfavorable weather conditions in major wheat exporting countries and to the damage affecting the US wheat crop. This issue was of major worry to the Egyptian government which has intended to maintain supplies of bread subsidies in tandem with its general policy of increasing food subsidies in the fiscal year 2012-2013. Despite the record domestic harvest registered in 2012, the total strategic stocks of local and imported wheat have decreased to 2.207 million tons as of March 2013, enough to cover only 89 days of consumption. Indeed, economic turmoil in the country has made it difficult to secure payments for wheat imports, with the rate of purchases having toppled since beginning 2013. As a matter of fact, Egypt used for the first time US export credits to pay for a wheat purchase. The program, created to facilitate US farm exports, assures lenders that they will get paid even in the case of a borrower's default.

On another level, the plan to establish the biggest poultry project in Egypt on an area of over 140,000 Feddans has been approved. An aggregate 286,000 Feddans make up the total phases of the project

OUTPUT OF MAIN CROPS

		FY 2010			FY 2011			FY 2012e		
	Productivity unit	Production (000s tons)	Area (000s Feddans)	Average Productivity	Production (000s tons)	Area (000s Feddans)	Average Productivity	Production (000s tons)	Area (000s Feddans)	Average Productivity
Vegetables	ton	17,510	1,496	11.7	21,514	1,903	11.3	24,611	1,914	12.9
Sugar cane	ton	15,482	317	48.8	15,709	321	48.9	17,949	346	51.9
Fruits	ton	10,073	1,511	6.7	8,370	1,376	6.1	12,310	1,500	8.2
Wheat	ardeb	7,169	3,001	15.9	8,367	3,048	18.3	7,901	3,150	16.7
Sugar beet	ton	7,840	386	20.3	7,486	362	20.7	7,635	362	20.7
Maize	ardeb	5,365	1,691	22.7	5,365	1,690	22.7	5,731	1,785	23.5
Rice	ton	4,330	1,094	4.0	4,329	1,095	4.0	4,600	1,100	4.2
Onion	ton	2,246	134	13.8	2,590	172	14.3	2,886	192	14.3
Millet	ardeb	774	333	16.6	691	329	15.0	736	340	15.5
Cotton (seeds)	m. c.	281	284	6.3	431	370	7.4	473	400	7.5

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

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

which is targeted at boosting annual poultry production. The project falls within the government's general plan to reclaim a million acres of agricultural land under a national project to close the country's food gap. In addition, the UAE agreed to undergo massive agricultural projects in Egyptian land with a budget of US$ 3 billion. Among those is a project reclaiming 100,000 Feddans in order to create the country's second largest poultry farm, as part of the Toshka project in the upper Nile region. Two other projects aim at creating a lab for artificial inoculation and a buffalo breeding industry, also in partnership with the UAE.

In an effort to boost the agricultural sector, the Principal Bank for Agriculture and Development, the largest specialized credit institution in Egypt, has decided to decrease interest rates on loans for farmers who grow crops. Small farmers, identified at 90% of Egypt's total farmers, will be granted loans at less than 3% interest rates. In addition, the bank has earmarked US$ 1.03 billion in loans for farmers who grow staples at an interest of about 5% per annum.

1.1.2. Industry

Manufacturing industries seen on a slightly better path

Throughout FY 2012 and so far in FY 2013, the manufacturing industries on one hand and the extractive ones on the other have been reporting somewhat contrasting trends. While both remain to different extents under the influence of a difficult environment which is curtailing business sentiment, extractions are still encountering difficulties to regain their upward path but manufacturing industries were seen as gradually emerging from the net slowdown they had witnessed in FY 2011.

In details, extractive industries reported a real growth of 0.1% in FY 2012 compared to a higher one of 0.6% in FY 2011. When broken down by type, petroleum industries reported a real growth of 1.0% in FY 2012 against a higher one of 2.4% in FY 2011. The gas industries witnessed a real contraction of 0.7% in FY 2012 compared to another one of 0.8% in FY 2011. The growth at the level of other extractions accelerated from 1.7% in FY 2011 to 2.3% in FY 2012. A look at FY 2013 shows not much change in the situation. Extractive industries posted an overall real contraction of 0.1% in the first three months of FY 2013 compared to a higher one of 1.0% in the same period of FY 2012. Petroleum narrowed by 0.7% in real terms during the aforesaid period of 2013 following another decline of 0.1% a year earlier. Gas and other extractive industries registered growth rates of 0.3% and 3.0% in the first three months of FY 2013 compared to a contraction of 1.7% for the former and a growth of 0.7% for the latter.

With regards to the manufacturing industries, they so far seem to be on a recovery path from the net slowdown they had witnessed in FY 2011. Accordingly, their growth accelerated from a contraction of 0.9% in FY 2011 to a positive rate of 0.7% in FY 2012. The same trend is seen so far in FY 2013, as a negative rate of 3.3% in the first three months of FY 2012 turned into a positive one of 2.8% in the same period of FY 2013. A breakdown by type shows that a further growth in manufacturing industries is more or less impeded by the activity of petroleum refinement. The latter reported a net contraction of 4.7% in FY 2012 following another one of 0.5% in FY 2011 while the growth of other manufacturing industries accelerated from a negative rate of 1.0% to a positive one of also 1.0%. Such a trend goes on in FY 2013 as petroleum

OUTPUT OF MAIN INDUSTRIAL PRODUCTS

	Unit	FY 2009	FY 2010	FY 2011	FY 2012e
Cement	000s tons	41,785	43,874	43,884	46,079
Cars	units	40,909	42,627	43,627	45,808
Lorries	units	26,965	28,097	28,378	29,796
Animal & poultry fodder	000s tons	12,360	13,040	13,379	14,048
Azotic fertilizers	000s tons	12,486	13,172	13,177	13,835
Buses	units	7,151	7,451	7,561	7,939
Reinforcing iron	000s tons	5,391	5,633	5,684	5,969
Refrigerators & washing machines	000s	2,150	2,243	2,261	2,374
Refined sugar	000s tons	1,883	1,988	2,058	2,161
Phosphatic fertilizers	000s tons	1,523	1,606	1,610	1,691

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

refinement reported a net contraction of 7.3% in the first three months compared with another one of 5.3% a year earlier. As to other manufacturing industries, their contraction of 3.2% in the first three months of FY 2012 recovered to a real growth of 3.6% in the same period of FY 2013.

Implemented investments in crude oil projects are estimated to have declined by nearly 45.0% in FY 2012 and by 25.1% year-on-year in the first three months of FY 2013. Conversely, significant efforts were put into the natural gas component as it reported a 58.3% annual growth in the value of implemented investments in FY 2012. Within this context, Dana Gas announced a second 2012 gas discovery in the Nile Delta, Egypt. The discovery was at West Sama-1 in the West El Qantara Concession. This new field discovery comes after the first successful drilling in the Komombo Concession earlier in the second quarter of the year. It also follows the announcement of commencement of Dana Gas' joint-venture, the Egyptian Bahrain Gas Derivatives Company NGL extraction plant at Ras Shukheir in Egypt.

In parallel, British Petroleum is preparing to issue a tender for the development rig of its West Nile Delta offshore natural gas project, which is based on a new financial model that was agreed in mid-2010. The total cost of the first-phase development is estimated at US$ 9 billion, all of which will be borne by the concession partners. The natural gas will be sold to the Egyptian Natural Gas Holding Company for domestic use, and condensates produced along with the gas will be pumped to a processing centre at Tanta and onwards to local refineries.

1.1.3. Construction

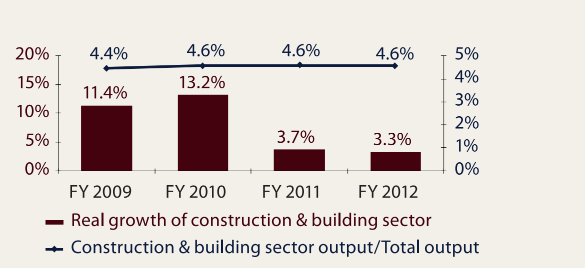
Cautiously emerging from the previous year slowdown

Egypt's construction and building activity remained under the influence of the country's overall volatile conditions which throughout FY 2012 moved back and forth between a tense situation and a quiet one, thus creating a wait–and–see attitude amongst investors. Following the double-digit rate seen in previous years, the construction and building sector reported a real growth of 3.3% in FY 2012, slightly slowing from another weak rate of 3.7% witnessed in FY 2011.

In parallel, the value of implemented investments within the construction sector declined by 70.5% in FY 2012 following a rise of 38.3% in FY 2011, as per Central Bank data. Such a trend comes mostly on account of weaker appetite from the private sector. The value of the latter's implemented investments made up nearly 83% of that of the construction and building sector in FY 2011, a share that plunged to circa 52% in FY 2012. Consequently, the value of the construction sector's share in total investment declined from 2.5% in FY 2011 to 0.7% in FY 2012.

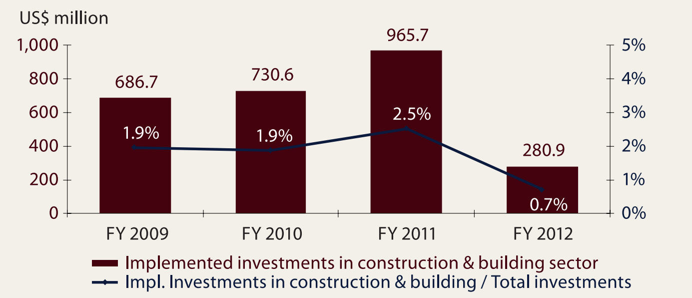
While the construction and building sector has been under the influence of the local instabilities, published data for FY 2013 paints a better picture as it begins to exhibit gradual signs of recovery. Indeed, the sector's real growth accelerated to 5.4% in the first half of FY 2013 following a contraction of 2.8% in the same period of FY 2012. With regards to the value of implemented investments, those related to the construction sector nearly doubled over the aforesaid period of FY 2013 with those stemming from the private sector surging by nearly 200%. On the overall, construction activity has risen by 60%

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

by the end of 2012 in comparison with the same period in 2011, as per the Ministry of Housing which attributed this vitality in part to the growing need for housing as the population expands, adding that some developers also are hurrying to finish projects before the new tax law takes effect. In parallel, to boost home ownership, the Egyptian Financial Services Authority proposed changes to the mortgage law to allow remortgaging and higher borrowing levels for people on low income.

Such a better performance is also mirrored by the interest exhibited from Gulf investors towards the market, mainly those within the UAE. The private sector has been targeting the Egyptian real estate market with names such as Emaar and Majid Al Futtaim. Both developers had announced plans to enter into a US$ 811.4 million joint venture to develop "Cairo Gate", a lifestyle and entertainment development on the Cairo-Alexandria desert highway. Emaar has also announced its US$ 2.1 billion "Emaar Square" in Cairo, a 250,000 square metre "city within a city" development in its flagship Uptown Cairo project. It features an open shopping mall, five-star hotel, serviced residences and office space, located at the highest point in Cairo with panoramic views of the city. Majid Al Futtaim has also decided to move forward with its Mall of Egypt project, a US$ 800 million development project, which will be built on 399,400 square metres of land in Sixth of October City outside of Cairo.

While the property market has been boosted by a relative rebound in the tourism industry, and higher demand for housing units, 2012 closed out to a combination of unrest and delayed economic reforms which somewhat creates a short-term backdrop and show the extent of challenges that remain.

1.1.4. Tourism

Gradually recovering from a turmoil-inflicted contraction

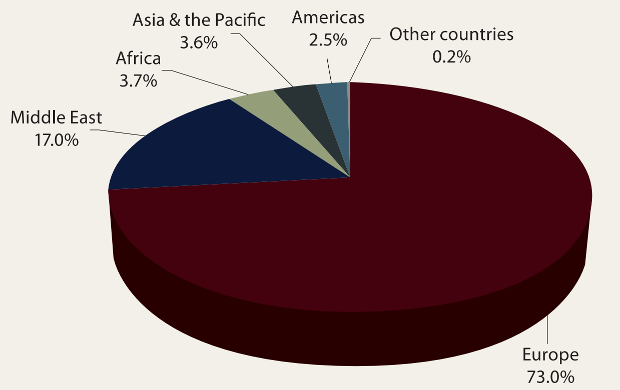
Egypt's tourism activity is steadily emerging from the significant slowdown it had witnessed in FY 2011 as a result of the widespread unrest. A combination of somewhat better security conditions, coupled with a season of elections and incentives initiated by multiple hotels within the country, have meant more foreigners flocking into Egypt. Accordingly, the tourism sector, which accounts for circa 3.1% of Egypt's GDP, reported a real growth of 2.3% in FY 2012 following a contraction of 5.9% in FY 2011. Published data for FY 2013 also paints the same picture as the sector's real growth reached 0.6% in the first three months against a net decline of 10.4% a year earlier, as per Central Bank data.

Figures on the number of arrivals show that 2012 was a year of improvement for tourism appetite. As a matter of fact, the number of incoming foreigners increased by 17.1% to reach 11.5 million in 2012 against 9.8 million in 2011, year during which there was a decline of 37.5%. Still, the number of visitors has yet to regain the 2010 pre-revolution levels during which it was at 15.8 million.

EVOLUTION OF TOURISM ACTIVITY

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

TOURISTS BREAKDOWN BY REGION IN 2012



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

Pertaining to tourists' nights, they recorded a growth of 18.5% in 2012, year during which the average stay per tourist reached 12 nights, almost the same as the 2011 level and above the year 2010 average of 9 nights per tourist. Furthermore, the occupancy rates in four and five stars hotels within Hurghada, Sharm El Shaikh, and Cairo went up throughout the year, moving from 63%, 58%, and 33% in 2011 to 71%, 70% and 41%, respectively. Such a higher demand is partly attributed to the decline in the average room rate which was lower by 8.3% for Hurghada, 4.0% for Sharm El Shaikh and 13.9% for Cairo, as per Ernst & Young.

Tourism in Egypt seems to enjoy commitment for support from the current government. Indeed, the Ministry of Tourism has dismissed worries about the future of beach tourism in the country stating that any Islamic investment in the sector would complement but not replace mainstream tourism. It is worth noting in this regard that beach resorts alone attract 70% of the traffic of tourists. Public support aimed at reviving the tourism sector has materialized through a recent initiative launched by the Central Bank of Egypt. According to the initiative, banks will grant credit facilities to customers seeking to finance tourism related activities. In addition, Egypt will be auctioning sites covering 28 million square meters of land for tourism developments, including Red Sea resorts such as Ain Sokhna and Marsa Allam. Some of the sites to be auctioned would be sold while others would be leased.

As to initiating projects in the hotel segment, 37 new top hotels with more than 10,000 rooms throughout Egypt are in the pipeline. One of the priciest resort projects is the Ritz Carlton Marassi Beach, budgeted at around US$ 1.75 billion and scheduled for December 2013. Another main project is planned by the Dubai hotel chain The Address. Another large hotel project namely the Radisson Blue Sharm el Sheikh Lagoon is to be inaugurated in July 2013. Furthermore, five hotels will be built at the Southern Sinai in the famous Sharm El Sheikh vacation region. Overall, the data published by the Central Bank shows that implemented investment within the tourism sector went up by 45.6% in the first three months of FY 2013, following a decline of 3% in FY 2012.

1.2. EXTERNAL SECTOR

Another year of fragility despite relative improvement

In 2012, Egypt's external accounts managed to report an improvement stemming from the low base seen in 2011 characterized by a staggering outflow of capital. Yet, the recovery of some of the external drivers was more or less offset by the weaker performance of others as they were still under the influence of the unsettled situation, thus leaving the balance of payments in the negative territory. While the overall politico-security conditions were comparatively a bit better last year, the country's external accounts were still impacted by the protracted occasional instabilities coupled with an ongoing weaker demand from the main trade partner, debt-stricken Europe.

At the level of trade activity, the balance of goods moved deeper into the negative territory to record a deficit of US$ 30.5 billion in 2012, up by 8.1% from 2011, year during which it had risen by 2.0%, as per the Economist Intelligence Unit (EIU). Such a hastened pace is attributed on one hand to the fact that exports reverted to a decline of 2.6% to US$ 27.2 billion in 2012, and on the other, to the 2.8% increase in imports which totaled US$ 57.7 billion, as per the same source. With regards to the former, activity was to a significant extent curtailed by the decline in petroleum exports which make up circa 50% of total. Also, weaker demand from Europe had a negative impact on exports as the goods destined to the debt-stricken continent account for nearly 45% of the total. At the level of imports, which are the largest use of FX in the current account, their decline in 2011 reverted to an increase in line with the growth of private consumption as adverse conditions somewhat eased not to mention the support provided by expenditures during elections season.

Pertaining to the services balance, the decline of the revenues from the Suez Canal were somewhat mitigated by the relative recovery of tourism receipts. Indeed, the former edged down by 1.7% in 2012 on account of a decline of 1.0% in the number of ships, while the latter, a major contributor to the services balance (45% of the services balances revenues), was up by 13%, as per the Ministry of Finance. As local instabilities were somewhat attenuated last year, attention to the elections season, coupled with a higher number of European and Middle Eastern incomers flocking into the country, supported the tourism sector which managed to recover from the erosion it had witnessed in 2011. Overall, the surplus of Egypt's services balance reached US$ 12.1 billion in 2012, up by 2.8% from 2011, year during which it had declined by 24.2%, as per the EIU.

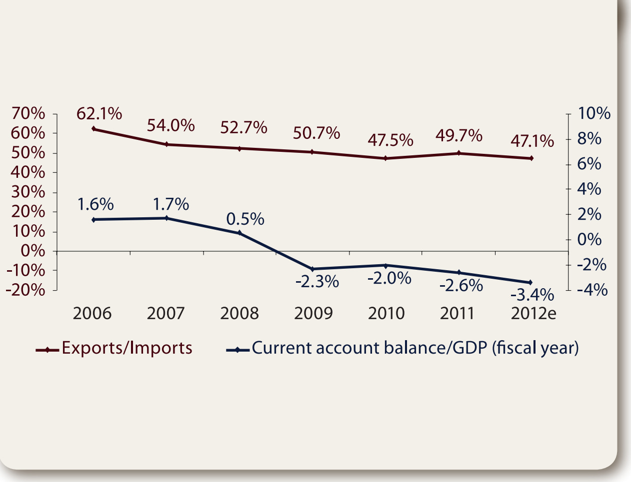
Concerning the current transfers balance, it was mainly supported by the rise in remittances from the Egyptian Diaspora. The latter, at US$ 18.0 billion in 2012, were up by 25.5% from 2011 as per the World Bank. First, greater savings are sent back by nationals working in the perceived as relatively safer GCC region, which happens to employ a large portion of Egyptian expatriates. Second, remittances to Egypt have surged since 2010, driven by increased support by migrants to their families in the face of political uncertainty or savings brought by returning migrants.

While some of Egypt's external growth drivers have shown a relative improvement, they however did not manage to counterbalance the impact of the ongoing deterioration of others, i.e. trade deficit. The rise in the latter's shortfall weighed significantly on the current account balance which remained in the negative territory to reach US$ 5.5 billion in 2012, narrowing from another deficit of US$ 7.6 billion recorded in 2011, as per the EIU.

Within the capital and financial accounts, the slightly better security conditions prevailing throughout the year have more or less boosted again the appetite of foreign investors to initiate projects within Egypt. Accordingly, the latest available data from the Central Bank showed that the country's investment inflows increased by 47.3% annually in the first nine months of 2012 following a decline of 28.4% in the same period of 2011. This has left the overall net FDI balance in a positive area of US$ 2.6 billion in 9M2012, against a total of US$ 0.4 billion a year earlier. Conversely, portfolio investment in Egypt remained in the negative territory as foreigners were selling, yet to a lesser extent, their holding of Egyptian bonds and Treasury bills.

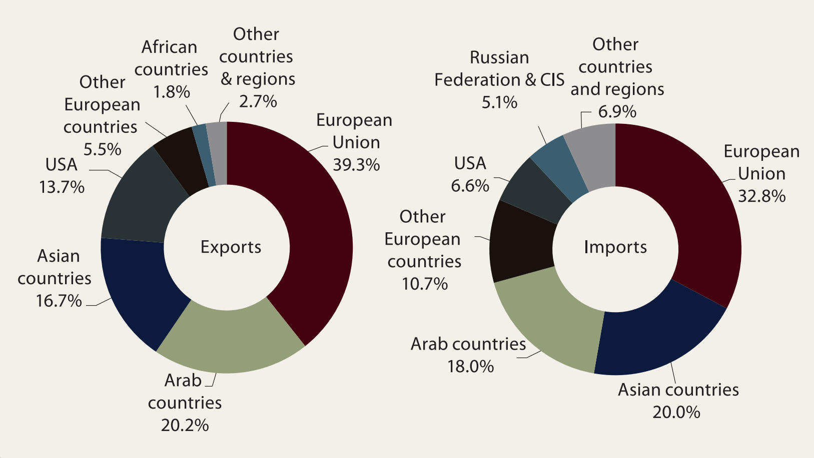
The ongoing deficit of the current account balance, added to another one of the capital and financial account, led to a balance of payment account remaining in the negative territory despite the improvement from the previous year. According to the latest available data from the Central Bank of Egypt, the balance of payments account recorded a cumulative deficit of US$ 3.8 billion in the first nine months of last year, against a deficit of US$ 12.7 billion during the same period of the previous year. The absence of effective international financial support disbursement, coupled with a still fragile external position, might create difficulties this year, raising concerns over balance of payments funding at large.

FOREIGN SECTOR INDICATORS



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

BREAKDOWN OF EXPORTS AND IMPORTS BY REGION (9M 2012)



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

1.3. PUBLIC SECTOR

Intensifying pressures on already worrisome public finances

During FY 2012, Egypt's fiscal accounts remained at the forefront of the country's macroeconomic issues as the delay in reforms along with a weak economic growth and the expansion of subsidies exacerbated what was already a critical issue for the country's government. Accordingly, Egypt's public finances reported a shortfall of 11.1% of GDP in FY 2012, overshooting the target of nearly 8% to reach the highest contemporary level so far witnessed by the country and the most significant one within the MENA region, as per the IMF. This has indeed put upward pressure on the country's borrowing costs and its indebtedness ratio which accounted for 79.7% of GDP in FY 2012, compared with 76.4% of GDP in FY 2011, as per the same sources.

On the revenues side, fiscal accounts reported an increase of 13.9% in local currency terms to reach the equivalent of US$ 57.2 billion in FY 2012, following a decline of 0.4% in FY 2011. The receipts' share of the country's GDP remained practically constant at 22.4% in FY 2012 compared with 22.0% in FY 2011, as per the IMF. Noteworthy is that the achieved revenues for FY 2012 were nearly 2.0% lower than pre-set budgeted figures. In fact, tax receipts were affected by the economic slowdown, recording a growth rate comparatively weaker than that seen in FY 2011 to reach a shortfall of circa LE 25 billion on the budget target. In parallel, their share of total revenues declined from around 72% in FY 2011 to almost 64% in FY 2012. Revenues were mostly supported by grants which were more than three times higher than those received in the previous fiscal year.

With regards to expenditures, they were up by 17.3% in local currency terms to attain the equivalent of US$ 85.6 billion in FY 2012, following a weaker rise of 10.1% reported in FY 2011. Public outlays were to a significant extent boosted by those related to subsidies, wages and interest payments. Concerning subsidies, their increase accelerated last year mainly on account of those related to petroleum products which make up the bulk of the category. Indeed, they were nearly 40% higher in FY 2012 to account for circa one-fifth of total expenditures. Pertaining to wages, their rise also hastened this year on account of the measures introduced by the government according to which the minimum monthly salary for current government employees was enhanced from LE 444 to LE 708 while those beginning to work for the government at the start of FY 2012 received LE 684 per month versus LE 422 in FY 2011. Interest payments reported a significant increase in FY 2012 as the government increased its local borrowing to finance the deficit.

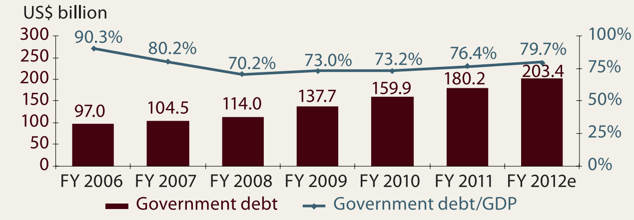
Under such conditions, Egypt's fiscal accounts sank deeper in FY 2012 to report a shortfall equivalent to US$ 28.4 billion, up by a yearly 25.0% in local currency terms. Indeed, this is a deviation from the government's commitment to fiscal consolidation with the shortfall, in absolute terms, attaining the highest level reported so far by the country.

SELECTED PUBLIC FINANCE INDICATORS

US$ billion	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012e
General government revenues	36.1	45.1	52.2	54.9	51.9	57.2
General government revenues/GDP	27.7%	27.8%	27.7%	25.1%	22.0%	22.4%
General government expenditures	46.0	58.1	65.0	72.1	75.3	85.6
General government expenditures/GDP	35.3%	35.8%	34.5%	33.0%	32.0%	33.6%
General government fiscal balance	-9.8	-13.0	-12.8	-17.1	-23.4	-28.4
General government fiscal balance/GDP	-7.5%	-8.0%	-6.8%	-7.8%	-9.9%	-11.1%

Sources: IMF, Bank Audi's Group Research Department

GOVERNMENT INDEBTEDNESS



Sources: IMF, Bank Audi's Group Research Department

Currently, work is underway to issue a revised budget for FY 2013. The Ministry of Finance has indicated that the deficit will be 10.4% of GDP, rather than 7.6% as originally planned, reflecting a more realistic assessment of the prospects for raising new revenue and trimming spending. The government has introduced price increases for high-octane petrol as well as for electricity supplied to residential users, and has announced plans to introduce rationing systems for the sale of subsidized butane and diesel. So far in FY 2013, published figures are painting a cloudy picture for fiscal accounts as the deficit reported an annual increase of nearly 35% in the first seven months of FY 2013. At this level, concerns would emerge as the IMF had called for the fiscal deficit to be gradually brought down from 11% of GDP in FY 2013 to 8.5% in FY 2014.

1.4. FINANCIAL SECTOR

1.4.1. Monetary Situation

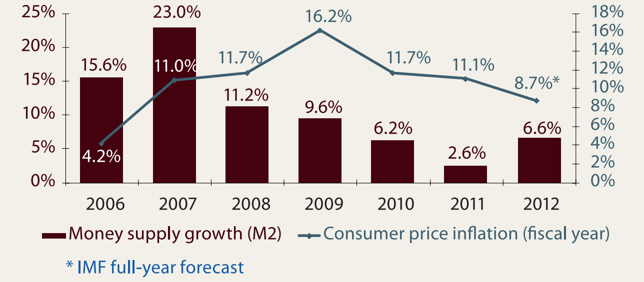
Foreign reserves depletion coupled with local currency depreciation

Monetary conditions in Egypt were marked in 2012 by a continuous deterioration in gross official reserves and further depreciation of the local currency against the US Dollar, while inflation was contained at relatively moderate levels. Within this context, the Central Bank of Egypt adopted a loose monetary policy in an attempt to increase local currency liquidity and ease credit conditions.

The sharp drop in tourism revenues and foreign direct investment following the local political uprising, the delay in concluding a long-waited IMF loan, and the new auction system for buying and selling US Dollars introduced by the Central Bank of Egypt at the end of December 2012, put pressures on the Egyptian Pound that has depreciated steadily against the US Dollar during the year 2012, moving from LE/US$ 6.04 at end-December 2011 to LE/US$ 6.36 at end-December 2012 and reaching LE/US$ 6.74 at the closing date of this report, which is its lowest level in two decades. Within this context, the Central Bank of Egypt has taken some measures to contain the depreciation of the currency, allowing starting February 10, 2013 Egyptian citizens living abroad who remit money to an Egyptian bank to repatriate the same value outside Egypt, a move that would help eliminate the black market for the US Dollar and would encourage Egyptians abroad to increase their remittances.

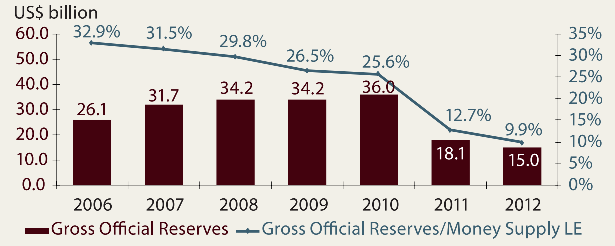
Under relatively mounting pressures, the foreign exchange market saw a wave of net conversions from Egyptian Pound to foreign currencies. This has prompted the Central Bank of Egypt to resort to its foreign currency reserves to support the local currency and counter a lack of capital inflows. Accordingly, Egypt's gross official reserves plummeted by 17% in 2012, moving from US$ 18.1 billion at end-December 2011 to US$ 15.0 billion at end-December 2012, covering 3.3 months of imports and circa 10% of the local currency money supply, and continued its fall in February 2013 to reach US$ 13.5 billion despite the US$ 5 billion financial support from Qatar and the start of foreign currency auctions by the CBE late December

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

to limit local banks' access to hard currency. On a cumulative basis, the Central Bank of Egypt has spent more than US$ 22 billion since the uprising in January 2011 in the aim of containing the fall of the local currency.

The depreciation of the local currency against the US Dollar and the rising food prices 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 5.0% on average in FY 2012, according to the Central Bank of Egypt. Yet, the inflation rate for all areas is estimated to have reached 8.7% in FY 2012, according to the IMF, and is expected to rise to 10.7% in FY 2013 due to the depreciation of the Egyptian Pound, the rise in global non-oil commodity prices and the subsidy reform. There is no doubt that inflation would shoot up if the Central Bank of Egypt were to stop intervening on the foreign exchange market to support currency liquidity, and there is no doubt that such concerns explain the Central Bank's continued defense of exchange rate stability even in the face of a rapid decline in its foreign currency reserves.

In the aim of enhancing local currency liquidity into the banking system after it has dropped significantly since the uprising due to budget deficit financing, the Central Bank of Egypt reduced twice in 2012 the required reserve ratio (RRR) on local currency deposits from 14% to 12% in March and to 10% in May, after remaining stable for a decade. This infrequent move also aimed to help ease credit conditions and bring down yields on government securities. In parallel, the CBE raised in March 2013 the overnight deposit rate and the overnight lending rate by 50 basis points to 9.75% and 10.75% respectively, in an effort to rein in inflation. The CBE also raised the discount rate by 75 basis points to 10.25% and the rate of the CBE's main operation by 50 basis points to 10.25%.

The broader money supply (M2) expanded moderately by 6.6% in 2012, the equivalent of US$ 11.4 billion, moving up from US$ 172.1 billion at end-2011 to US$ 183.5 billion at end-2012. This compared to a lower growth of 2.6% in 2011. Money supply in its narrow sense (M1) widened by 7.1% in 2012 to reach US$ 45.3 billion.

In the forthcoming period, the Central Bank of Egypt would continue to closely manage the depreciation of the currency ahead of Parliamentary elections, and may allow a faster depreciation of the Pound in the near future given the depletion of foreign reserves, unless an IMF stand-by credit facility is concluded. Also, given that the economic growth remains weak, and provided that there is no sharp rise in inflation, the CBE is not actually expected to raise interest rates in the near term.

1.4.2. Banking Activity

Resilient deposit base yet subdued private sector lending amid rising sovereign exposure

Egypt's banking sector witnessed another difficult year during 2012, with sporadic waves of politico-security tensions and a prolonged transition phase coupled with accrued fiscal and currency concerns taking their toll on economic activity momentum, with spillover effects on banks' operating conditions. Banks' aggregate activity, measured by total assets of banks operating in the country, yet managed to pull out a rather satisfactory performance last year on the back of a resilient deposit base, posting a 10.2% increase in local currency terms (4.5% in US Dollar terms) to reach the equivalent of US$ 226.6 billion at end-December 2012, and seemingly picking up some steam following a quite subdued activity growth in the previous year.

Total deposits, accounting for around 75% of banks' total balance sheets as per the latest Central Bank statistics as at end-December 2012, continued to drive activity growth throughout 2012. Total deposits at Egyptian banks recorded a 10.3% increase in the December 2011 to December 2012 period (4.6% in US Dollar terms) to reach the equivalent of US$ 171.5 billion. Banks' deposit base thus appears to be unscathed by the rather volatile political and security conditions across Egypt, growing almost steadily month after month during 2012. Last year's increase compares to a quite mild 2.9% deposit increase in local currency terms in the previous year amid acute political and security tensions.

The distribution of banking sector deposits by currency reveals that the increase in deposits during 2012 was almost entirely due to higher funds from the private sector. In fact, government deposits slightly nudged up last year, with local currency deposits' decline barely offset by a rise in those in foreign currencies. On the other hand, private sector deposits posted an 11.6% increase in 2012, with local currency deposits accounting for 75% of total private sector deposit growth, and the remainder attributed to foreign currency deposits. As such, the rising private sector local currency deposit base, despite the recent concerns over the sustainability of the authorities' FX reserve base and the currency depreciation pressures, was practically attributed to the resident household sector which accounts for 84% of total private sector local currency deposits and continues to ensure a stable and resilient funding base for banks operating in Egypt.

Within this context, banks' deposit dollarization ratio almost maintained its previous year's level, reaching 24.4% at end-December 2012. Anyhow, given rising concerns over currency conversions, the Central Bank of Egypt lately imposed a daily limit of US$ 30,000 on corporate clients' cash withdrawals, noting that the latter amounts to US$ 10,000 on individuals' withdrawals, while charging extra fees on currency exchange for individuals, among other measures.

Also, large Egyptian banks reportedly increased their deposit rates in recent weeks to entice depositors to park their funds in the local currency. Egypt's Central Bank recently said it is committed to guaranteeing local and foreign currency deposits at all banks operating in Egypt, adding that liquidity in local and foreign currencies was enough to meet commitment to clients. A few weeks ago, the sector regulator allowed overseas Egyptians remitting money to the country to repatriate it.

Furthermore, Egyptian banks' reliance on wholesale market funding is rather limited, which actually minimizes refinancing risks. As a matter of fact, the breakdown of banks' liabilities shows that bonds and long-term loans account for a mere 2.1% of balance sheets.

While deposits proved resilient and even picked up some steam last year, the overall cautious mood seems to have had a more tangible impact on borrower and lender appetite for risk. As a matter of fact, banks' credit facilities edged up by a mild 5.5% in local currency terms (0.1% in US Dollar terms) in 2012 to reach the equivalent of US$ 81.2 billion at end-December 2012. This is the result of slightly declining credit facilities to the government offset by a moderate 6.5% rise in credit facilities to the private sector.

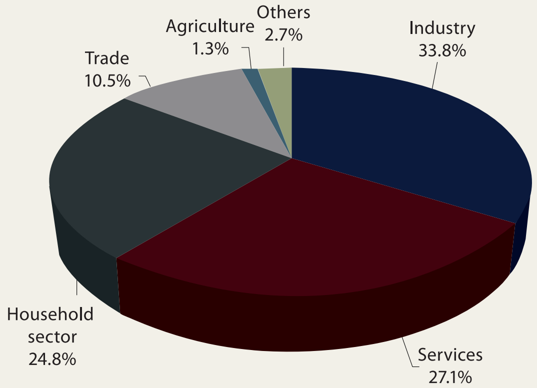
In details, private sector credit facilities in foreign currencies stagnated last year, while those in local currency reported a more or less moderate rise attributed to the household, industrial and trade and services sectors. The Central Bank of Egypt had actually reduced the required reserve ratio on local currency deposits by 200 basis points to 12% and then the latter ratio was reportedly decreased to 10% by mid-year, aiming to provide permanent liquidity to the banking sector and help ease credit conditions in the market.

BANKING SECTOR INDICATORS

in US$ million	2007	2008	2009	2010	2011	2012
Banking Activity						
Assets	184,651	190,545	210,029	221,039	216,740	226,556
Deposits	128,432	141,405	156,692	164,048	163,948	171,486
Credit Facilities	69,112	78,212	78,891	78,925	81,148	81,248
Capital + Reserves	8,264	10,016	11,589	13,794	13,530	15,834
Growth rates						
Assets	23.9%	3.2%	10.2%	5.2%	-1.9%	4.5%
Deposits	23.4%	10.1%	10.8%	4.7%	-0.1%	4.6%
Credit Facilities	14.6%	13.2%	0.9%	0.0%	2.8%	0.1%
Capital + Reserves	15.4%	21.2%	15.7%	19.0%	-1.9%	17.1%

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

CREDIT FACILITIES BREAKDOWN IN 2012

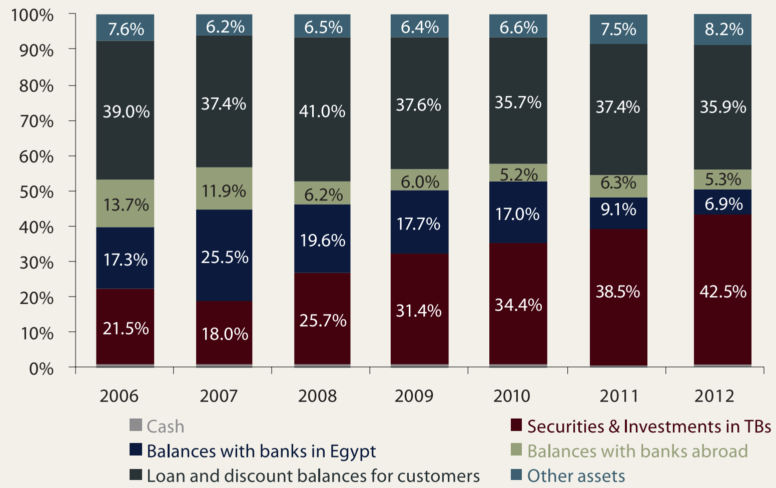


Sources: Central Bank of Egypt, Bank Audi's Group Research Department

The additional funds that banks in Egypt benefited from last year seem to have been mostly invested in government securities. The growing exposure to the sovereign comes at a time when banks have been reporting a slight reduction in their core liquidity (defined as the sum of cash and placements with banks in Egypt and abroad). Core liquidity reached 17.3% of total deposits at end-December 2012, down from 21.5% at end-2011 and 31.1% at end-2010 just prior to the popular uprisings, thus putting some pressure on banks' liquidity position. Although banks' core liquidity is being somewhat squeezed and government securities account for a sizeable chunk of asset utilization, the loan-to-deposit ratio still stands at a relatively low level of 47% at end-December 2012. Egypt actually remains an under-banked market, with credit facilities at close to 35% of GDP, providing considerable room for further lending growth ahead.

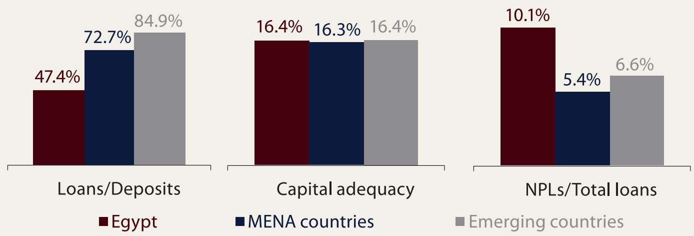
A look at the uses side of the consolidated balance sheet of Egyptian banks indeed shows that the bulk of the asset increase over 2012 was attributed to securities and investments in Treasury bills. The latter category posted a 21.7% growth in the covered period to account for a sizeable 42.5% of total assets at end-December 2012, against 38.5% at end-December 2011, 34.4% at end-December 2010 and less than 20% just before the outburst of the global financial crisis. Out of the total securities portfolio of Egyptian

BANKING SECTOR ASSET COMPOSITION



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

COMPARATIVE FINANCIAL SOUNDNESS INDICATORS*



* 2012 figures or latest available

Sources: Central Bank of Egypt, IMF, Fitch, Bankscope, Bank Audi's Group Research Department banks, 90% represent Egyptian government securities, which have posted a 23.4% rise last year, and this reflects the persistently growing exposure of banks to the sovereign. Banks are indeed a considerable source of funding for the government, in light of a growing fiscal deficit and the cautiousness of foreign investors amid an uncertain domestic outlook.

Despite banks' rising domestic sovereign exposure, which is equivalent to more than 5 times total capital and reserves, the sector enjoys adequate official capitalization levels. The latest Central Bank data indicates a capital adequacy ratio of 16.4% at end-September 2012, higher than the minimum requirement of 10% and slightly rising from 15.6% at end-2011, and of which around 85% is Tier 1 capital. Yet, it is important to note that rising sovereign exposure, perhaps not quite reflected in the former ratio, renders banks on the overall more susceptible to possible sovereign refinancing pressures. In fact, the sector's total capital and reserves to total assets ratio stood at a relatively low 7.0% at end-December 2012, noting that privately owned banks display relatively higher capital to assets ratios than the sector average.

On the asset quality front, Egyptian banks recorded a slight amelioration, with the non-performing loans to total loans ratio moving slightly down from 10.9% at end-2011 to 10.1% at end-September 2012, a level nonetheless higher than regional and international averages. The declining NPL levels came within the context of the writing off of some bad loans from banks' balance sheets, having been nearly fully provisioned. Sector NPLs are almost fully provisioned for, with the loan provisions to NPLs ratio at 95.7% at end-September 2012.

At the level of profitability, banks' bottom lines have been somewhat recovering from the previous year's adverse performances though to a certain extent still weighed down by the difficult operating environment, and more particularly the overall limited quantity effect, subdued business growth and rising provisioning needs. In the absence of consolidated profit figures, we resorted to the aggregation of bottom lines of Egyptian listed banks, which although accounting for roughly one fifth of total sector size, gives an indication of sector trends. Those aggregated profits recorded a 54% yearly improvement from a lower base in US Dollar terms in the first nine months of 2012, after having recorded double-digit dips in the previous year's corresponding period.

All in all, Egypt's banking sector has sailed through a year of extended uncertainties rather well, recording a pick-up in activity growth and improved profitability from a lower base in the previous year, although the rising exposure to domestic government securities is somehow starting to weigh on banks' solvency/ liquidity profile. The sector is also witnessing some shake-ups at a micro level. Within the context of ongoing troubles in Europe prompting European banks to divest from some non-core markets, a couple of banks are in the process of changing hands or planning a shareholder change to the benefit of regional banks expanding into markets such as Egypt they deem present lucrative medium to long term growth opportunities.

1.4.3. Equity and Bond Markets

Sound recovery across Egyptian capital markets in 2012 followed by a trend reversal in early 2013

The year 2012 saw a rebound for Egyptian capital markets after the sharp drops observed in 2011, as a preliminary agreement between the IMF and the Egyptian authorities over a long-awaited credit facility, the conclusion of the Presidential elections in a peaceful way, and the relative improvement in Egypt's outlook triggered increases in equity and bond prices and resulted into contractions in the cost of insuring debt.

The Egyptian Exchange saw a buoyant activity in 2012 and a strong rebound in prices following sharp drops observed over the year 2011 after the toppling of the former President. In fact, the bourse's main benchmark index (EGX 30) surged by a staggering 50.8% in local currency terms in 2012, which is its highest growth since 2007. Many factors contributed to the pick-up in prices, with local and foreign investors finding a good opportunity in buying beaten-down Egyptian stocks after the Presidential elections were concluded peacefully in June 2012 without any sign of violence on the local front, the IMF and the Egyptian authorities reached in November a staff-level agreement on a 22-month Stand-By Arrangement amounting to circa US$ 4.8 billion, and the newly elected Egyptian President cancelled in

December a decree that had generated widespread unrest by awarding him near-absolute powers. As to the breakdown by sector, all sectors witnessed a favorable performance in 2012 with the basic resources sector prices surging by 146%, followed by the banking sector (+82%), the real estate sector (+78%), the telecommunications sector (+70%), the food and beverage sector (+56%), the financial services sector (+31%), the construction and material sector (+24%) , the travel and leisure sector (+23%), the healthcare and pharmaceuticals sector (+13%), the personal and household products sector (+13%), the industrial goods, services and automobiles sector (+11%), and the chemicals sector (+7%).

Yet, the Egyptian Exchange saw price declines so far this year, bucking the trend that has prevailed over the year 2012, with the Egyptian price index (EGX30) falling by 2.0%, as political tensions from the opposition's boycotting of upcoming Parliamentary elections weighed on investors' sentiment. As to market pricing ratios, the Egyptian Exchange traded at a P/E ratio of 12.4x at end-2012 versus 10.5x at end-2011. In parallel, the dividend yield recorded 8.6% at end-2012 as compared to 10.4% at end-2011.

The sharp rise in prices over the year 2012 was coupled with stability in the number of listed companies on the Egyptian Exchange (213 companies). Accordingly, the market capitalization rose by 21.4% year-on-year in foreign currency terms, moving up from US$ 48.6 billion at end-2011 to US$ 59.1 billion at end-2012. The ratio of market capitalization to GDP increased from 21% at end-2011 to 23% at end-2012, which spots light on the Egyptian bourse's relatively higher contribution in the economy.

The total trading value for listed and unlisted securities rose from US$ 24.6 billion in 2011 to US$ 29.1 billion in 2012, up by 18.4%, noting that the number of trading days was 245 days in 2012 as compared to 207 days in 2011. Within this context, the turnover ratio, measured by total trading value to market capitalization, retreated slightly from 50.5% in 2011 to 49.3% in 2012.

Likewise, Egyptian debt papers followed an upward trajectory in 2012. Egypt'20 closed up by 14.50 pts, and Egypt'40 reported a price increase of 12.50 pts, as investors found a good opportunity in buying high-yielding papers amid bets that Egypt would benefit from a US$ 4.8 billion IMF loan and on improved investor sentiment after the Presidential elections were concluded in a peaceful manner. Yet, Egypt's sovereign bonds saw price declines so far in 2013, with papers maturing in 2020 and 2040 falling by 5.50 pts and 6.50 pts respectively on concerns about the Parliamentary elections, which some parties threatened to boycott. Egypt's five-year Credit Default Swap spread, which is a measure of market risk perception, contracted by 135 bps in 2012, closing at 505 basis points at end-December. Yet, it expanded again by 161 bps since the beginning of 2013.

CAPITAL MARKETS INDICATORS

	2007	2008	2009	2010	2011	2012
Market capitalization (US$ billion)	139.1	86.3	91.1	84.1	48.6	59.1
Total value traded (listed & unlisted securities, US$ million)	65,722	96,515	81,718	55,369	24,561	29,086
Non-Arab foreign participation as % of total value traded	18.3%	19.5%	12.7%	16.5%	23.6%	14.9%
Total volume of traded securities (million)	15,091	25,556	36,602	33,414	18,491	34,261
Total number of transactions (000s)	9,016	13,456	14,628	10,201	5,590	6,234
No. of listed companies	435	373	306	213	213	213
No. of traded companies	337	322	289	211	204	204
% Change in price index (EGX 30)	51.3%	-56.4%	35.1%	13.8%	-49.3%	50.8%
P/E ratio	-	9.9x	12.1x	14.7x	10.5x	12.4x
Dividend yield	-	8.8%	7.0%	7.1%	10.4%	8.6%

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

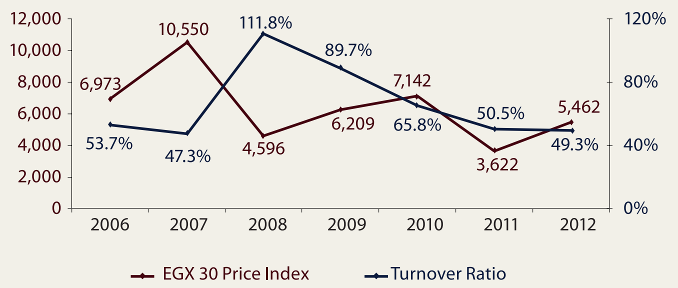
International credit rating agencies took several actions in 2012. Standard & Poor's lowered consecutively Egypt's long-term foreign and local currency credit ratings from "B+" at end-2011 to "B-" in December 2012, six notches below investment grade, with "negative" outlook. S&P referred the cut to the increased polarisation between the Muslim Brotherhood's Freedom and Justice Party and sections of the population that is likely to weaken the sovereign's ability to deliver sustainable public finances, promote balanced growth and respond to further economic or political shocks. The negative outlook reflects S&P's view that a further downgrade is possible if a significant worsening of the domestic political situation results in a sharp deterioration of economic indicators such as foreign exchange reserves or the government's deficit.

Also, Fitch downgraded consecutively Egypt's long-term foreign and local currency Issuer Default Rating from "BB" towards end-2011 to "B" in January 2013 with "negative" outlook. Egypt's rating reflects, according to Fitch, a balance between short-term reserve pressure, political upheaval, a weak and deteriorating fiscal position and capital flight against the credit rating agency's assumption that an IMF program will be in place after the election.

In parallel, Moody's downgraded consecutively Egypt's government bond ratings from "B1" towards end-2011 to "Caa1" in March 2013 with "negative" outlook. Moody's lately cited the continued unsettled political conditions that have significantly weakened Egypt's economy, the sustained deterioration in Egypt's external payments position and government finances that have reached a level at which the country's vulnerability to economic or political shocks has widened and the risk of default has consequently increased, and the lack of predictability in economic and fiscal policies and outcomes, which is underscored by continued uncertainty surrounding the Egyptian government's ability to secure financial support from the IMF.

As to new issues, it is worth mentioning that the Egyptian government mostly sold local currency denominated debt in 2012 to fund its widening fiscal deficit, and approved in February 2013 a draft law that would allow the state to issue Islamic bonds, a move that is aimed to help narrow a gaping budget deficit and boost foreign currency reserves. Within this context, Egypt recently announced plans to issue its first Sukuk in 2013 to fund energy and mega projects, saying that it expects to raise around US$ 10 billion a year from the Sukuk market.

STOCK MARKET PERFORMANCE



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

2. CONCLUDING REMARKS

With the Egyptian political situation remaining rather fluid, there are notable risks to any macro forecasts for Egypt. The recent escalation of domestic tensions has raised concerns about the country's economic outlook. The polarization and divide between the government and those in the opposition appears to be widening, adding to the country's ongoing unsettled political conditions. As Egypt goes through a complicated political transition which has increased economic uncertainty, the government is facing sustained difficulties in attracting foreign financing at large.

Budget execution highlights challenges to fiscal reforms. Subsidies and grants largely weighed on public finances as their share in total spending increased by 10% compared to the previous year. Debt service payments and the wage bill also added to these pressures, rising by 36% and 19% respectively. Fiscal performance suggests the government's targeted budget deficit of 7.6% of GDP during the fiscal year is unlikely to be met, with the IMF forecasting a deficit as high as 9.8% for the current year. Risks to sharper currency movements along with weaker budget execution will also add upward pressure on domestic yields. Strains in the balance of payments are reflected in the depreciation of the Pound against the Dollar that resulted from the greater exchange rate flexibility brought about by the introduction of capital controls.

The reported difficulty to agree on an IMF plan has also hit investor confidence in the country, especially that foreign reserves are at critical levels. An IMF program would have directly provided US$ 4.8 billion in financial support and would have helped to shore up investor confidence through a monitored program of economic reform. The IMF deal seems to be unlikely to be finalized before parliamentary elections, with more detailed negotiations apt to be protracted and challenging. The continuing uncertainty surrounding the Egyptian government's ability to secure financial support from the IMF amidst the further weakening in Egypt's external payments position and the economic impact of the intensification of civil unrest has prompted international rating agencies to downgrade Egypt's ratings, while maintaining the rating on review for further possible downgrade.

Any recovery in the economy is likely to be further delayed, with tourism and investment in particular remaining at low levels and private consumption likely to remain dampened by rising inflation. Economic prospects and confidence continue to be held down by political instability and the failure to implement reforms. A real GDP growth of 3% in 2013 after a 2% growth in 2012 as forecasted by the IMF is far below the requirements of an economy which has seen its cyclical output gap widening since the beginning of its domestic turmoil. Such a growth pace remains by all means also insufficient to generate enough jobs for the 700,000 new entrants to the labor force each year and which require a minimum of 7% real growth per annum.

In brief, Egypt currently faces a number of challenges while continuing to enjoy some intrinsic strengths. At the level of strengths, we mention the external donor support, the relatively well diversified economy, the somehow resilient banking sector and the large domestic funding base for government debt. Facing those rise a number of challenges related to the post-revolution unsettled politics and social unrest, the tough economic policymaking environment, the recent deterioration in the external payments position, the large fiscal deficit and substantial public debt, notwithstanding the recent history of high inflation.

Looking ahead, the implementation of a new program paving the way for macroeconomic stability, faster growth and a stronger balance of payments and fiscal position would be positive for the country's risk outlook in the near term. On the other hand, the failure to secure a new IMF program or a serious delay in agreeing a program, leading to unsustainable fiscal and external positions, would be adversely impacting risks and outlook. The main ultimate issue remains that of the turbulent transition coupled with considerable political volatility and sporadic outbursts of violence within the context of an overall fragile Egyptian economy at large.

DISCLAIMER