Executive Summary

Main Highlights...

Positive Fiscal developments: *Budget deficit slightly declined in the first 7 months of FY-13/14 to reach 5.8 percent of GDP, compared to 6.8 percent during the same period a year earlier.* This was mainly due to an increase in tax revenues and grants, accompanied with a slower pace of growth on the expenditure side.

Meanwhile, a second stimulus package was announced to accelerate growth. Together with the first stimulus package, both amount to 3 percent of GDP. About two thirds of the two stimulus packages were devoted to increasing public investment in infrastructure, with the remainder allocated to achieving greater equity.

As for the monetary developments, M2 growth continued to accelerate reaching 19.2 percent at end of December 2013, while reserves stabilized in January, on the back of Saudi Aid, despite an exceptional FX auction, coupled with Paris Club debt repayment.

Urban headline inflation eased somewhat in January to 11.4 percent, mainly due to a decline in services' prices, as well as an unfavorable base effect. *However, food prices continued to rise, leading to a slight increase in core inflation.*

Regarding the stock market, EGX30 index continued to increase for 7 months in a row, reaching record highs, not witnessed ever-since September 2008. This suggests a bullish investor sentiment concerning the Egyptian economic outlook.

Fiscal Perspective:

Slight decrease in Budget Deficit was witnessed...

- *Budget Deficit* declined slightly during the first 7 months of FY 2013/2014 in value and as percent of GDP, compared to the same period last year. This came as a result of a higher increase in revenues relative to expenditure.

July- January 13/14 Budget Deficit LE 119.6 billion/ 5.8 percent of GDP	July- January 12/13 Budget Deficit LE 119.8 billion/ 6.8 percent of GDP
Revenues LE 217.9 billion/ 10.6 percent of GDP	Revenues LE 169.7 billion/ 9.7 percent of GDP
Expenditure LE 333.5 billion/ 16.3 percent of GDP	Expenditure LE 288.9 billion/ 16.5 percent of GDP

Source: Ministry of Finance, Macro Fiscal Policy Unit

Both Tax and Non-Tax Revenues increased during the period of study...

On the revenue side,

- Total revenues increased during July- January 2013/2014 by 28.4 percent, recording LE 217.9 billion (10.6 percent of GDP), mainly due to the increase in both tax (6.5% of GDP), and non-tax revenues (4.1% of GDP).

- Tax revenues increased due to the increase in all tax chapters except for taxes on goods and services, especially, the increase in receipts from Egyptian General Petroleum Company, and receipts from Other Companies related to economic activity, additionally, the increase in Taxes on Treasury Bills and Bonds Payable Interest.

Tax Revenues increased due to:

Taxes on Income, Capital Gains and Profits increased by LE 10.2 billion (19% growth) to reach LE 63.8 billion (3.1% of GDP)

Mainly on the back of an increase in:
- Taxes on domestic salaries by LE 1.4 billion
- Receipts from EGPC by LE 14.9 billion to reach LE 30.6 billion (1.5% of GDP), after including the second settlement in January 2014

Taxes on Property increased by LE 1.6 billion (17% growth) to reach LE 11.1 billion (0.5% of GDP)

Mainly as a result of an increase in Taxes on T-bills and bonds payable interest by 22.2% y-o-y to LE 9.3 billion (0.5% of GDP)

Taxes on International Trade increased by LE 0.3 billion (3.2% growth) to reach LE 9.9 billion (0.5% of GDP)

In light of an increase in taxes on valued customs by 5.3 % y-o-y to LE 9.5 billion (0.5% of GDP)

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

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

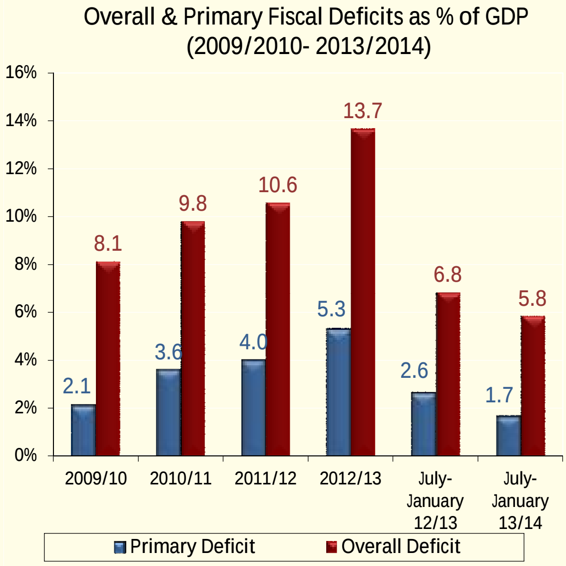
- Increase in grants to reach LE 37.3 billion during July-January 2013/2014 (1.8 percent of GDP), mainly due to:

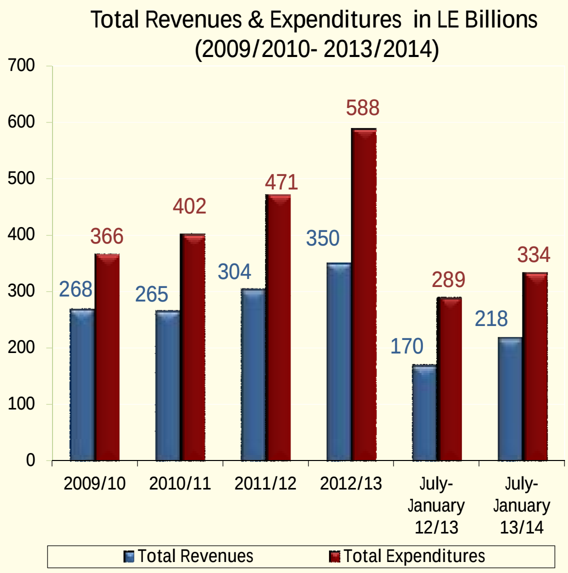
  a) LE 29.7 billion increase in grants—half of the dollar denominated deposits at the central bank- to be allocated to finance the first stimulus package related to the presidential decree no. 105, 2013.

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

- Increase in revenues from sales of goods and services by 49.6 percent y-o-y to LE 12.7 billion (0.6 percent of GDP) mainly due to the increase in revenues from special accounts and funds[1] by LE 3.8 billion to record LE 10.5 billion in the period of study compared to LE 6.7 billion during the same period last year.

- Increase in dividends collected from Egyptian General Petroleum Company by LE 7 billion.





Source: Ministry of Finance

On the Expenditures Side:

Increase in Wages, Investments and Social Benefits

Total expenditures increased during July- January 2013/2014 by 15.4 percent, recording LE 333.5 billion (16.3 percent of GDP), mainly due to:

- The increase in wages and compensation of employees by LE 16.6 billion to LE 95.2 billion (4.6 percent of GDP). Wages spending on Education Sector reached LE 41.5 billion during the period of study, while wages spending on Health Sector has reached LE 9.3 billion.
- The increase in subsidies grants and social benefits by LE 9.8 billion (10.7% growth) to LE 101 billion (4.9 percent of GDP).

  Payments to pension funds increased by LE 10.4 billion during July-January 13/14 (of which an increase of LE 2.4 billion in January 2014), to reach LE 19.5 billion during July- January 2013/2014, compared to LE 9.1 billion during the same period last year. Meanwhile, subsidies to General Authority for Supply of Commodities (GASC) have witnessed an increase of LE 0.5 billion in January 2014, to reach LE 11.6 billion during July-January 13/14.

- The increase in interest by LE 12 billion to LE 85.5 billion (4.2 percent of GDP).
- The rise in other expenditures by LE 3 billion to LE 21.4 billion (1 percent of GDP).

1 The increase comes in light of the law number 19 for the year 2013, 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.

- The increase in purchase of goods and services by LE 0.03 billion to LE 11.8 billion (0.6 percent of GDP).

- The increase in purchases of non-financial assets (investments) by LE 3.2 billion to LE 18.7 billion (0.9 percent of GDP).

  Some LE 18.7 billion were disbursed as purchases of non-financial assets (investments) during the first 7 months of 2013/2014, increasing by 21 percent compared to the same period last year, while investments are expected to increase during the coming period.

The government has taken significant steps towards reviving growth…

- 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, MoF launched a second supplementary budget in January 2014 with an amount of LE 33.9 billion. The new appropriation includes some LE 20 billion in additional infrastructure spending. Like the first stimulus package, the bulk of the second package was devoted to investment in infrastructure. The rest covers commitments made by the government to raise the minimum wage for government employees and salaries of teachers and medical professionals. *This will bring total stimulus expenditure during the current fiscal year to an unprecedented 3 percent of GDP.* The second stimulus package will be financed by a grant from the UAE, as a result, it will not have any negative impact on the budget deficit.
- *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 and fiscal sectors going forward.*
- *In addition, a LE 1.2 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 0.9 billion.*

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 percent by the end of this fiscal year.

Increase in Domestic Debt…

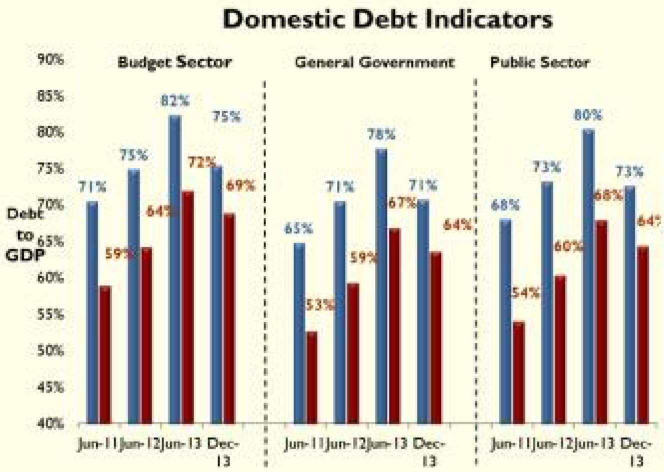
Ø *Domestic budget sector debt* recorded LE 1546 billion (75.4 percent of GDP) by end of December 2013, compared to LE 1294 billion (73.8 percent of GDP) by end of December 2012.

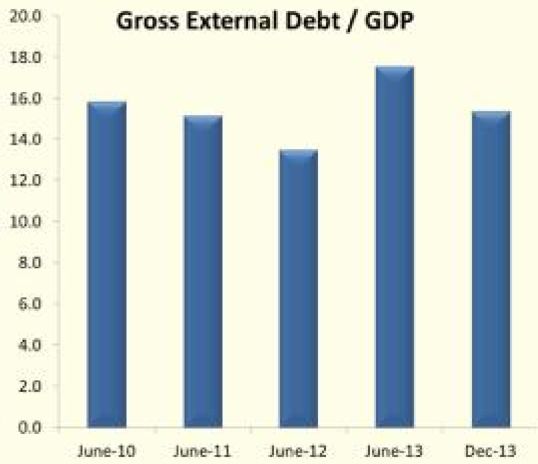
This increase could be explained as a result of several factors of which:

- 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.

It is worth mentioning that the total government debt (domestic and external) reached LE 1751 billion (85 percent of GDP) in December 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.

2 The notable increase in non-government external debt during the first half of the fiscal year 2013/2014 can be explained in light of a net increase of nearly US$ 4.4 billion in external debt on the monetary authorities compared to end of December 2012/2013. The breakdown of inflows is as follows: US$ 2 billion from UAE, US$ 2 billion from Saudi Arabia and US$ 3 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. Moreover, it is important to highlight that Egypt has returned another matured deposits worth US$ 1 billion to Qatar during the period of study, in addition to paying an amount of US$ 1 billion debt owed to foreign oil companies operated In Egypt.

Monetary Perspective:

On a yearly basis, M2 continued to accelerate...

- *M2 annual growth* continued to grow reaching nominal growth rate of 19.2 percent as of end December 2013 (real growth rate of 7.5 percent) compared to 12.3 percent in December 2012, stimulated by the increase in net domestic assets, mainly in net claims on government and GASC. While lending to private sector remained tight, as annual growth in credit to the private sector reached 6.4 percent (LE 497.7 billion) in December 2013, compared to 7.6 percent in December 2012.

  Total deposits growth –excluding deposits at the CBE- continued to pick-up reaching 18 percent (y-o-y) to LE 1.3 trillion at the end of November 2013, compared to 9.1 percent in November 2012. Out of total deposits, 88.3 percent belonged to the non-government sector at end of November 2013. To that end, loans-to-deposits ratios decelerate slightly at end of November 2013 registering 43.6 percent, compared to 47.8 percent in November 2012. (Detailed data for December 2013 is not yet available)

NIR accelerated to 25.8 percent y-o-y

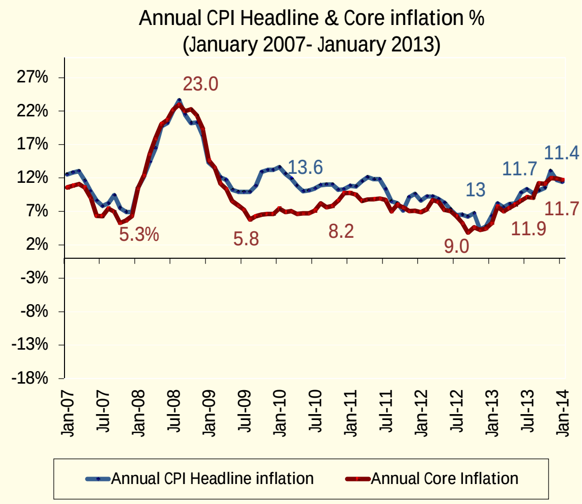
- During January 2014, *Net International Reserves (NIR)* increased merely by US$ 0.73 billion to record US$ 17.1 billion, up from US$ 17.03 billion in December 2013, thus recording a y-o-y growth of 25.8 percent (m-o-m 0.4 percent). The witnessed increase in January 2014 was on the back of US$ 2 billion deposits received from Saudi Arabia. The aid received compensated a fall in NIR, due to the exceptional FX auction conducted by CBE late January worth US$ 1.5 billion, in addition to US$ 0.7 billion servicing of the Paris Club debt.

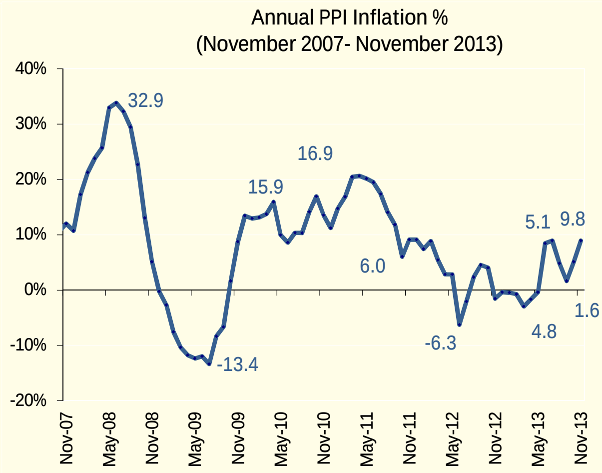
- *Total number of tourists arrivals increased slightly during the month of December 2013*, reaching 678 thousand tourists compared to 673 thousand tourists in the previous month. Continued improvement in security should definitely increase tourist arrivals going forward.

Despite inflationary pressures, inflation declined y-o-y during January 2014

- *CPI annual Urban Inflation* increased during the period July-January 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 eased during January 2014 to 11.4 percent, compared to 11.7 percent recorded during the previous month, which is attributed to the decrease in annual inflation rate of "Housing, Water, Electricity, Gas and Other Fuels", "Furnishing, Housing Equipment", "Transport", "Tobacco", and "Recreation and Culture", and the declining prices of butane cylinders, due to easing supply bottlenecks. Meanwhile monthly inflation increased to 1.4 percent after declining by 1 percent in the previous month, mainly due to the rise in the prices of dairy milk products during the month of study.





- *Annual core inflation* declined during January 2014 to 11.7 percent compared to 11.9 percent during December 2013. However, monthly core inflation rose to 1.1 percent compared to 0.4 percent during the previous month. This could be explained in light of the increase in food prices contributing by 1.2 percentage points, which was offset by the decline in other services prices contributing by negative 0.12 percent.

CBE easing monetary policy in H1-FY13/14…

- During its *Monetary Policy Committee* meeting held on February 27, 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 discount rate was also kept 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 February 25, 2013, the CBE introduced LE 65 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.

Other related indicators:

Capital markets are bullish on the economic outlook…

- The EGX-30 index increased by 722 points during February 2014, reaching 8127 points compared to 7405 during January 2014. Moreover, market capitalization increased by 8.8 percent m-o-m during the month of study to reach LE 492 billion (24 percent of GDP) compared to a LE 452 billion during the previous month.
- Industrial production index rose by 5 percent in December 2013 to 151.6 points, compared to 143.4 points in November 2013.

Previous Developments…

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

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.

- 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.

GCC aid dominates the BOP front…

Ø *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, NIR imports coverage rose to record 4.1 months of imports during the first quarter of FY 13/14 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).