# Executive Summary

***Real GDP growth*** **came at a 1 percent in Q1-FY13/14**, compared to 2.5 percent a year earlier, mainly in light of security reasons and political developments during this period.

***As expected, Modest growth in Q1-FY13/14…***

§ **On the supply side,** main growth drivers were public services sectors, including education, health and the general government sectors, which grew at a 4.9 percent (GDP real contribution of 0.8 percentage point (PPT)) during the period of study, compared to a 2.9 percent (0.5 PPT) a year earlier. Other sectors such as agricultural, forestry and fishing sector, showed robust growth, contributing by 0.5 PPT in Q1-FY13/14, same as a year earlier. Meanwhile, sectors that are yet to fully recover include manufacturing and wholesale and retail that continued their slow down, contributing by 0.2 PPT & 0.3 PPT during the first quarter of the fiscal year respectively, compared to 0.4 PPT for both a year earlier. While tourism and natural gas sectors contributed by -0.9 PPT & -0.7 PPT respectively in Q1-FY13/14.

§ **On the demand side**, both private and public consumption continued to boost economic activity during the period of study**,** registering growth rates of 4.2 percent and 5.9 percent compared to 3.8 percent and 2.7 percent respectively during the same period last year. Thus, leading to a total contribution of 4.2 PPT for final consumption, compared to 3.5 PPT a year earlier. On the other hand, investments which declined by 7.3 percent compared to the same period last year, contributed by -0.8 PPT, suggesting the impact of the stimulus is still lagging. However going forward, with the roadmap on track and political stability restored, growth in these sectors should definitely accelerate.

***..but early positive signs for a recovery can be witnessed***

Yet a deeper look shows early signs of recovery……

- Industrial production index rose for the first time since the beginning of 2013/14, to reach 143.4 in November 2013, recording a monthly increase of 14 percent.
- PMI increased to a level of 50+ points – for the first time since January 2011 – in November and December, which indicates expanding economic activity.
- The EGX 30 index performance improved during H1-FY13/14 to record ratios of 42.7 percent – the highest since January 2011.
- An upgrade in Egypt's credit rating by Standard & Poor's in November 2013, after six successive downgrades since the beginning of 2011. Fitch ratings has also changed the outlook of the Egyptian economy to stable from negative, which was maintained since January 2013.

***The government has taken significant steps towards implementing its new strategy, namely expansionary fiscal and monetary policies supported by fresh injections from abroad, with the aim of a quick recovery in the economy.***

- ***From a fiscal perspective****, the government introduced the first tranche of a stimulus package, worth LE 29.7 billion ($ 4.3 billion) during the first half of FY13/14. Such stimulus will be directed at investments in infrastructure, health and education, thereby reviving consumption growth, and crowding in private investments. In addition to the first package, the Ministry of Finance is preparing to launch a second supplementary* *budget. This will bring total stimulus expenditure during the current fiscal year to a historical 3 percent of GDP.*

- *Moreover, the government has reached an agreement with oil companies operating in the country to settle outstanding arrears worth US$ 6 billion over four years. A disbursement of US$ 1.5 billion has already been released in December. This deal has come with assertion by oil companies that they would reinvest in the country and expand their production facilities. This is expected to have a significant spillover on the real sector , firstly through the resumption of extraction activity (whose contraction during the past three years have weighed heavily on growth), secondly through the elimination of energy bottlenecks in other manufacturing sectors. It should also help alleviate pressures of oil imports on the balance of payment sand on subsidies bill.*
- *In addition, a LE 2.2 billion program was adopted by the government to repay arrears to contractors. The government is also undergoing a new program geared towards supporting factories facing closure with a fund restructuring cost of almost LE 0.8 billion.*

***Meanwhile, from the monetary perspective****, in conjunction with the expansionary fiscal policy, the Central bank of Egypt decreased benchmark policy rates by a cumulative 1.5 percent during the same period, easing lending rates for investors as well as treasury borrowing yields on behalf of the government.*

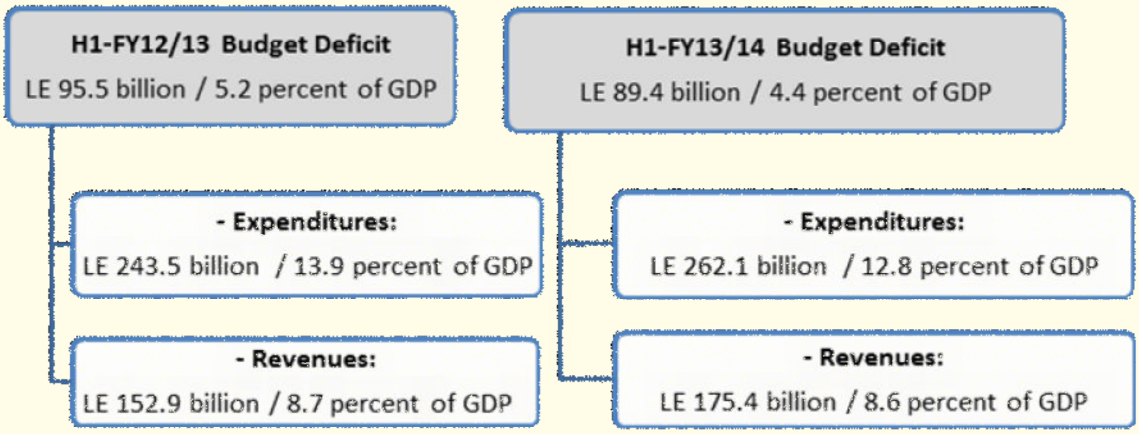
***Going forward, the government will continue on its track towards full recovery***

*The implementation of the abovementioned measures and reforms combined with a political road map on track, should lead to significant recovery in the economy bringing growth to about 3–3.5% by the end of this fiscal year.*

***Decrease in Budget Deficit …***

***Budget Deficit* decreased in the first 6 months of FY 2013/2014 (H1-FY13/14) in value and as percent of GDP,** compared to the same period last year.

**Budget Deficit decreased in the first half of FY 2013/2014 (LE billion/percent of GDP):**




**Source:** Ministry of Finance, Macro Fiscal Policy Unit

***Tax revenues dropped due to sovereign related authorities…***

***On the revenue side,*** main contribution came from the non-tax revenues, specifically the grants section, whereas the tax revenues decreased mainly due to a decrease in receipts collected from sovereign entities (Central Bank of Egypt, Suez Canal Authority, Egyptian General Petroleum Company) that will eventually be collected in the upcoming period .

**Developments on the revenue side in H1-FY13/14:**

- Aggregate ***increase*** of LE 22.5 billion in total revenues to LE 175.4 billion (8.6 percent of GDP)
- Tax revenues ***dropped*** by LE 7.3 billion to LE 103.8 billion (5.1 percent of GDP)
- Non-Tax revenues **increased** by LE 29.8 billion to LE 71.6 billion (3.5 percent of GDP)

**Tax Revenue Breakdown:**

**Income taxes dropped by LE 4.7 billion (9.4 percent growth ) to reach LE 45.1 billion (2.2 percent of GDP**

This was mainly on the back of a decrease in sovereign related tax revenues by 25.6 percent y-o-y to LE 22.5 billion (1.1 percent of GDP). (It is noteworthy that only one settlement worth L.E 24.9 billion for Q1-FY13/14 was implemented between the Ministry of Finance and the Egyptian General Petroleum Company-EGPC (of which LE 15.3 billion taxes on EGPC profits. **Noting that income taxes on other corporations excluding sovereign related revenues increased by 13.2 percent y-o-y to LE 9.9 billion (0.5 percent of GDP).**

**Taxes on goods and services decreased by LE 3.5 billion (7.8 percent growth) to reach LE 41.3 billion (2.0 percent of GDP)**

This was mainly as a result of a decrease in general sales taxes from services, specifically those related to the restaurants, hotels, and communications sectors. In addition, excises on domestic comodities dropped, due to a decline in sales tax on petroleum products.

**Taxes on property income increased by LE 1.7 billion (21.8 percent growth) to reach LE 9.5 billion (0.5 percent of GDP)**

This can be explained in light of the increase in taxes onT-bills and T-bonds.

***...while Non tax revenues hiked due to extraordinary grants***

The significant increase in non-tax revenues could be explained in light of the following:

- Increase in grants to reach LE 36.9 billion during the first half of 2013/2014 (1.8 percent of GDP), as a result of: a) LE 29.7 billion increase in grants—half of the dollar denominated deposits at the central bank- to be allocated to finance the first stimulus package related to the presidential decree no. 105, 2013.

  b) LE 7 billion the equivalent of US$ 1 billion grant from the UAE.

- Increase in revenues from sales of goods and services by 50 percent y-o-y to LE 11.1 billion (0.5 percent of GDP) due to a 56.5 percent y-o-y increase in revenues from special accounts and funds by LE 3.4 billion to record LE 9.3 billion in the period of study[1] compared to LE 5.9 billion during the first half of the previous year.

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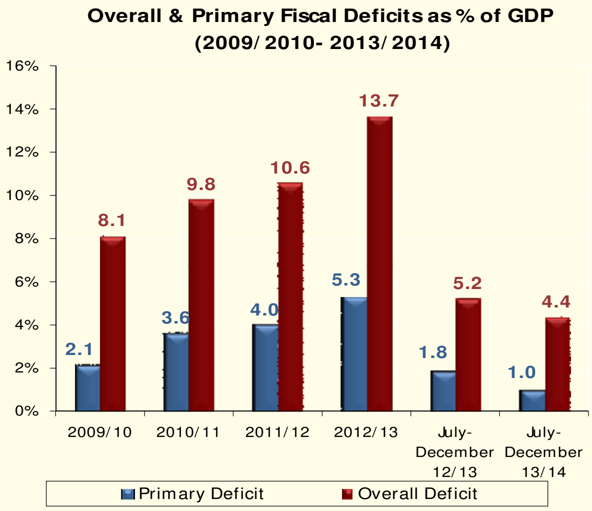
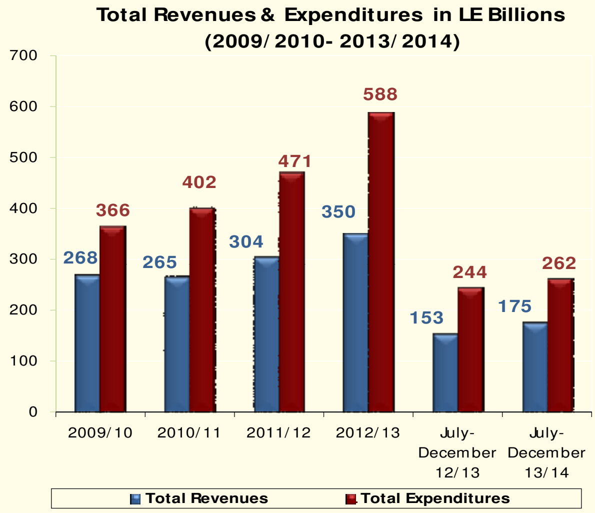
[1] The increase comes in light of the law number 19 for the year 2013, and which stipulated that budget entities should pay to the Ministry of Finance 10% of the revenues from special accounts and fund. In addition 25% of the outstanding balance on June 30th, 2013 to be repaid to the treasury starting 30/6/2013.




Source: Ministry of Finance




*Increase in Wages and Investments*

***On* the Expenditures Side:**

Total expenditures increased during July- December 2013/2014 by 7.6 percent, recording LE 262.1 billion (12.8 percent of GDP), mainly due to:

- The increase in wages and compensation of employees by 17.6 percent to LE 80 billion (3.9 percent of GDP).
- The increase in interest by 17.6 percent to LE 69.6 billion (3.4 percent of GDP).
- The increase in other expenditures by 15.1 percent to LE 17.9 billion (0.9 percent of GDP).
- The increase in purchases of non-financial assets (investments) by 17.6 percent to LE 14.7 billion (0.7 percent of GDP).
- The increase in purchase of goods and services by 1 percent to LE 9.7 billion (0.5 percent of GDP).
- However, subsidies, grants and social benefits decreased by 10.8 percent (3.4 percent of GDP), mainly due to a reduction in petroleum subsidies transferred to EGPC.

**Some important developments on the expenditure side:**

- Payments to pension funds increased by LE 9.2 billion during first half of FY13/14 (of which an increase of LE 4.9 billion in December 2013), to reach LE 17 billion during the first half of 2013/2014, to increase by 118 percent compared to the same period of last year. Meanwhile, an increase of LE 2.1 billion in subsidies to General Authority for Supply of Commodities (GASC) in December 2013, to reach LE 11 billion in the first half of FY13/14 compared to LE 8.9 billion during the same period of last year.

- Some LE 14.7 billion were disbursed as purchases of non-financial assets (investments) during the first half of 2013/2014, increased by 17.6 percent compared to the same period of last year, while investments are expected to increase during the second half of the FY 13/14.

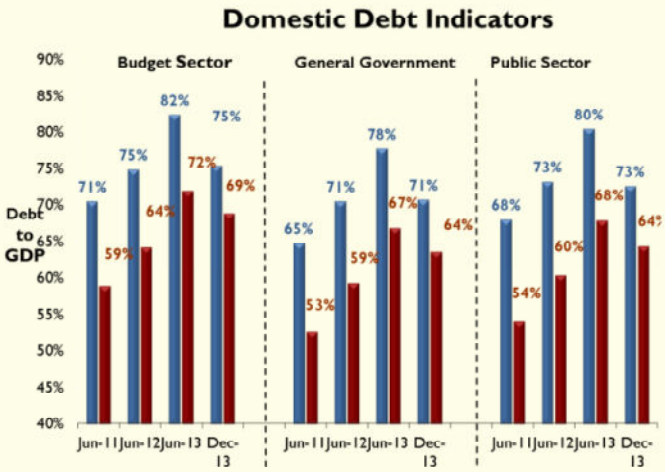
*Increase in Domestic Debt…*

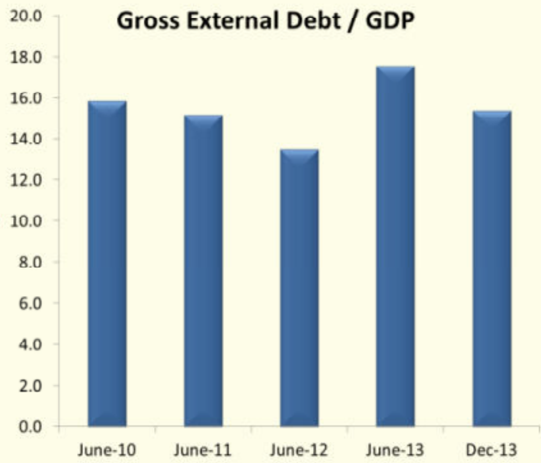
***Domestic budget sector debt*** recorded LE 1546 billion (75.4 percent of GDP) by end of December 2013, compared to LE 1294 billion (73.8 percent of GDP) by end of December 2012.

**This increase could be explained as a result of several factors of which:**

- A rise in T-Bills net issuance from LE 433 billion in December 2012 to LE 512.5 billion in December 2013.
- A rise in T-bonds net issuance from LE 312.3 billion in December 2012 to LE 340.3 billion in December 2013.
- A new bond issued to the SIF on behalf of the government worth LE 14.2 billion during the year 2013/2014.

***Worth mentioning that the total government debt*** (domestic and external) reached LE 1709 billion (83 percent of GDP) in September 2013, compared to LE 1644 billion (94 percent of GDP) at end of June 2013.




Source: Ministry of Finance

***External debt stock***[2] **(government and non-government debt)** recorded US$ 45.8 billion by the end of December 2013 compared to US$ 38.8 billion by the end of December 2012 (most of the increase represented aid from the Gulf Countries with concessional and preferential terms). External debt as percent of GDP recorded 15.4 percent by the end of December 2013, which is relatively low if compared to the average of peer countries (Middle East and North Africa countries recorded an average of 25.5 percent of GDP during the year 2013).

**Main External debt indicators are as follows:**

§ **External debt service to exports of goods and services ratio** has been unchanged since 2008/2009 till 2012/2013 stabilizing at 6.4 percent. This indicates a safe level to meet debt service obligations.

§ **Short term debt to total external debt ratio** decreased from 17.15 percent at end of December 2012 to 6.16 percent at end of December 2013.

***M2 slightly decreased in October on a monthly***

***M2 annual growth*** continued to grow reaching **nominal growth rate** of 17.8 percent as of end October 2013 (Real growth rate of 7.4 percent) compared to 11 percent in October 2012, stimulated by the increase in net domestic assets, mainly in net claims on government

[2] The notable increase in non-government external debt in the first quarter of the fiscal year 2013/2014 can be explained in light of a net increase of nearly US$ 3 billion in external debt on the monetary authorities compared to the end of year 2012/2013. The breakdown of inflows is as follows: US$ 2 billion from UAE, US$ 2 billion from Saudi Arabia and US$ 2 billion from Kuwait. Meanwhile the Qatari short term deposit worth US$ 2 billion was cancelled and a Qatari deposit worth US$ 1 billion was converted into T-bonds during the period of study.

and GASC. However this rate has slightly declined if compared to an annual growth rate of 18.7 percent recorded in the previous month.

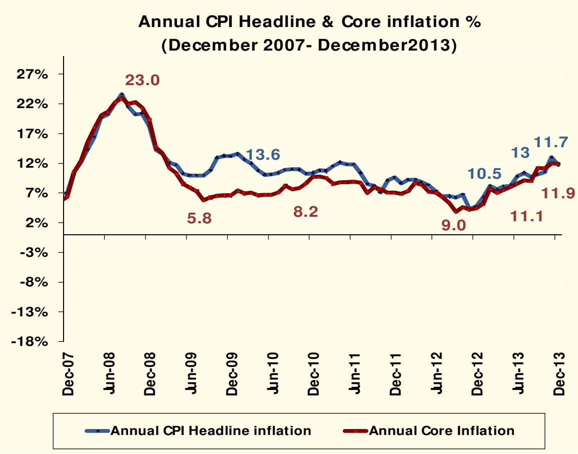
*International reserves at US$ 17 billion…*

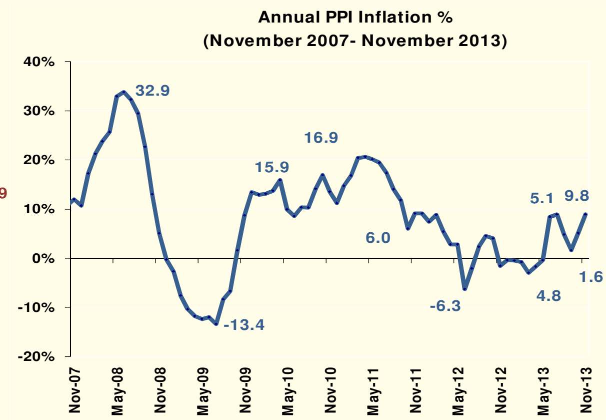
During December 2013, ***Net International Reserves (NIR)*** has been shed by US$ 0.8 billion to record US$ 17 billion, from US$ 17.8 billion in November 2013. Noteworthy, NIR witnessed an annual growth rate of 13.5 percent, despite the monthly decrease. It is important to highlight that Egypt has returned another matured deposits worth US$ 0.5 billion to Qatar, in addition to paying down of US$ 1.5 billion debt owed to international petroleum firms operated In Egypt.

*Despite inflationary pressures, inflation declined y-o-y during December 2013*

***CPI annual Urban Inflation*** increased during the period July-December 2013 recording an average of 10.9 percent, compared to 5.8 percent during the same period of last year. Factors contributing to inflationary pressures include; higher food prices (the largest weight in CPI), and some other seasonal reasons, as well as an unfavorable base effect.

However, it is noteworthy that the annual inflation growth rate has started to decline starting December 2013 recording 11.7 percent, compared to 13 percent recorded during the previous month; which is attributed to the decrease in annual inflation rate of "Food and Beverages" due to decrease in prices of fruits and vegetables (particularly tomato, carrots, potatoes, peas, taro, oranges, bananas), and the declining prices of butane cylinders, due to easing supply bottlenecks.




***Annual core inflation*** stabilized at almost 11.91 percent during December 2013 compared to 11.95 percent during November 2013. However, monthly core inflation declined to 0.4 percent compared to 0.5 percent during the previous month. This could be explained in light of the decline in food prices contributing by 0.38 percentage points, in addition to the decline in consumer goods prices contributing by 0.03 percent.

*CBE easing monetary policy in H1-FY13/14…*

During its ***Monetary Policy Committee*** meeting held on January 16, 2013, CBE decided to keep the **overnight deposit rate** and **overnight lending rates** unchanged at **8.25 percent** and **9.25** percent respectively, and to keep the CBE's **main operation** unchanged at **8.75 percent**. The committee justified that decision in light of balancing upside risks, the inflation outlook, with the downside risks to economic growth at present.

**In an attempt to absorb excess liquidity and to protect the domestic currency, the CBE announced the reintroduction of deposit operations.** In this context, on January 28, 2013, the CBE introduced LE 55 billion worth of 7-day maturity at a fixed annual interest rate of 8.75 percent.

It is noteworthy that the CBE has offered US$ 1.5 billion on January 27, 2014 at ***Foreign Exchange exceptional auction*** to meet banks import financing needs.

***GCC aid dominates the BOP front…***

***On the external sector side, BOP*** showed a significant improvement during the period July-September 2013/2014 recording an overall surplus of **US$ 3.7 billion** –the highest since July-September 1997/1998– compared to an overall deficit of **US$ 0.5 billion** in the same period last year. **This improvement can be explained in light of** the significant increase in the **current account balance**, recording a surplus of US$ 0.8 billion – for the first time since FY 2008/2009– compared to a deficit of US$ 1.3 billion recorded in July-September 2012/2013. In addition, the **Capital and Financial Account** witnessed a notable increase in net inflows recording US$ 4.0 billion, compared to US$ 1.5 billion during the same period last year.

§ **On a more detailed level, the surplus recorded in the current account** balance can be attributed to the significant increase in **public transfers** during the period July-September 2013/2014 recording US$ 4.3 billion in light of grants received from Arab countries (US$ 1 billion from the United Arab Emirates, US$ 2 billion in-kind grants from Gulf countries in the form of petroleum shipments and US$1.3 billion international funding and grants from various countries) compared to US$ 40 million during the same period last year. On the other hand, this surplus was reduced by the decline of **services receipts**, registering US$ 4 billion (accompanied by an annual decrease of 64.7 percent, equivalent to US$ 2 billion, in **tourism receipts** to record US$ 0.9 billion).

§ It is noteworthy that exports coverage to imports during the period of July-September 2013 slightly rose to 43.6 percent, compared to 43.5 percent during the same period a year earlier. Meanwhile, Net International Reserves (NIR) imports coverage rose to record 4.1 months of imports during the first quarter of FY13/14 compared to 3.3 months of imports during the same period last year.

§ On the other hand, the surplus recorded in the **Capital and Financial Account** came due to an increase in **Portfolio investments** in Egypt, recording a net inflow of US$ 1.3 billion, compared to a net outflow of US$ 0.3 billion. In addition, **Net foreign direct investments** in Egypt increased by 7 percent, recording a net inflow of US$ 1.2 billion during the period July-September 2013/2014 (increasing from US$ 1.16 million).

***Tourism sector is expected to pick-up over the coming Months…***

**Total number of tourists arrivals** increased significantly during the month of October 2013 by 86 percent, reaching 0.5 million tourists compared to 0.3 million tourists in the previous month. It is noteworthy that more than 25 countries have lately raised the ban on travel to Egypt, which should improve the sector's performance during the coming period.

***Capital markets are bullish on the economic outlook…***

**The EGX-30 index** increased by 599 points during December 2013, reaching 6783 points compared to 6184 during November 2013. Moreover, market capitalization increased by 6 percent m-o-m during the month of study to reach LE 427 billion (20.8 percent of GDP) compared to a LE 403 billion during the previous month.