63656

Egypt Economic Update
Fall 2010

I. OVERVIEW

Growth recovery continues its course. Real GDP grew 5.3 percent in FY10, up from the 4.7 percent in FY09, but still below the rates recorded during the boom of 2005-08. Quarterly data show that growth was picking up steadily (up by 5.8 percent in the last 2 quarters) on the back of resilient domestic consumption and a substantial fall in imports. There has also been robust activity in sectors such as construction, tourism and communication. Yet, the recovery has not been rapid enough to significantly affect unemployment rate (down to 9.1 percent in March 2010 from 9.2 percent a year ago).

The external position remains robust. Driven by lower imports, the trade deficit declined in the first 9 months of FY10 (to 8.6 percent of GDP from 10 percent a year ago). This more than offset the decline in the services surplus, narrowing the current account deficit to 1.2 percent of GDP (from 1.8 percent). Strong net portfolio inflows (3 percent of GDP after 3 years of net outflows) turned the overall external balance positive (surplus of 1.4 percent of GDP). Egypt's net international reserves increased to US$35.3 billion at the end of July 2010, up from US$31.6 billion a year ago. Finally, external debt continued to decline as a share to GDP (to 14.8 from 17 percent between March 2009 and March 2010).

Areas of concern remain inflation, the fiscal deficit and domestic debt. Inflation has subdued, but remains at double-digit levels (down from 16.5 percent in FY09 to 11.5 percent in FY10), driven mainly by food price increases. The fiscal deficit widened to 8.3 percent of GDP. This constitutes a 1.5 point increase over the deficit for FY09. The Government has plans to reduce the deficit to 3 percent of GDP points over the next five years, mainly through new revenue measures, but this may prove challenging as the country enters a period of parliamentary and presidential elections scheduled for 2010 and 2011. The General Government net domestic debt increased to 47.8 percent of GDP at end-March 2010, from 43.5 percent a year ago, raising concern about the impact of public finances on the domestic economy.

II. RECENT MACROECONOMIC DEVELOPMENTS

Growth, unemployment and inflation

1. ***Egypt's growth accelerated in the second half of FY10.*** Real GDP growth in H2-FY10 reached 5.8 percent**,** up from 4.4 percent in H2-FY09 and 4.8 percent in H1-FY10, taking up overall GDP growth to an average of 5.3 percent for the full FY10.[1] Detailed GDP data, available only for the first 9 months of FY10 (9M-FY10), show that GDP growth continued to be driven by domestic consumption (around 80 percent of GDP) which grew by 4 percent, as well as the positive contribution of external demand (by 1.4 points), with imports falling by a faster rate (-7.3 percent) than the fall in exports (-3.7 percent). Although capital formation picked up by 7.7 percent in Q3-FY10 from a -0.8 percent decline in H1-FY10, its growth rate over 9M-FY10 (2.6 percent) was lower than in the previous year (3.2 percent), bringing its share to GDP to 19.5 percent from 20 percent a year ago. In terms of sectors, non-oil manufacturing (18 percent of GDP), wholesale and retail trade

[1] All growth rates in the note are Y-o-Y rates, unless otherwise mentioned.

(13 percent of GDP) and construction and building (6 percent of GDP) are the main contributors to GDP growth (by 0.8 to 0.9 points each). The fast growing sectors remained construction and building, restaurants and hotels, and communication (up by 13.7, 12.8 and 12.6 percent, respectively).

Figure 1: GDP growth driven by domestic consumption resilience and imports' fall

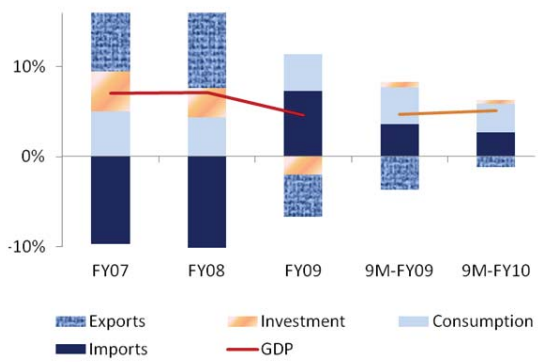
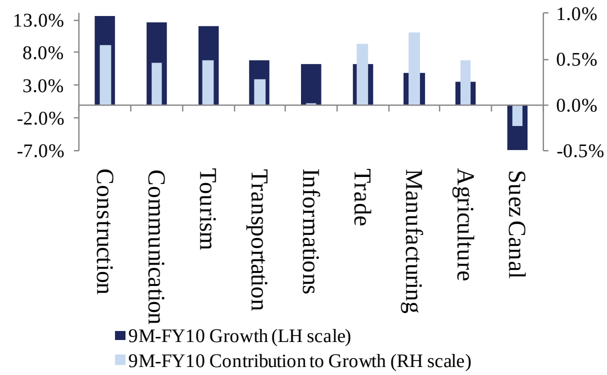


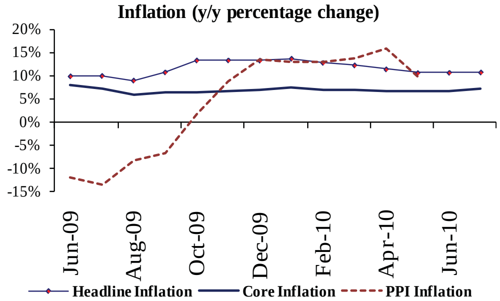
Figure 2: Sectoral Growth rates and contribution to GDP growth



2. ***Unemployment decreased only slightly.*** Employment has not kept up the pace of economic growth during the recovery, and unemployment dipped to 9.1 percent in Q3-FY09, down from 9.2 percent a year ago. This was driven by a slight decline in female unemployment (to 22 from 22.9 percent) which more than offset the increase in male unemployment (up to 5.2 from 5.1 percent). Unemployment is highest among the youth (18 percent), and in urban areas (12.5 percent). One worrisome aspect of the Egyptian labor market is the structural shortage of skilled workers while there is an excess of semi-skilled technical school and university graduates who need extensive training to become eligible for the Egyptian labor market.

3. ***Inflation has subdued but remains at double-digit levels.*** CPI inflation averaged 11.5 percent in FY10, down from 16.5 percent in FY09. The decline was mainly due to the lower prices of fruits and vegetables which have been the key drivers of headline inflation since February 2009. However, adjustments in regulated prices of health insurance, school tuition and water supply, as well as higher prices of several food items, have lately brought the annual rate up. In January 2010, bottlenecks in distribution of butane cylinders significantly increased their prices and brought the inflation rate to its peak of the year (13.6 percent). The partial reversal of increases in the butane cylinders prices that followed were offset by higher food prices (namely red meat, poultry, sugar and rice). Core inflation averaged 6.7 percent in FY10 down from 11.3 percent in FY09, and inched up to 7.1 percent in July driven by increases in prices of summer holidays and by sporadic increases in the prices of food items that are usually associated with the month of Ramadan. The Producer Price Index (PPI) inflation has been rising steadily, reaching a peak of 15.9 percent in April 2010, mainly due to producer prices in the mining sector (up by 38 percent), as well as the electricity, steam, gas and air conditioning supply (22 percent).

Inflation (y/y percentage change)



External sector

4. ***While tourism showed solid growth in FY10, Suez Canal revenues recovered slowly.*** Growth in tourism revenue accelerated from 4.7 percent in H1-FY10 to 17.8 percent in H2-FY10, compared with 2.8 and -9.5 percent in the corresponding periods in FY09. The increase in tourism

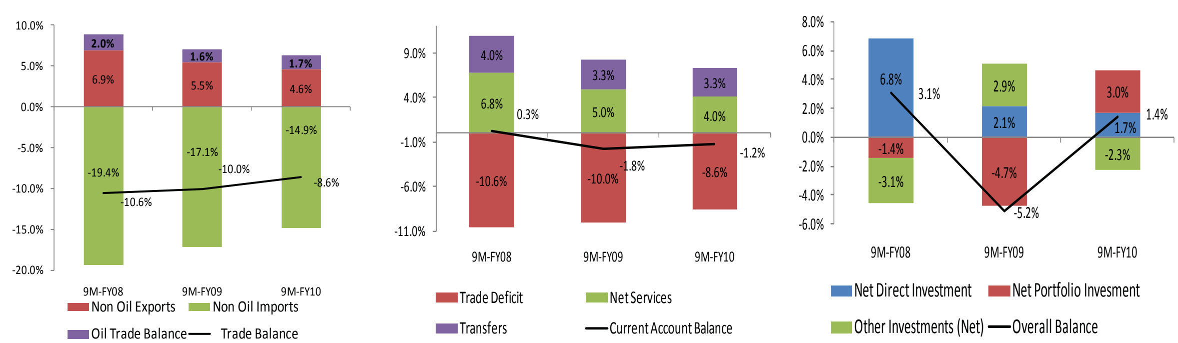
revenues during the full FY10 averaged 10.6 percent to reach US$11.6 billion. This was driven by an increase in tourist arrivals (up by 12.2 percent to 13.8 million tourists), while the average number of nights per tourist has remained unchanged (around 10 nights).[2] As to Suez Canal revenues, they have been recovering but at a slower pace. The waterway's revenues turned positive (up by 12.6 growth) in H2-FY10, after declining by 24 percent a year ago and by 17 percent in H1-FY10. The increase in Suez Canal revenues since the beginning of 2010 reflects the continued improvement in global trade, especially between Asia and the rest of the world, and rising oil prices which render alternative maritime routes more expensive. The Suez Canal Authority's decision to leave its toll rates unchanged in 2010, for the second year in a row, must have also supported the Canal's activity levels. Yet, still Suez Canal revenues during the full FY10 (US$ 4.5 billion) are 4.3 percent lower than FY09 revenues and 12 percent lower than FY08 revenues.

5. ***Driven exclusively by lower imports, Egypt's trade deficit improved, narrowing the current account deficit.*** The decline in merchandise imports in FY10 (down to US$48.9 billion from US$50.32 a year ago, or to 22.5 of GDP from 26.7 percent), has more than offset the decline in merchandise exports (down to US$23.8 billion from US$25.2 billion, or to 11 percent of GDP from 13.4 percent). The trade deficit has thus narrowed to 11 percent of GDP, from 13.4 percent over the same period. Also, the net services surplus declined to 4.8 of GDP from 6.6 percent, as the relatively solid growth in tourism (up by 10.6 percent to US$ 11.6 billion- a record level) could not compensate for the decline in all other services revenues. The outstanding increase in private transfers in H2-FY10 to (up by 73 percent to US$9.5 billion) after declining by 9 and 17 percent in FY09 and H1-FY10, respectively, brought its share to GDP up to 4.4 percent in FY10 from 4 percent in FY09. As a result, the current account deficit declined to 2.0 from 2.3 percent of GDP.

6. ***The overall external balance turned positive due to unprecedented strong net portfolio inflows.*** The balance of payments remained in surplus throughout the four quarters of FY10, registering US$ US$3.4 billion or 1.6 percent of GDP in FY10. This was primarily driven by the 3.9 percent of GDP surplus in the capital and financial account (compared with a deficit of 0.7 percent in FY09), which more than compensated for the current account deficit. One major characteristic of the capital account in FY10 was the record net portfolio inflows (US$7.8 billion or 3.6 percent of GDP) after 3 years of net outflows. These flows were directed mainly towards foreign purchases of T-bills, because of high yields on domestic debt and a relatively stable Pound. On the contrary, FDI flows continued to decline, reaching a four-year low of US$6.8 billion (3.1 percent of GDP).

7. ***Egypt's net international reserves rose to $35.3 billion*** (or 6 months of imports of goods and services) at the end of July 2010, up from US$ 31.6 billion (or 5 months of imports) a year ago. Since, the central bank has deposits in foreign currency (up by US$ 4 billion in H2-FY10) that are not included in the official reserves, the change in the latter understates the true magnitude of the increase in liquidity in foreign currency of the central bank.

Figure 4: Improved External Balances



---

[2] This average is the main determinant of revenue receipts given that average spending by night has been unchanged at US$85 since FY06.

8. ***External debt continued to decline as a share of GDP***. Despite an increase from US$31.5bn in June 2009 to US$32.3bn in March 2010, total external debt fell as a ratio to GDP from 17 percent to 14.8 percent. While the government debt declined (from 13.9 to 11.5 percent of GDP), the non-government debt increased slightly (from 3.1 to 3.3 percent of GDP). Except for the share of private sector debt to total external debt (down from 0.3 to 0.2 percent), all other debt indicators deteriorated over the same period: per capita external debt increased from US$418.6 to US$428.5; the short-term debt increased as a share to total external debt (from 6.8 to 8 percent) or and as a ratio to net international reserves (from 6.8 to 7.5), gross external debt to exports ratio jumped from 64.4 to 296.

Public Finance

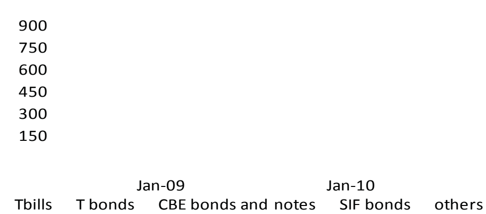
9. ***The fiscal deficit widened as a consequence of the slowdown and the corresponding fiscal stimulus.*** After six consecutive years of improvement, the budget sector fiscal deficit (the narrow definition) posted the largest increase in FY10 to reach 8.3 percent of GDP (almost LE100 bn), well above the 6.9 percent in FY09. The increase in the deficit was driven by a sharp fall in revenues (down by 4.8 points to 22.4 percent of GDP) which exceeded the decrease in expenditure (down by 3 points to 30.7 percent of GDP). Most of the revenues' fall is attributed to non-tax revenues (down by 3.1 percent of GDP). While income taxes fell by 1.2 percent of GDP (due solely to corporate tax revenues) and indirect taxes by 0.5 percent of GDP; property taxes increased by 0.4 percent of GDP. Except for interest payments (up by one percent of GDP), all expenditure lines fell, especially the contribution of the government in insurance funds (social benefits) and subsidies which fell by 2.4 and 1.1 percent of GDP. Public investment spending declined to 4 percent of GDP from 4.2 in FY09, yet still higher than the three previous years (ranging between 3.4 and 3.8 percent of GDP), reflecting the moderate size of the fiscal stimulus in FY10 (at most one percent of GDP).

Table 1: Fiscal deficit widened in FY10

	FY07	FY08	FY09	FY10
	In percent of GDP			
Revenues	**24.2%**	**24.7%**	**27.2%**	**22.4%**
Tax revenues	15.4%	15.3%	15.7%	14.5%
Non-tax revenues	8.3%	9.2%	10.7%	7.6%
Grants	0.5%	0.2%	0.8%	0.4%
Expenditures ***of which***	**29.8%**	**31.5%**	**33.8%**	**30.7%**
Interests	6.4%	5.6%	5.1%	6.1%
Subsidies, Grants, and Social Benefits	7.8%	10.3%	12.2%	8.6%
Investments	3.4%	3.8%	4.2%	4.0%
Overall fiscal balance	**-7.3%**	**-6.8%**	**-6.9%**	**-8.3%**

10. ***Domestic public debt continues to increase.*** Reflecting the widening fiscal deficit, all definitions of public domestic debt increased in FY10. General government net domestic debt increased at end-March 2010 to 47.8 percent of GDP from 43.5 percent a year ago. Likewise, the net domestic debt of the budget sector increased to 55.7 of GDP from 53.3 percent over the same period. Over 35 percent of the gross budget sector domestic debt is T-Bills, with the ratio to T-bonds declining to 2 from 2.6 over the same period, reflecting the shortening of the maturity of the debt.

Figure 5 – Structure of domestic public debt



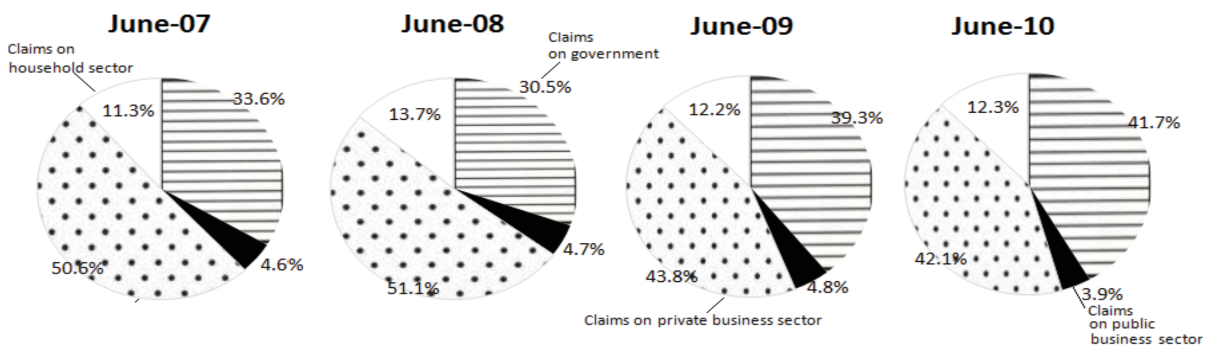
Monetary and exchange rate policies and the financial sector

11. ***The Central Bank of Egypt (CBE) has kept interest rates unchanged since September 2009.*** The CBE cut its overnight deposit and lending rates by 50 bps in July 2009 and by 25 bps in September and has since then kept them unchanged at 8.25 percent and 9.75 percent, respectively. Also, the discount rate was left unchanged at 8.5 percent. The stability of policy interest rates comes on the back of the assessment of the CBE that they are appropriate and supportive of the economic

recovery while consistent with maintaining core inflation[3] within the CBE's comfort zone. Banks' interest rates of lending and deposits have been in the range of 11- 11.2 percent and 5.9-6 percent, respectively throughout the second half of FY10, compared with 12.1 and 6.5 percent in June 2009. Interest rates of T-bills declined as well during FY10 to be below 10 percent on average, compared with 10.7 percent in the second half of FY09 and 11.3 percent in the full FY09. Although all interest rates have remained on average negative or close to zero in real terms in FY10, they were less negative than their corresponding average rates in FY09.

12. ***Domestic credit growth started to pick up only at the end of FY10.*** After peaking to 21.8 percent in June 2009, annual growth in the total domestic credit persistently declined to reach 7.3 percent in April 2010. Only in May did the growth rate increase to 9.2 percent and further to 11.4 percent in June 2010 ***(***a six-month high). The improvement in sentiment in the economy, the increased level of spending and business activity by the private and household sectors in the months leading to the summer, and prior to Ramadan, and the usual increase of government spending, and thus borrowing, in the months leading up to the fiscal year end (end of June) contributed to the rise in level of credit growth to these sectors. While growth in net claims on the government fell from 57 percent in end-FY09 to 18 percent in end-FY10, growth in credit to households grew from 8 to 12.4 over the same period and growth in credit to the private business sector turned to positive since March to reach 7 percent in end-FY10. Nonetheless, the Government's share in domestic credit increased (up from 39.3 to 41.7 percent) at the expense of the private business sector (down from 43.8 to 42.1 percent), reversing the trend seen in the boom period.

Figure 6– Increasing share of Net Claims to the Government to the detriment of credit to the private business sector



13. ***Growth of broad money supply was stable at low levels during most of FY10.*** M2 growth has been rebounding gradually from its low of 6.8 percent in April 2009, as spending in the economy and incoming inflows increased with the improvement in economic conditions. After fluctuating in a narrow range during most of FY10, annual M2 growth accelerates to 10.4 percent in June 2010, its highest y-o-y growth since January 2009 (9.5 percent). This was on the back of a rise in local currency deposits (up by 13.4 percent), particularly those of the household sector which constitutes 76 percent of total deposits (up by 15 percent). Growth in net domestic assets (NDA) continued to be the main driver of M2 growth, explaining almost 70 percent of it.

14. ***The exchange rate has been trading within a tight band.*** Driven by capital flows and tracking US$-Euro movements, the Egyptian pound steadily appreciated vis-à-vis the US$ until January 2010 (up by 2.75 percent to LE5.437. Since then, it has depreciated to reach LE5.664 in June (down by 4.17 percent), the lowest value for the pound since July 2007. The exchange rate to the Euro followed an opposite trend, first depreciating between July and December 2009 to reach LE8.083 (down by 2.2

[3] The CBE removes from the core inflation index the effect of the most volatile items such as fruits and vegetables, as well as some administered prices.

percent), before substantially appreciating during H2-FY10 -following the weakness in the euro zone- to reach LE 6.989 in June 2010 (up by 11.6 percent).

15. ***The Egyptian stock exchange improved in FY10, though with some fluctuations.*** The Egyptian stock exchange index (EGX) picked up in the beginning of FY10, coinciding with the affirmation of several international financial institutions about the stability and potentiality of the Egyptian economy and financial market. Afterward, the stock market corrected sharply in November 2009 (following Dubai World debt restructuring/default announcement) and in May and June 2010 (following the Greek sovereign debt crisis). Overall, EGX index increased from 5703 in end-June 2009 to 6033 in end-June 2010(up by 5.8 percent), and further to 6317 and 6510 in the end of the following two months. This is still way below the levels reached before the global financial crisis (peaking to 11787 in end-April 2008). However, Egypt's stock market, which has the highest correlation to global emerging markets of any MENA market, is one of the region's most investible markets and it is expected to continue to benefit from high levels of global liquidity.

Figure 7– EGX Fluctuations in tandem with Dow Jones

III. STRUCTURAL POLICIES AND SECTORAL NEWS

Subsidized energy and food prices increase

16. ***Government raised gas prices for non-energy intensive industries by 18 percent, and implemented new electricity pricing for energy intensive industries.*** On July 1st, prices of natural gas and electricity for industry were raised. ***For energy-intensive industries,*** which include iron and steel, cement, aluminum, copper and fertilizers and use around 60 percent of energy for all industries, the price of natural gas had remained unchanged at US$3/mBTU (below the cost price). Yet, the tariff for electricity was increased by 50 percent in peak hours of consumption- defined as 7:30 pm to 11:00 pm in the summer, and 5 pm to 9 pm in the winter. The move is intended to encourage conservation of electricity usage, in line with international standard, by encouraging companies to shift production to off-peak times to help balance the consumption load as electricity consumption rapidly increases. ***For non-energy intensive industries***, the price of natural gas increased from US$1.7/mBTU to US$2.0/mBTU only, to preserve the competitiveness of these industries both locally and in external markets. These industries represent 97 percent of industrial projects in Egypt and use around 30 percent of energy for all industries. Prices of electricity were also raised for these industries according to an equation linking the price of electricity with the price of gas (yet, details of the precise equation have not been released). Regarding flat glass, ceramics and porcelain industries, they are charged US$2.3/mBTU starting FY11, instead of US$3/mBTU. The price of gas for these industries was reduced from US$3/mBTU to US$1.7/mBTU for 12 months, extended for another six months ending June 2010, to help them accommodate the effect of the global crisis. All chemical and processed glass industries, including around 1300 small and medium size factories in the fields of plastics and paper (using only 3 percent of energy for industry) will be charged as non-energy intensive industries starting FY11.

17. ***The MOEE announced a 7.5 percent increase in electricity prices for household, commercial and governmental establishments starting October 2010***. Although the government initially planned to increase electricity prices by 5 percent annually, it opted for a larger 7.5 percent rise following the government's decision to increase prices of petroleum products supplied to power

plants by 9 percent. The 7.5 percent will be divided so that 5 percent will go to the MOEE while the remaining 2.5 percent will go to the oil sector. To ease the inflationary pressure and delay the negative impact on households' budget, the MOEE decided to implement the price adjustment in October as consumers use less electricity during that time.

18. ***Subsidized food prices under the ration card system were unified in May 2010.*** Ration cards used to provide fixed monthly quotas of basic (or compulsory) quotas of ½ kg of oil and 1 kg of sugar for each household member registered in the system at LE 0.5 and LE 0.6, respectively; and additional (optional) quotas of 1 kg of oil and 1 kg of sugar for 4 entitled household members maximum at LE4.25 and LE1.75, respectively. Effective May 2010, prices of subsidized oil and rice disbursed through ration cards were unified at LE 3.0 and LE1.0, respectively. The decision aims to eliminate chances for trading subsidized goods on the black market and to simplify the administration of the food subsidy system Later on in July, the government raised the subsidized price of sugar to LE 1.1 to finance the resulted increase in the subsidy bill. While total expenditure of entitled households who buy additional quotas will decline, total spending of households who rely on only basic quantities will increase by LE1.5/person/month.

19. ***The Government plans to introduce a coupon system for butane cooking gas after mid-September, when the fasting month of Ramadan ends.*** The government also intends to sell butane gas (one of the most highly subsidized energy products) to shops and restaurants at actual cost. The inflationary impact of such decision depends on whether the market-priced canisters will be sold to segments that do not have access to the gas grid or to individuals who do not have ration cards.

Incentives for a larger role for the private business sector

20. ***Parliament approved PPP law on May 10th.*** The law should facilitate the implementation of PPPs, thus speeding up the ongoing government plan to expand Egypt's infrastructure. The government has a list of investment projects worth LE82 billion which it intends to promote to the private sector. Two projects had already been awarded to Orascom construction Industries in water and waste water. The Italian San Paolo group will offer, within four months, bonds worth LE2 billion in the local Egyptian market, with maturities of up to 15 years to finance projects with the private sector under the Public-Private Partnership (PPP) program. Also, the Cabinet has approved the offering of a number of road projects with an investment cost of LE10 billion under the Public-Private Partnership and the BOT systems to reduce traffic congestion in Greater Cairo areas.

21. ***National Bank of Egypt to underwrite PPP financing***. An agreement between the Ministry of Finance and the National Bank of Egypt (NBE) will allow the latter to be the principal coordinator and underwriter in financing loans under the PPP program. The agreement does not rule out the participation of other banks in financing PPP projects, but in the case of a shortfall in financing by other banks, NBE will act as the underwriter of the required financing. The first phase of the projects that will be executed under the new law will need financing of around LE15 billion, LE8 billion of which will finance waste water projects, hospitals and schools. The government has a list of PPP projects which it is promoting to the private sector, both local and foreign, worth LE80 billion, dedicated mostly to infrastructure projects.

22. ***Development of 7 trade zones and logistical centers worth LE10 billion.*** Ministry of Trade and Industry officials announced the commencement of the first phase of the development of seven trade zones and logistical centers between the private sector and the government with the application of nine bids from local and foreign companies. Operation of the first phase of the project is expected by the end of 2011 with investments of LE10 billion. The second and third phases, which include the establishment of commercial centers in 22 governorates, will be tendered this year as well. In relation to this, to facilitate the establishment of industrial and commercial zones, a presidential decree was

issued transferring the authority to issue new construction and operation licenses for these zones from Governors to the Minister of Trade and Industry.

23. ***A new subsidy export system based on the share of value-added started in July 2010.*** The new system replaces disbursement of export subsidy based on a percentage given to each unit of exported product. The budget of the Export Subsidy Fund in FY11 reachesLE4 billion, compared to LE3.7 billion in FY10. The Industrial Development Authority is assessing the local component ratios in different factories to determine the amount of the export subsidy. There are 26 subsidy programs operating under the Fund benefiting 1200 companies. Subsidies also cover 50 percent of transportation costs to Africa, China, Russia and Kazakhstan, and are extended to industrial zones in Upper Egypt.

Loans and Bond Issuance

24. ***New Urban Communities Authority offered a 5-year government-guaranteed bond worth LE2.5 billion bonds***. By end of March 2010, the sale received 1.5 times more offers than bonds available. The bond's coupon, guaranteed by the Ministry of Finance, is a variable rate equivalent to the average rate on net weighted return (after taxes) on 182-day bills, in addition to 0.625 percent, paid bi-annually. Another tranche of LE2.5 billion maturing after 13 months will be offered in a private placement. These bonds aim to finance the third fiscal stimulus package worth LE11.2 billion in FY10. The Authority had offered a LE4.6 billion securitized bond in late 2009, which was backed by a land sale to a Qatari company.

25. ***The government offered a 10-year bond worth US$1 billion and a 30-year bond worth US$0.5 billion*** during the third week of April, with rates of 5.75 percent (200 basis points over comparable US government Eurobonds) and 6.875 percent respectively. This is the first international dollar-denominated issue in nearly a decade. The bonds were assigned a long-term foreign currency ***rating of BB+ by Fitch ratings agency, and Ba1 by Moody's.***

26. ***Public sector companies have successfully settled around LE32.5 billion of debts.*** Effective July 1st, 2010, none of the public sector companies had any debt obligations to banks. This is expected to contribute to higher profitability levels at these companies. Public textile, chemical, and iron and steel companies were amongst the beneficiaries of the debt settlement process. The public sector registered more than LE3 billion profits in FY10, after incurring losses in earlier years, and is expected to make LE5 billion during FY11. Settlement has taken place over three phases, the first involving paying LE9.7 billion to public banks, the second paying LE12.6 billion to the National Bank of Egypt (NBE) and Banque Misr (BM), while the third aimed at settling the remaining dues to NBE and BM. Settlement of the historical debt has been executed using proceeds from privatization, the sale of government assets like the third mobile license, and the transfer of land owned by the public companies to the banks to settle the final tranche of debts.

27. ***A halt has been called to the privatization program.*** With the exception of offering minority stakes in some public companies to Egyptians with the government maintaining majority ownership of these companies, the Ministry of Investment announced in May 2010 a halt in the overall privatization program in favor of an approach based on private-sector management of state-owned assets, and the intention to develop profitable companies and restructure the losing ones. The number of remaining public enterprise companies is estimated to be around 153 companies.

Others

28. ***The People's Assembly approved in June the long-overdue state pension law and the social welfare law.*** The new pension law provides pension coverage for different, previously uncovered,

segments of society, including seasonal workers, in addition to unemployment benefits. Accordingly, a new pension system is established in parallel to the existing system, which will increase pensions and allow better investment of pension funds, especially in the stock market. The law means a shift to a state-managed defined contribution scheme. 65-70 percent of premiums will be allocated to government debt, with the remainder going to a range of risk assets, including equities. Currently, only 2-3 percent of the LE300 billion (US$55 billion) pension pool (for both private and public sector employees) is invested in equities; most in government debt or tied up in infrastructure projects. Government estimates that around LE500 million (US$91 million) will be collected under the new pension law during its first year. As to the ***social welfare law***, it aims at expanding the current coverage of social welfare, while tying it to the ongoing economic developments to ensure the best possible care for families in need. The law, expected to benefit 1.1 million families, complements the new pension law.

29. ***Frequent and lasting power outages during the summer season suggest the need for new power generation.*** The electricity cuts were explained by accelerating domestic demand (up by 13.5% in FY10 compared with 9% in FY09 and 5% in FY08), and lack of gas supplies. On June 30, the Council of Ministers has issued a decree for all government buildings nationwide to reduce their electricity consumption by 50 percent and to reduce light usage in streets. The MOEE also launched a campaign on July 15 for replacement of the traditional lamps with "energy-saving" lamps, to be sold in all distribution companies outlets in Cairo with half of its price and expected to save up to a billion Egyptian Pound from this campaign. The electricity shortage has drawn the attention to the need to increase investment in gas production, and to proceed with the plans to build four nuclear power plants, as well as increasing the share of power generation from renewable (especially wind power). Plans to build the four nuclear plants remain at the feasibility study stage, and no contractors for their construction have yet been selected.

30. ***Quick government movement to contain the effects of Russian wheat export ban***. Egypt is the biggest importer of wheat, where local consumption is around 14 million tons annually, and half of this amount is imported. Following a decision by Russia, the largest wheat supplier to Egypt in recent years, to ban wheat exports as a consequence of a drought, international wheat prices soared. According to the Egyptian Ministry of Trade and Industry, such a surge in prices will cost the Egyptian budget between LE 2.5 billion and LE 4 billion. Prices of unsubsidized flour, bread and pasta have surged, provoking discontent at a sensitive political juncture, with parliamentary elections looming. It is worth noting that the safe strategic reserve of wheat in Egypt shall last to next January 2011. Egypt issued a new tender to import 225 thousand tons of American wheat where prices range from $ 289.9 and $ 293 per ton. Meanwhile, Egypt will diversify the sources of wheat imports, as last August Egypt came to an agreement to import wheat from France, United States, and Canada.

IV. OUTLOOK

31. ***Egypt's macroeconomic outlook is stable.*** Assuming that domestic demand holds up, and Egyptian exports continue their observed recent trend, we expect that the Egyptian economy grows in the range of 6.0 to 6.2 percent in FY11. This is underpinned by strong commitment to maintain structural reforms momentum, and a relatively stable global economy. However, unemployment will remain a challenge as growth as high as 6 percent will barely absorb the increasing number of new entrants to the labor market. Unemployment will continue to be an overriding concern and will gradually fall to around 8.7 percent in FY11. Finally, inflationary pressures are expected to rise, as global prices are likely to filter to domestic consumer prices, domestic demand will gain more solid ground, and gradual adjustment of energy prices will be implemented. Inflation will therefore pick up slightly later this year before easing to one-digit levels in 2012. Core inflation is expected to remain within the CBE's assumed comfort zone of 6-8 percent. Interest rates are not thus expected to rise, yet

real interest rates will remain low or negative. With the CBE foreign exchange policy aiming to maintain currency stability and low inflationary pressures, the Egyptian pound will continue to trade within a tight band. In general, the monetary policy will remain accommodative as policy focus is on supporting the economic recovery. This outlook is consistent with that of Standard & Poor's Ratings Services which affirmed in March 2010 its 'BB+/B' foreign currency and 'BBB-/A-3' local currency sovereign credit ratings on Egypt, in response to the improvement in Egypt's medium-term prospects.

32. ***External balances will remain solid and fiscal deficit will remain large.*** While the trade deficit is expected to gradually widen in FY11 on the back of the economic recovery, the services surplus will widen again, as tourism and Suez Canal revenues will continue to increase and remittances will remain strong. The current account deficit is thus expected to narrow in FY11. FDI inflows will be more moderate than in recent years, and portfolio investments inflows, driven by high interest rate differentials and stable local currency, are expected to continue to result in BOP surpluses, though remaining volatile, depending on global developments.

33. ***Fiscal stance is sustainable over the medium term.*** The planned fiscal deficit will narrow to 7 percent in for FY11, which is still large. With elections for Parliament and the presidency coming in 2010 and 2011 respectively, it is likely that the Government will maintain relatively high levels of spending and will find it challenging to meet its target of cutting the fiscal deficit by 5 percent of GDP by FY13. Additional revenues are anticipated from improved earnings from the Suez Canal and customs duties, measures to increase tax compliance, and a new property tax. Given the Government's caution over contracting foreign debt, we expect the deficit to be financed largely by local borrowing, keeping the upward trend of the domestic public debt. While the current fiscal and debt position is sustainable over the medium term, any further deterioration could be risky and could make it difficult to provide financing for the private sector.

34. ***Major risks to the medium-term outlook are***: i) a double-dip recession would undermine Egypt's economic recovery and put greater pressure on fiscal and external balances; ii) reduction of fuel subsidies and introduction of a value added tax (VAT), while necessary to narrow the large fiscal deficit, may result in a sharp one-off spike in prices; and iii) a disorderly process of presidential succession may slow or even halt progress in key reform areas, compromising our positive outlook.

ANNEX 1: KEY MACROECONOMIC INDICATORS

GDP	FY05	FY06	FY07	FY08	FY09	9M-09	9M-10
Annual percentage change							
Real GDP at Market Price	4.5	6.8	7.1	7.2	4.7	4.7	5.1
Real oil GDP	0.8	19.6	3.5	3.7	5.7	6.3	-22.9
Real non-oil GDP	5.5	5.2	7.4	7.5	4.6	4.6	7.6
In percent of GDP							
Agriculture	14.9	14.1	14.1	13.2	13.7	14.3	14.7
Industry	34.4	36.5	35.0	36.2	36.0	35.2	35.2
Oil GDP	*13.5*	*16.3*	*15.0*	*16.2*	*15.6*	*14.1*	*13.6*
Services	50.8	49.4	51.0	50.6	50.3	50.5	50.1

Real sector indicators	FY05	FY06	FY07	FY08	FY09	FY10
Unemployment rate (percent)	10.5	11.5	9.5	8.9	9.2	9.1
Suez Canal						
Number of ships	17,334	18,476	19,479	21,080	19,772	14,574
Revenues (US$ mill)	3,290	3,564	4,168	5,113	4,866	3,366
Tourism						
arrivals (,000 tourists)	8,650	8,693	9,788	12,294	11,231	13,800
revenues (US$ mill)	6,433	7,238	8,183	11,674	9,588	11,600
Annual percentage change (unless otherwise stated)						
Cement Production	1.6	22.0	4.2	6.0	11.2	9.2
Iron and Steel Production	1.4	4.9	0.8	3.7	46.4	32.7
Energy Consumption for Industrial use (MK/h)	8.3	6.9	6.3	7.1	0.6	5.4

External sector	FY05	FY06	FY07	FY08	FY09	FY10
US$ billion (unless otherwise stated)						
Merchandise Exports	13.8	18.5	22.0	29.4	25.2	23.9
of which non-oil	8.5	8.2	11.9	14.9	14.2	13.6
Merchandise Imports	24.2	30.4	38.3	52.8	50.3	48.9
Percent of GDP (unless otherwise stated)						
Trade balance	-11.6	-11.2	-12.5	-14.4	-13.4	-11.6
Remittances	4.8	4.7	4.8	5.3	4.0	4.4
Current account balance	3.2	1.6	2.1	0.5	-2.3	-2.0
FDI	4.4	5.7	8.5	8.2	4.3	3.1
Overall Balance	5.0	3.0	4.0	3.3	-1.8	1.6
External debt	32.3	27.5	22.9	21.3	16.4	14.8**
US$ billion (unless otherwise stated)						
Net International Reserves (US$ bill)	19.3	22.9	28.5	34.6	31.6	35.2
months of imports	*9.6*	*9.0*	*9.1*	*7.9*	*7.3*	*8.9*

** Data till July*

***Data till March*

Prices (Period Average)						
	FY05	FY06	FY07	FY08	FY09	FY10
	Percent (unless otherwise stated)					
CPI inflation	11.4	4.2	11.0	11.7	16.2	10.7
PPI inflation				17.8	3.8	5.5*
Exchange rate (LE/US$)	6.01	5.75	5.71	5.50	5.51	5.51
Deposit interest rate	7.7	6.5	6.0	6.1	7.0	6.0
Lending interest rate	13.4	12.7	12.6	12.2	12.4	11.3
TB interest rate	10.1	8.8	8.7	7.0	11.3	9.8
Deposit policy rate (eop)	9.5	8.0	8.8	10.5	8.5	8.3
Lending policy rate (eop)	12.5	10.0	10.8	12.5	10.0	9.8
Discount rate (eop)	10.0	9.0	9.0	10.0	8.5	8.5
Government finance						
	Percent of GDP					
	Fiscal sector (budget sector) (1)					
Revenue (including grants)	20.6	24.5	24.2	24.7	27.2	22.4
Tax Revenue	14.1	15.8	15.4	15.3	15.7	14.5
Direct	6.1	8.0	8.1	7.7	8.1	7.2
Indirect	8.0	7.8	7.3	7.6	7.6	7.3
Non-Tax Revenue (2)	6.5	8.7	8.8	9.4	11.5	8.0
of which Property income	3.3	5.9	6.1	5.9	5.1	4.6
Total expenditure	30.2	33.6	29.8	31.5	33.8	30.7
Interest	6.1	6.0	6.4	5.6	5.1	6.1
Subsidies	2.6	8.8	7.2	9.4	9.2	8.6
Investment	4.3	3.4	3.4	3.8	3.9	4.0
Net financial acquisition	0.2	-1.0	1.7	0.0	0.3	0.0
Other	17.0	16.4	11.0	12.6	15.3	12.0
Cash deficit (3)	9.4	9.2	5.6	6.8	6.6	8.2
Overall deficit	9.6	8.2	7.3	6.8	6.9	8.3
Primary deficit	3.5	2.2	0.9	1.2	1.8	2.2
Domestic debt profile						
Net Budget Sector debt	72.5	72.0	64.2	53.5	54.1	55.3
Net Genereal Government debt	51.5	53.8	49.6	42.7	45.0	47.9
Net Domestic Public debt (4)	52.3	53.9	48.8	43.2	45.8	50.0
Financial Indicators						
	Annual percentage change (unless otherwise stated)					
	Banking Sector					
Broad money (end of period)	13.6	13.5	18.3	15.7	8.4	10.4
Loan-to-deposit ratio (except CBE)	58.8	56.2	53.5	52.9	52.1	52.2
Bank Credit	10.6	9.2	4.3	7.5	21.8	11.4
to government (excl public sector)	26.6	15.2	-3.2	-2.4	57.0	18.3
to private sector	3.6	8.6	12.3	12.6	5.1	8.2
Net foreign assets of banking system	80.9	133.4	218.6	303.7	254.1	280.1
	Stock Market					
EGX30 (% change)	235.1	-1.2	63.5	25.9	-42.0	-2.3
Market Volatility	1.5	2.2	1.0	1.0	2.0	1.30
Market Capitalization (% of GDP)	62.6	61.0	80.8	91.1	44.7	34.2

* Average 11 months

(1) Includes central administration, local government and public service authorities

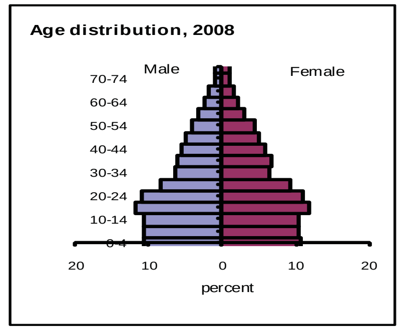
(2) Includes grants

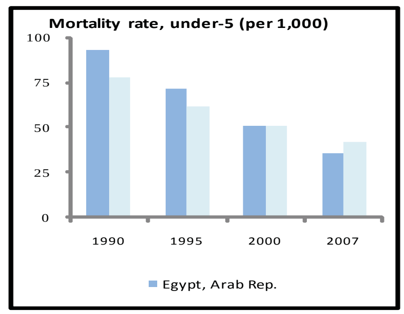
(3) The cash deficit is the difference between revenues and expenditures excluding net financial acqusiition.

ANNEX 2: EGYPT AT A GLANCE

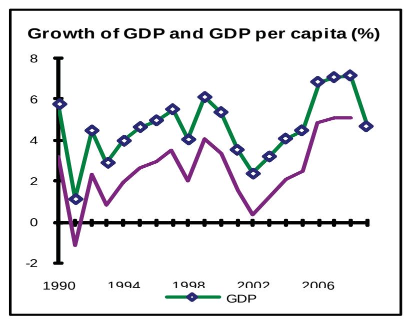
Egypt, Arab Rep. at a glance

Key Development Indicators	Egypt	M. East & North Africa	Lower middle income
(2008)			
Population, mid-year (millions)	81.5	325	5,624
Surface area (thousand sq. km)	1,001	8,778	98,795
Population growth (%)	1.8	1.8	1.3
Urban population (% of total population)	43	57	45
GNI (Atlas method, US$ billions)	146.9	1,053	15,683
GNI per capita (Atlas method, US$)	1,800	3,242	2,789
GNI per capita (PPP, international $)	5,460	6,076	5,330
GDP growth (%)	7.1	5.8	6.2
GDP per capita growth (%)	5.1	3.8	4.9
(most recent estimate, 2005–2007)			
Poverty headcount ratio at $1 a day (PPP, %)	..	2	..
Poverty headcount ratio at $2 a day (PPP, %)	..	20	..
Life expectancy at birth (years)	70	70	67
Infant mortality (per 1,000 live births)	30	32	51
Child malnutrition (% of children under 5)		13	12
Adult literacy, male (% of ages 15 and older)	75	65	75
Adult literacy, female (% of ages 15 and older)	58	82	86
Gross primary enrollment, male (% of age group)	107	109	109
Gross primary enrollment, female (% of age group)	102	104	104
Access to an improved water source (% of population)	98	88	84
Access to improved sanitation facilities (% of population)	66	74	55





Net Aid Flows	1980	1990	2000	2008
(US$ millions)				
Net ODA and official aid	1,383	5,430	1,328	1,416
Top 3 donors (in 2008):				
European Commission	834	2,346	635	854.5
United States	33	140	242	615.9
Germany	107	347	65	66.4
Aid (% of GNI)	6.4	12.9	1.3	0.8*
Aid per capita (US$)	32	98	20	14*



Long-Term Economic Trends	1980	1990	2000	2009	1980–90	1990–2000	2000–09
Consumer prices (annual % change)	20.8	12.6	3.7	16.2			
GDP implicit deflator (annual % change)	3.2	17.7	4.9	11.2			
Exchange rate (annual average, local per US$)	0.7	1.55	3.45	5.5			
Terms of trade index (2000 = 100)	..	97	100	108			
					(average annual growth %)		
GDP (US$ millions)	21520	59055	91604	188494	5.4	4.3	4.9
		(% of GDP)					
Agriculture	18.3	19.4	16.7	13.7	3.0	3.0	3.4
Industry	36.8	28.7	33.1	36.0	8.8	4.2	5.4
Manufacturing	12.2	17.8	19.4	15.2	..	6.4	5.0
Services	45.0	52.0	50.1	50.3	7.8	4.6	5.3
Household final consumption expenditure	69.2	71.9	75.9	76.2	0.4	4.1	3.6
General gov't final consumption expenditure	15.7	11.4	11.2	11.4	-0.5	4.6	3.1
Gross capital formation	27.5	28.8	19.6	19.3	0.0	3.9	5.2
Exports of goods and services	30.5	20.7	18.0	25.0	5.2	1.0	13.3
Imports of goods and services	42.9	32.0	24.0	31.9	-2.0	1.0	10.3
Gross savings	..	16.2	12.9	12.4	..	-0.2	2.1

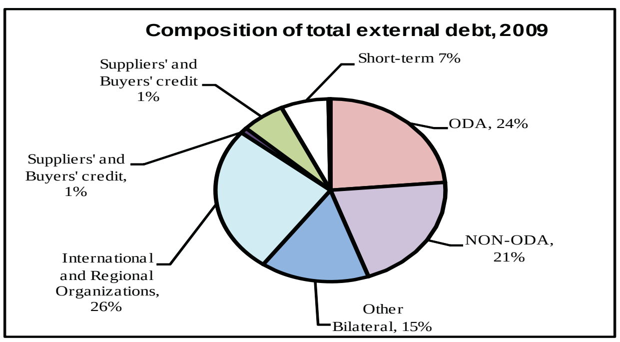
Notes: * data are 2007 .. indicates data are not available.

Development Economics, Development Data Group (DECDG).

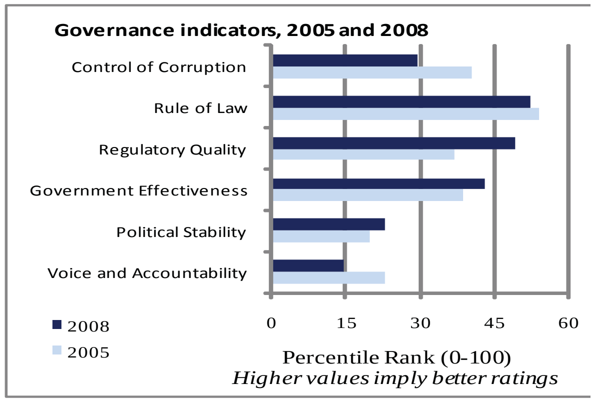
Balance of Payments and Trade	2000	2005	2009
(US$ millions)			
Total merchandise exports (fob)	6,388	13,833	25,169
Total merchandise imports (cif)	17,860	24,193	50,342
Net trade in goods and services	-5,850	2,517	????
Workers' remittances and compensation of employees (receipts)	2,843	4,330	7,806
Current account balance	-1,171	2,911	-4,424
as a % of GDP	-1.1	3.2	-0.4
Reserves, including gold	..	19,302	31,308

Central Government Finance			
(% of GDP)			
Revenue	*26.5*	24.7	27.4
Tax revenue	*16.0*	13.8	15.7
Expense	*24.2*	31.6	34.3
Cash surplus/deficit	*-1.6*	-7.0	-6.6
Highest marginal tax rate (%)			
Individual	32	32	20
Corporate	40	40	20

External Debt and Resource Flows			
(US$ millions)			
Total debt outstanding and disbursed	29,187	28,949	31,531
Total debt service	1,832	2,702	2,601
HIPC and MDRI debt relief (expected; flow)	–	–	–
Total debt (% of GDP)	28.6	31.1	17.0
Total debt service (% of exports)	8.5	9.4	6.2
Foreign direct investment (net inflows)	1,235	3,902	6,773
Portfolio equity (net inflows)	269	831	-9,622



Private Sector Development	2000	2005	2010
Time required to start a business (days)	–	34	7
Cost to start a business (% of GNI per capita)	–	104.9	16.1
Time required to register property (days)	–	193	72
Ranked as a major constraint to business (% of managers surveyed who agreed)			
Tax rates	..	81.8	..
Macroeconomic instability	..	74.5	..
Stock market capitalization (% of GDP)	28.1	62.6	44.3
Bank branches (per 100,000 people)	..	*3.6*	



Technology and Infrastructure	2000	2007
Paved roads (% of total)	*78.1*	*81.0*
Fixed line and mobile phone subscribers (per 1,000 people)	102	518
High technology exports (% of manufactured exports)	0.3	0.2

Environment		
Agricultural land (% of land area)	3	*3.5*
Forest area (% of land area, 2000 and 2005)	0.1	*0.1*
Nationally protected areas (% of land area)	..	*5.3*
Freshwater resources per capita (cu. meters)		22
CO2 emissions per capita (mt)	1.9	2.3
GDP per unit of energy use (2000 PPP $ per kg of oil equivalent)	5.2	*5.7**
Energy use per capita (kg of oil equivalent)	689	*795*

World Bank Group portfolio	2000	2008
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	639	0
Disbursements	6	0
Principal repayments	87	77
Interest payments	41	0
IDA		
Total debt outstanding and disbursed	1,266	1,444
Disbursements	49	11
Total debt service	32	62
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	163	239
of which IFC own account	163	239
Disbursements for IFC own account	25	89
Portfolio sales, prepayments and repayments for IFC own account	14	26
MIGA		
Gross exposure	0	0
New guarantees	0	0

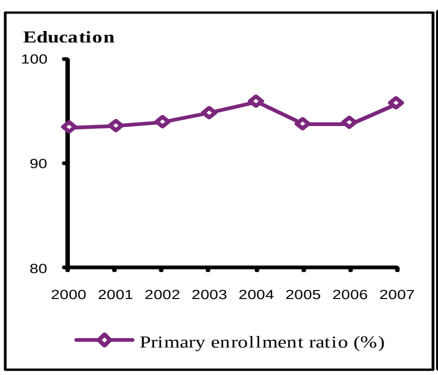
Note: Figures in italics are for years other than those specified. *(2005 PPP $ per kg of oil equivalent)
.. indicates data are not available. – indicates observation is not applicable.

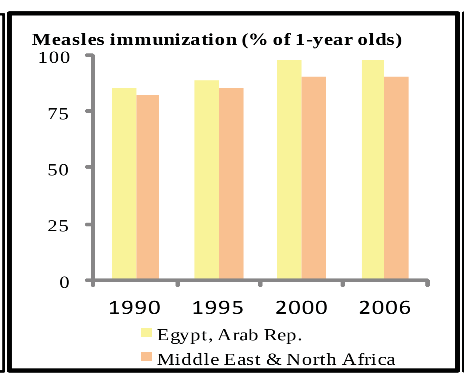
Development Economics, Development Data Group (DECDG).

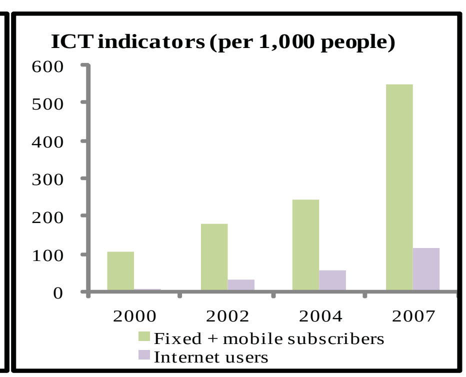
Millennium Development Goals

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Egypt, Arab Rep.			
Goal 1: halve the rates for $1 a day poverty and malnutrition	**1990**	**1995**	**2000**	**2007**
Poverty headcount ratio at $1 a day (PPP, % of population)	*4.0*	3.8	3.1	..
Poverty headcount ratio at national poverty line (% of population)	..	22.9	16.7	..
Share of income or consumption to the poorest qunitile (%)	..	..	8.6	..
Prevalence of malnutrition (% of children under 5)	10	17	4	*5*
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	*84*	..	93	96
Primary completion rate (% of relevant age group)	..	*92*	97	98
Secondary school enrollment (gross, %)	*71*	..	83	*87*
Youth literacy rate (% of people ages 15-24)	61	..	..	*66*
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	*81*	..	92	95
Women employed in the nonagricultural sector (% of nonagricultural employment)	21	19	19	22
Proportion of seats held by women in national parliament (%)	4	*2*	2	*2*
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	104	71	49	36
Infant mortality rate (per 1,000 live births)	76	56	40	30
Measles immunization (proportion of one-year olds immunized, %)	86	89	98	98
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	84	..
Births attended by skilled health staff (% of total)	*37*	46	61	*79*
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	..	..	..	..
Contraceptive prevalence (% of women ages 15-49)	*48*	48	56	*59*
Incidence of tuberculosis (per 100,000 people)	42	..	..	21
Tuberculosis cases detected under DOTS (%)	..	43	45	72
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	94	..	..	98
Access to improved sanitation facilities (% of population)	54	..	..	*66*
Forest area (% of total land area)	0.0	..	0.1	*0*
Nationally protected areas (% of total land area)	..	..	..	*5*
CO2 emissions (metric tons per capita)	1.4	1.6	1.9	*2*
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	5.1	5.2	5.2	*5.7**
Goal 8: develop a global partnership for development				
Fixed line and mobile phone subscribers (per 1,000 people)	29	44	102	518
Internet users (per 1,000 people)	0	0	7	132
Personal computers (per 1,000 people)	..	4	12	46
Youth unemployment (% of total labor force ages 15-24)	..	..	27.7	*34*







Note: Figures in italics are for years other than those specified. *(2005 PPP $ per kg of oil equivalent)
.. indicates data are not available
Development Economics, Development Data Group (DECDG).