Executive Summary

Main Highlights...

The president approved the state budget for the fiscal year 2014/2015 according to presidential decree number 65 for the year 2014; this is considered an important step towards re-prioritize public spending and achieving inclusive growth. The government is targeting fiscal and economic reforms to achieve economic revitalization, and strengthen social justice while maintaining economic stability and financial sustainability.

Meanwhile, *according to the new budget for the FY 2014/2015,* ***government revenues*** *are estimated to reach* ***LE 549 Billion****, recording an annual growth of 8 percent, compared to LE 507 billion, which is expected during the fiscal year 2013/2014. While* ***government expenditures*** *are estimated to reach* ***LE 790 billion*** *with 7 percent annual growth. To that end, the* ***budget deficit*** *is estimated to record* ***LE 240 billion*** *(10 percent of GDP), while* ***total government debt*** *(domestic and external) will reach a sum of* ***LE 2.2 trillion*** *at the end of 2014/2015 (about 90% of GDP, decreasing from 93.8% of GDP for the fiscal year 2012/2013).*

It's worthy to note that preliminary fiscal data for the year 2013/2014 is still under preparation and will be published when finalized. Meanwhile, the Budget deficit has recorded LE 189.4 billion (about 9.3% of GDP), *according to the latest figures* ***for the period July-May 2013/2014,*** *compared to 11.7% during the same period last year. This was mainly due to* ***an increase in taxes on income, and exceptional grants, accompanied with a slower rate of implementation in investments during the period of study. Moreover, total government debt (domestic and external)*** *reached LE 1806 billion (88.8 percent of GDP) at end of March 2014, compared to LE 1562 billion (89.1 percent of GDP) at end of March 2013.*

Despite the slow recovery pace of GDP, Manufacturing Index increased significantly– for the second month in a row *– recording an annual growth of 28.8 percent to reach 188.2 points during May 2014, compared to 146.1 points in May 2013 and compared to 185.1 points during April 2014. Furthermore, the Purchasing Manager Index (PMI) has reached in June 2014 a six-month high of 51.5 points, implying an improvement in operating conditions at Egypt's non-oil producing private sector companies.*

Moreover in the external sector, *the* ***BOP*** showed a significant improvement during the first nine months of 2013/2014 **recording an overall surplus of US$ 2.2 billion (0.8 percent of GDP)**, compared to an overall deficit of **US$ 2.1 billion** (0.7 percent of GDP) during the same period last year. This can be explained in light of the notable decrease in **current account deficit**, on the backdrop of the noticeable increase in **public transfers** coupled with the deceleration in **trade deficit**. Moreover, the **capital and financial account** witnessed net inflows of US$ 3.5 billion (1.2 percent of GDP), compared to net inflows of US$ 6.5 billion during the same period last year.

During June 2014, Net International Reserves (NIR) decreased merely by US$ 600 million to record US$ 16.68 billion, down from US$ 17.3 billion in May 2014. The witnessed decrease in June 2014 came on the back of the repayment of mid-year debt installments to Paris club.

As for the monetary developments, M2 annual growth *increased slightly, reaching* ***17*** *percent at end of May 2014 compared to* ***16.5*** *percent recorded in April 2014. Moreover,* ***Headline***

Urban inflation stabilized at 8.2 percent in June 2014 *for the second month in a row (after reaching the highest inflation record of 13 percent during November 2013).*

*During its **Monetary Policy Committee** meeting held on July 17, 2014, CBE decided to raise the **overnight deposit rate** and **overnight lending rates**, and the CBE's **main operation** by 100 basis points to 9.25 percent, 10.25 percent, and 9.75 percent, respectively. The discount rate was also raised by 100 basis points to 9.75 percent.*

Fiscal Sector:

Budget Deficit **continued to decline during the first 11 months of FY 2013/2014 in value and as percent of GDP,** compared to the same period last year. This was mainly due to an increase in tax revenues and exceptional grants, with a slower rate of implementation in investments.

Budget Deficit continued its decelerating trend…

July- May 13/14 Budget Deficit LE 189.4 billion (9.3 percent of GDP)	July- May 12/13 Budget Deficit LE 204.9 billion (11.7 percent of GDP)
Revenues LE 337.8 billion (16.6 percent of GDP)	**Revenues** LE 271.3 billion (15.5 percent of GDP)
Expenditure LE 519.7 billion (25.6 percent of GDP)	**Expenditure** LE 474.3 billion (27.1 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 significantly during July-May 2013/2014 by 24.5 percent, recording LE 337.8 billion (16.6 percent of GDP), mainly due to the increase in taxes on income by 6 percent (4.8 percent of GDP), and non-tax revenues increased significantly by 86.9 percent (6.1 percent of GDP).

Tax Revenues increased due to:

Taxes on Income, Capital Gains and Profits increased by LE 5.5 billion (6 percent growth) to reach LE 97.2 billion (4.8 percent of GDP).

Mainly on the back of an increase in:
- Taxes on domestic salaries by LE 2.2 billion reaching LE 17.5 billion.
- Taxes on industrial & commercial profits by LE 2.3 billion to LE 7.5 billion.
- Taxes on Corporate Profit on EGPC by LE 4.9 billion to reach LE 30.6 billion (1.5 percent of GDP), after including the first and second settlements in December 2013, and January 2014 in a row.
- Receipts from Suez Canal by LE 0.7 billion.
- Receipts from Other Companies by LE 0.1 billion.

Taxes on Property increased by LE 2.2 billion (14.6 percent growth) to reach LE 17.3 billion (0.8 percent of GDP)

Mainly as a result of an increase in Taxes on T-bills and bonds payable interest by 17.2 percent y-o-y to LE 14.2 billion (0.7 percent of GDP)

Taxes on International Trade increased by LE 1 billion (4.1 percent growth) to reach LE 14.9 billion (0.7 percent of GDP)

In light of an increase in taxes on valued customs by 7.3 percent y-o-y to LE 14.3 billion (0.7 percent of GDP)

- **The abovementioned increase came despite of**;
    - The decline of Other Taxes by 3.1 percent (particularly due to the decline in Tax on movable capital revenues from CBE)

...while Non tax revenues hiked mainly due to extraordinary grants, in addition to an increase in receipts from Sovereign Authorities

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

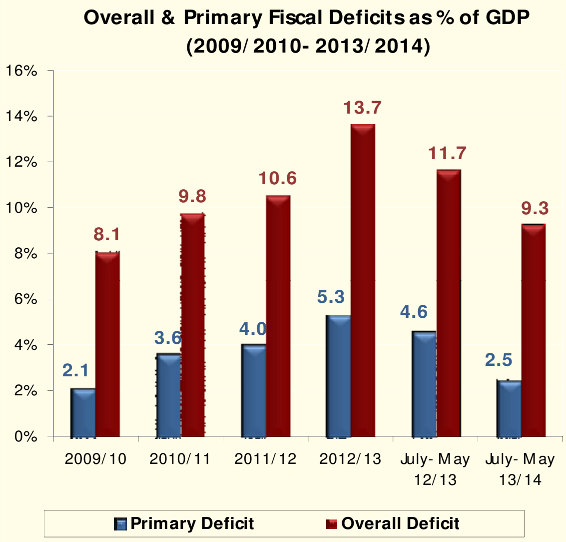
- Increase in grants to reach LE 51.5 billion during July-May 2013/2014 (2.5 percent of GDP), mainly due to:

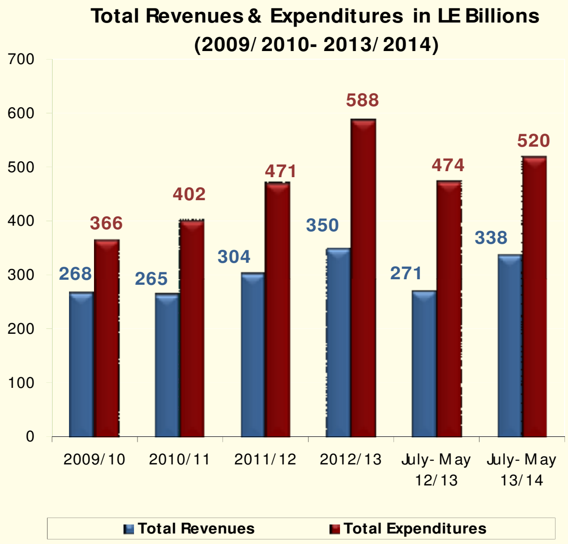
  a) LE 29.7 billion increase in grants—half of the dollar denominated deposits at the central bank- to be allocated to finance the first stimulus package related to the presidential decree no. 105, 2013.

  b) LE 21 billion (the equivalent of US$ 3 billion) cash grants from Gulf countries.

- Increase in dividends collected from EGPC by LE 7 billion, dividends collected from Central Bank by LE 1.8 billion, and dividends collected from Suez Canal by LE 1.4 billion.
- Increase in revenues from sales of goods and services by 34 percent y-o-y to LE 18.4 billion (0.9 percent of GDP) due to the increase in revenues from special accounts and funds[1] by LE 4 billion to record LE 14.9 billion in the period of study compared to LE 10.8 billion during the same period last year.

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 percent of the revenues from special accounts and funds; additionally, 25 percent of the outstanding balance was repaid only during 2013/2014.





Source: Ministry of Finance

On the Expenditures Side:

Increase in Wages, Investments and Social Benefits

Total expenditures increased during July- May 2013/2014 by 9.6 percent, recording LE 519.7 billion (25.6 percent of GDP), mainly due to:

- The increase in wages and compensation of employees by LE 28.9 billion to LE 151.9 billion (7.5 percent of GDP).

- The increase in interest payments by LE 14.3 billion to LE 139 billion (6.8 percent of GDP).
- The rise in other expenditures by LE 4.7 billion to LE 33.4 billion (1.6 percent of GDP).
- The increase in purchases of non-financial assets (investments) by LE 7 billion (1.7 percent of GDP). It is worthy to note that some LE 34.7 billion were disbursed as purchases of non-financial assets (investments) during the period of study increasing by 25.5 percent compared to the same period last year.

The abovementioned increase in expenditures came despite of;

- The decrease in subsidies grants and social benefits by LE 9.4 billion to LE 140.7 billion (6.9 percent of GDP) in light of the following:-

  - Subsidies decreased by LE 26.2 billion during July-May 13/14, to reach LE 101 billion, compared to LE 127.2 billion during the same period last year, mainly due to the delay in completing the settlements that were planned to take place during the fiscal year.

- The decrease in Purchases of Goods and Services by LE 0.2 billion to LE 20 billion (1 percent of GDP) in light of the following:-

  - The decline in spending on goods by LE 0.6 billion during July-May 13/14, to reach LE 9 billion, compared to LE 9.5 billion during the same period last year, mainly due to the decline of spending on Water and Lighting by 12.3 percent to reach LE 3 billion.

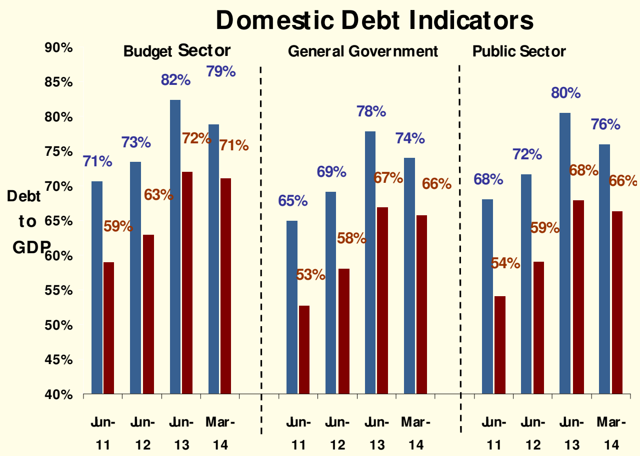
Meanwhile**, according to the new budget for the FY 2014/2015, **government revenues** are estimated to **reach LE 549 Billion**, recording an annual growth of 8 percent, compared to LE 507 billion, which is expected during the fiscal year 2013/2014. While **government expenditures** are estimated to reach **LE 790 billion** with 7 percent annual growth. To that end, the **budget deficit

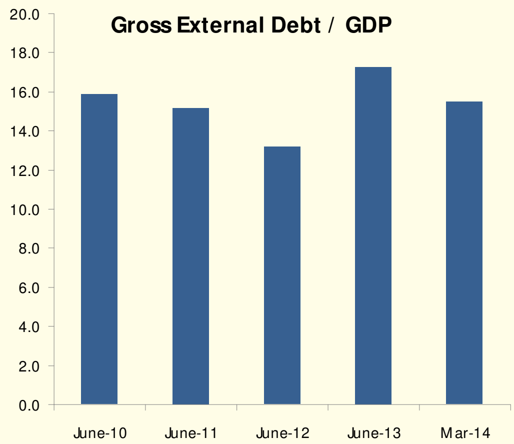
*is estimated to record **LE 240 billion** (10 percent of GDP), while total government debt (domestic and external) will reach a sum of **LE 2.2** trillion at the end of 2014/2015 (about 90% of GDP, decreasing from 93.8% of GDP for the fiscal year 2012/2013).*

Increase in Domestic Debt…

Domestic budget sector debt recorded LE 1604 billion (78.9 percent of GDP) by end of March 2014, compared to LE 1387 billion (79.1 percent of GDP) by end of March 2013.

It is worth mentioning that the total government debt (domestic and external) reached LE 1806 billion (88.8 percent of GDP) in March 2014, compared to LE 1644 billion (94 percent of GDP) at end of June 2013, and LE 1562 billion (89.1 percent of GDP) in March 2013.





Source: Ministry of Finance

External debt stock[2] **(government and non-government debt)** recorded US$ 45.3 billion by the end of March 2014 compared to US$ 38.4 billion by the end of March 2013 (most of the increase represented aid from the Gulf Countries with concessional and preferential terms). External debt as percent of GDP recorded 15.5 percent by the end of March 2014, 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)**.**

Monetary Perspective:

M2 annual growth rate increased slightly during May 2014.

According to recent data released by the CBE, M2 annual growth increased slightly during May 2014 recording 17 percent (Y-o-Y) to reach LE 1484.4 billion, compared to 16.5 percent recorded in April 2014. The slight increase witnessed in M2 comes as result of the growth in both money and quasi money annual growth rate reaching 20.9 percent (LE 401.3 billion) and 15.6 percent increase (LE 1083.2 billion), respectively, compared to 19.9 percent and 15.3 percent recorded during April 2014, respectively.

Moreover, net domestic assets of the banking system annual growth increased during the month of study reaching 19.9 percent (LE 1358.4 billion), compared to 18.1 percent recorded

2 The notable increase in non-government external debt during the period July-March 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 March 2012/2013. The mentioned increase in monetary authorities' debt could be explained as a result of net change of deposits inflows and redemption of other deposits. 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, Egypt has returned a total of US$ 3 billion deposits (US$ 2 billion was cancelled and US$ 1 billion was matured).

during the previous month. This comes on the back of the increase witnessed in **claims on private sector** recording an annual growth of 6.9 percent (LE 526.6 billion) up from 5.5 percent last month. This growth comes on the back of the increase witnessed in both claims on household sector and private business sector annual growth reaching 14.9 percent and 6.4 percent, respectively, compared to 11.9 percent and 3.2 percent recorded in April 2014, respectively.

The aforementioned increase in claims on private sector overcame the slight deceleration in **net claims on the government** annual growth reaching 26.8 percent (LE 993.8 billion), compared to 27.3 percent during the previous month.

Meanwhile, **net foreign assets** annual growth decelerated during May 2014, recording annual decline of 6.9 percent (LE 126.1 billion), compared to annual growth rate of 1.4 percent recorded at end of April 2014, partly due to the witnessed decrease in annual growth rate of **CBE net foreign assets** to reach -2.6 percent compared to 20.4 percent recorded in April 2014.

Total deposits annual growth – excluding deposits at the CBE – increased to reach 19.2 percent y-o-y (LE 1382.8 billion) at the end of April 2014, compared to 15 percent in April 2013. Out of total deposits, 87.4 percent belonged to the non-government sector. On the other hand, **annual growth rate in total lending by banking sector** (excluding CBE) decreased during the year ending April 2014 recording 4.8 percent (LE 569.5 billion), compared to 8.9 percent recorded at end of April 2013. To that end, loans-to-deposits ratios declined at end of April 2014 registering 41.2 percent, compared to 46.8 percent in April 2013. (Deposits and loans detailed data for May 2014 is not yet available).

NIR has declined during June 2014

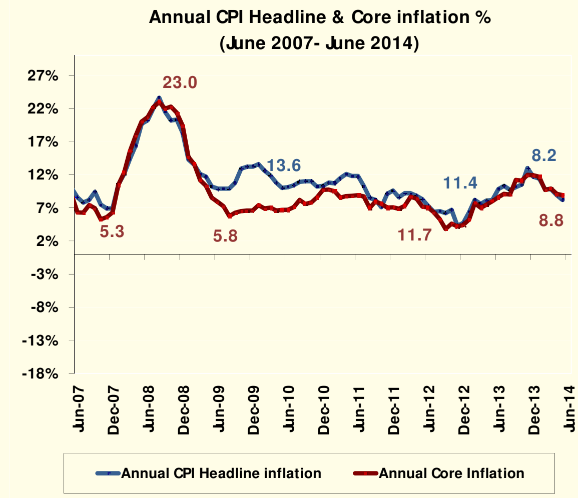
During June 2014, Net International Reserves (NIR) decreased merely by US$ 600 million to record US$ 16.68 billion, down from US$ 17.3 billion in May 2014. The witnessed decrease in June 2014 came on the back of the repayment of mid-year debt installments to Paris club.

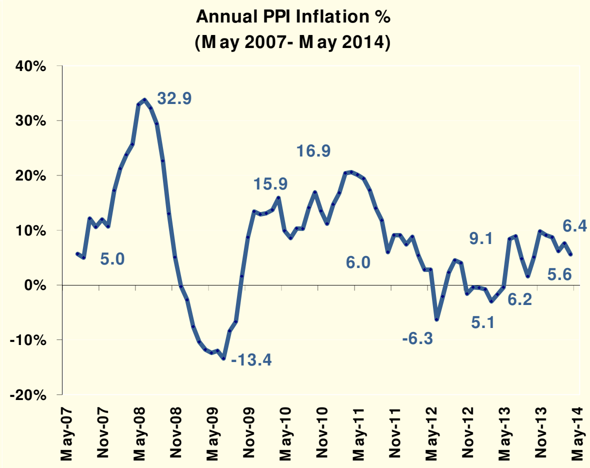
Monthly CPI continued to ease during June 2014 compared to the first 11 months of the FY13/14

CPI annual Urban Inflation increased during the FY year 2013/2014 recording an average of 10.1 percent, compared to 6.9 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 stabilized at 8.2 percent in June 2014 for the second month in a row (after recording 13 percent the highest inflation during November 2013). This development is mainly attributed to the slower increase in annual inflation rate of some sub items in the "Food and Beverages" group, on the top of which; "Vegetables", "Bread and Cereals", "Milk Cheese and eggs", "Oils and Fats", "Fish and Seafood", " Sugar". Meanwhile, annual inflation rate increased for other main groups, on the top of which; "Clothing and Footwear", "Housing, Water, Electricity, and Gas", and which counterparts the decline in annual inflation of other groups, on the top of which; "Furnishing, Household Equipment", "Transport", "Recreation and Culture", "Restaurant and Hotels".

On the other hand, **monthly inflation** rose to 0.8 percent during June 2014 compared to a decline of 0.7 percent in the previous month.





Annual core inflation declined during June 2014 to 8.8 percent compared to 8.9 percent during May 2014. However, monthly core inflation rose to 0.7 percent, compared to a decline of 0.2 percent during the previous month. The monthly inflation could be explained in light of the increase of food prices contributing by 0.63 percentage points in the monthly inflation.

During its ***Monetary Policy Committee*** meeting held on July 17, 2014, CBE decided to raise the **overnight deposit rate** and **overnight lending rates**, and the CBE's **main operation** by 100 basis points to 9.25 percent, 10.25 percent, and 9.75 percent, respectively. The discount rate was also raised by 100 basis points to 9.75 percent.

This is considered the Third time for CBE to raise policy rates since November 2011 (First time in November 2011, second in March 2013). Meanwhile, CBE decided to cut policy rate Three times since August 2013 (first and second time in August and September 2013 respectively followed by the third time in December 2013).

The committee justified such decision, in light of the expected inflationary pressures due to government' price adjustments recent decision, while taking into consideration the GDP outlook, more specifically:

- The economic growth during the third quarter of 2013/2014 picked up slightly due to the improved performance in manufacturing, and construction sectors, despite the contraction witnessed in the tourism and petroleum sectors.
- Meanwhile, the upside risks to the inflation could be explained in light of the government's recent decision to adjust the prices of several regulated items, such as fuel, electricity, and tobacco, as part of the 2014/2015 fiscal consolidation plan. This is expected to result in a shift in headline CPI during July 2014, and a shift in both headline and core CPI by the end of September 2014.
- To that end, MPC decided to introduce a preemptive rate hike to curb inflation expectations and to counter inflationary risks to the Egyptian economy over the medium term.

Moreover, ***in an attempt to absorb excess liquidity and to protect the domestic currency,*** *the CBE introduced on July 15, 2014 LE 40 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$ 1.1 billion on May 14, 2014 at Foreign Exchange exceptional auction to meet banks import financing needs.

GDP growth rate...

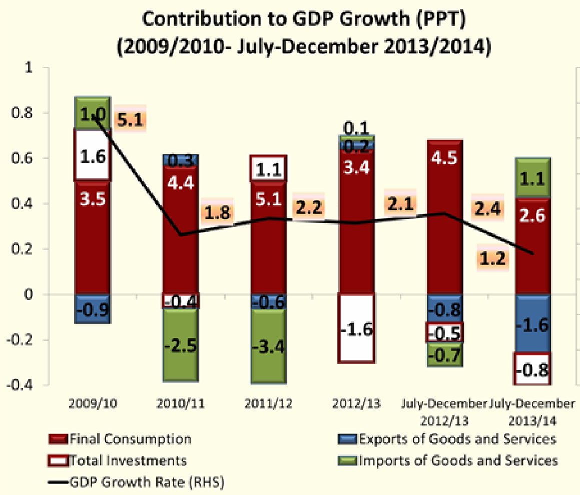
Five key sectors led growth in H1-FY13/14...

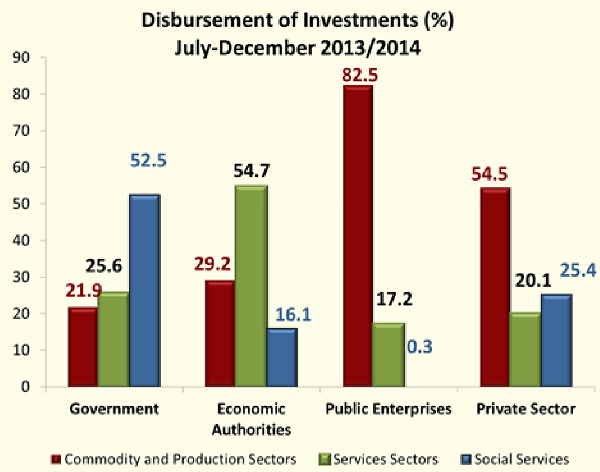
GDP Latest figures ***suggest the economy's recovery pace is still slow.*** *GDP growth came at a humble 1.2 percent in H1-FY13/14, compared to 2.4 percent during the same period last year, mainly due to security reasons and political developments. Moreover, disbursements of the announced two stimulus- packages –that focused on propping up government investments- were not fully captured in GDP growth during the period of study, mainly due to tendering procedures for stimulus related projects.* ***This suggests that recovery in the second half of FY13/14 would assume a faster pace.***

> ***Going forward, the government's strategy will shift to the second phase of reviving the economy,*** *via preparing an additional stimulus package that will focus solely on removing bottlenecks that hinder private sector investments in key economic sectors, namely; industrial, housing and construction, communications and tourism. This should accelerate the pace of growth, while crowding in the private sector, which is a key contributor to employment.*

On the supply side, key sectors that led growth in the first half of FY13/14 were the **agricultural sector and the general government**, with real growth rates of 3.5 and 5.5 percent respectively, contributing by 0.6 and 0.5 PPT, compared to 0.5 and 0.3 PPT a year earlier. **Wholesale and retail trade** real growth came at 3.2 percent in the same period (0.4 PPT compared to 0.3 PPT a year earlier), while **non-oil manufacturing sector and the construction sector** witnessed growth at 2.3 and 3.9 percent (0.3 and 0.2 PPT) respectively, same as a year earlier. Together, they represented around 56 percent of total real GDP in the period of study.

Meanwhile, Tourism and natural gas extraction sectors continued to subdue growth in the first half. Tourism has been severely hit due to several unfortunate events, falling by 30 percent y-o-y in the first half of FY13/14, while natural gas extraction fell by 8.2 percent in the same period, contributing negatively to growth.





On the demand side, Private consumption grew by only 2.5 percent y-o-y in the period of study, after having accelerated by 4.2 percent y-o-y in Q1-FY13/14, implying that Q2-FY13/14 real growth came at a humble rate of 0.8 percent. Similarly, **public consumption** grew at 4.8 percent in the period of study, compared to 5.6 percent a year earlier, after having accelerated by 5.9 percent in Q1-FY13/14, implying a slow-down in growth (3.6 percent) in Q2-FY13/14.

Investments continued to hinder GDP growth in the first six months of FY13/14 with a (-ve) real contribution of 0.8 PPT, compared to 0.5 PPT negative contribution in the same period last year.

As for the distribution of total **investments by economic agents** (in nominal terms),public investments (government + economic authorities + public business sector) accounted for 25.6 percent of total investments in Egypt during the period of study, while the private sector accounted for 74.4 percent in the same period, noting that nearly half of government investments were directed towards social services sectors.

Meanwhile***, net exports*** posted a negative contribution of 0.5 PPT in the first half, down from -1.6 PPT a year earlier. ***Exports*** continued to decelerate in the first half of FY-13/14, decreasing by 9.5 percent with a contribution of -1.6 PPT to real GDP growth, compared to -0.8 PPT a year earlier. While ***imports*** dropped by 4.2 percent in the same period, contributing positively by 1.1 PPT, compared to -0.7 PPT in the same period last year.

Despite the slow recovery pace of GDP, Manufacturing Index increased significantly– for the second month in a row *– recording an annual growth of 28.8 percent to reach 188.2 points during May 2014, compared to 146.1 points in May 2013 and compared to 185.1 points during April 2014. Furthermore, the Purchasing Manager Index (PMI) has reached in June 2014 a six-month high of 51.5 points, implying an improvement in operating conditions at Egypt's non-oil producing private sector companies.*

The EGX-30 index decreased by 81 points during June 2014, reaching 8162 points compared to 8243 during May 2014. On the other hand, market capitalization increased by 0.4 percent m-o-m during the month of study to reach LE 478 billion (23.5 percent of GDP) compared to a LE 476 billion during the previous month. However, the value of traded stocks increased in June 2014, recording LE 41.9 billion, up 46.5 percent m-o-m compared to LE 28.6 billion recorded in May 2014.

On the External Sector side:

BOP showed a significant improvement during the first nine months of 2013/2014 **recording an overall surplus of US$ 2.2 billion** (0.8 percent of GDP), compared to an overall deficit of **US$ 2.1 billion** (0.7 percent of GDP) in the same period last year, and compared to an average deficit of US$ 3.6 billion over the last 5 years. The recorded surplus can be explained in light of the notable decrease in the **current account deficit**, recording US$ 0.2 billion (0.1 percent of GDP) compared to a deficit of US$ 5.7 billion (2.1 percent of GDP) in the same period last year. This was mainly driven by the noticeable increase in **public transfers** coupled with the deceleration in **trade deficit**. Moreover, the **capital and financial account** witnessed net inflows of US$ 3.5 billion (1.2 percent of GDP), compared to net inflows of US$ 6.5 billion (2.3 percent of GDP) during the same period last year, while net errors and omissions recorded an outflow of US$ 1.1 billion, compared to an outflow of US$ 2.8 billion during the period July-March 2012/2013.

§ On a more detailed level, the decrease witnessed in the **current account balance deficit** can be attributed to:

- The significant increase in **public transfers** during the first nine months of 2013/2014 recording US$ 10.5 billion in light of grants received from Arab countries (US$ 1 billion from the United Arab Emirates, US$2 billion from the Kingdom of Saudi Arabia, US$ 5.8 billion in-kind grants from Gulf countries in the form of petroleum shipments and US$ 1.7 billion international funding and grants from various countries), compared to US$ 0.6 billion during the same period last year.
- The decline in **trade deficit** by 1.5 percent to reach US$ 25.2 billion during the period of study, compared to US$ 25.6 billion during the same period last year. This was mainly due to the increase in exports proceeds by 4.2 percent, and thus resulted in the following:
  - Increase in exports to imports coverage ratio to reach 42.8 percent during the period July-March 2013/2014, compared to 41.4 percent during the same period last year.
  - Rise in NIR imports coverage ratio to record 3.6 months of imports during the first nine months of FY 13/14 compared to 2.8 months of imports during the same period last year.

§ On the other hand, **services balance** decreased significantly by 75.5 percent to record a surplus of US$ 1.3 billion compared to a surplus of US$ 5.4 billion during the same period last year. This deterioration was driven mainly by an annual decrease of 57.3 percent and 15 percent in tourism receipts and other receipts, respectively.

§ Meanwhile, the surplus recorded in the **capital and financial account** was due to the following developments:

- The increase in **net foreign direct investments in Egypt** by 31.9 percent, recording a net inflow of US$ 4.7 billion (1.6 percent of GDP) during July-March 2013/2014, compared to US$ 3.6 billion (1.3 percent of GDP) during the same period last year.
- **Portfolio investments in Egypt** recorded a net inflow of US$ 1.2 billion (0.4 percent of GDP) during the period of study, compared to a net outflow of US$ 0.8 billion (0.3 percent of GDP) during the period of study, due to the government issuance of bonds equivalent to US$ 1 billion, as a replacement for a Qatari deposit with the same value.
- The decrease in **liabilities of the CBE**, recording a net inflow of US$ 2 billion compared to a net inflow of US$ 4 billion during the same period last year, as CBE reimbursed part of the deposits that have been placed by some Arab countries (of which US$ 1 billion to Qatar).

Total number of tourists arrivals decreased during the month of May 2014, reaching 768.2 thousand tourists compared to 860 thousand tourists in the previous month. Moreover, Tourists nights also decreased during the month of study b to record 7331.5 nights compared to 7621.4 nights. It’s important to highlight, that Germany lifted its travel ban on Sharm El-Sheikh in South Sinai during the month of July 2014, according to the tourism ministry. Additionally, other European countries in light of Germany’s decision are considering lifting their warnings too, which could have a positive effect on the number of tourists in the coming period.