April 2010
IMF Country Report No. 10/94

Arab Republic of Egypt: 2010 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Arab Republic of Egypt

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with the Arab Republic of Egypt, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on February 16, 2010, with the officials of the Arab Republic of Egypt on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 9, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 24, 2010 discussion of the staff report that concluded the Article IV consultation.

- A statement by the Executive Director for the Arab Republic of Egypt.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

ARAB REPUBLIC OF EGYPT

Staff Report for the 2010 Article IV Consultation

Approved by Ratna Sahay and David Marston

March 9, 2010

- **This report is based on discussions held in Cairo during February 3–16, 2010.** The staff team comprised A. MacArthur (head), E. Arbatli, K. Moriyama, K. Ongley (all MCD), M. Albino-War (FAD), and K. Youssef (MCM). Mr. Shaalan and Ms. Abdelati (both OED) also participated in the technical and policy discussions.
- **Counterparts:** Discussions were held with Ministers Boutros-Ghali (Finance), Mohieldin (Investment), and Osman (Economic Development), Central Bank Governor El Okdah, other government officials, as well as with representatives from the private sector, academia, labor organizations, and the parliament.
- **Context of past surveillance:** Five years of reforms and prudent macroeconomic policies created the space needed to respond to the global financial crisis, and the supportive fiscal and monetary policies of the past year have been in line with staff's advice. The authorities remain committed to resuming fiscal consolidation broadly in keeping with past advice to address fiscal vulnerabilities.
- **Egypt's exchange rate regime** is classified as "other managed arrangement." On January 2, 2005, Egypt accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. The exchange system is free of restrictions on payments and transfers for current international transactions.
- **Strengthening data quality**, and enhancing its coverage, timeliness and transparency will greatly improve the effectiveness of surveillance and, importantly, help boost the quality and communication of policy-making.
- **Consultation cycle:** The last Article IV consultation was concluded on December 22, 2008. The staff report was published and Directors' comments can be found at http://www.imf.org/external/pubs/cat/longres.cfm?sk=22646.0. The next Article IV consultation will take place on the standard 12–month cycle.

Contents

Page

STAFF APPRAISAL[1]

1. **Egypt's economy has been resilient to the crisis.** Financial contagion was contained by limited direct exposure to structured products and low levels of financial integration with world financial markets. Sustained and wide-ranging reforms since 2004 had reduced fiscal, monetary, and external vulnerabilities, and improved the investment climate. These bolstered the economy's durability and provided breathing space for appropriate policy responses.

- **Financial market conditions have eased since the initial downturn.** A sharp outflow of capital took place in the second half of 2008, as foreign investors pulled out of equity and government debt markets. Investors' confidence in Egypt and appetite for risk have improved since March 2009, and the stock market reversed course, capital inflows resumed, and official international reserves have been rising.

- **Economic performance was better than expected, although headline inflation remains elevated.** Growth fell only to 4.7 percent in FY2008/09 on the strength of consumption spending, and production in the construction, communications, and trade sectors. The first half of FY2009/10 provides further evidence of a pickup in growth and external demand. After falling rapidly from 24 percent, headline inflation has risen above 13 percent in recent months, although much of the impetus appears to be idiosyncratic. Core inflation remains within the central bank's informal comfort zone.

2. **Prompt fiscal and monetary responses helped cushion the impact of the post-Lehman slowdown.** Additional infrastructure expenditures—some off-budget—provided a targeted and temporary stimulus. Also helping to limit the slowdown, interest rates were cut sharply. The rapid capital outflow in late 2008 was met mostly with a drawdown in official reserves and the Central Bank of Egypt's (CBE's) foreign currency deposits with commercial banks, limiting the impact on the Egyptian pound and real economy.

3. **As the recovery gains strength, the focus of policies can shift back toward fiscal consolidation and other growth-oriented reforms.** With growth expected to reach 5 percent in FY2009/10 and 5.5 percent in FY2010/11, the need for further stimulus is waning.

Fiscal Policy

4. **The FY2009/10 budget is appropriately supportive, but budget execution should give regard to the pace at which activity rebounds.** The government's FY2009/10 fiscal deficit target of 8.4 percent of GDP is expected to be met on the strength

[1] Also the concluding statement of the Article IV consultation mission (http://www.imf.org/external/np/ms/2010/021610.htm).

of careful fiscal management. If revenues perform better than expected as a result of strengthening activity, it would be prudent to save these. While the large government borrowing requirement represents a potential risk, financing should be available without undue stress. Development of markets for longer-term government debt is under way. The authorities could also consider diversifying toward additional foreign financing. These steps can help lengthen the average maturity of the debt, reduce financing costs, and lessen pressures on the banking system to finance the budget.

5. **The authorities' objective of reducing the fiscal deficit to about 3 percent by FY2014/15 is critical to achieving private sector-led growth and reducing vulnerabilities.** Reducing the overall deficit by about 5 percent of GDP over the next five years is feasible, based on the experience of other countries, and would lead to a further 15 percentage point decline in the debt-to-GDP ratio. Such adjustment will be crucial to maintain investor confidence, preserve macroeconomic stability, and create scope for future countercyclical fiscal policy. Anchoring the strategy in reforms to increase the low tax revenue-to-GDP ratio and the efficiency of public spending will help durably address Egypt's main fiscal vulnerabilities. Priorities include adopting as early as possible a full-fledged VAT, complementing energy subsidy reform with better-targeted transfers to the most needy, and containing the fiscal cost of the pension and health reforms.

6. **Staff advises that the FY2010/11 budget target a narrowing of the deficit compared to this year.** A tightening of 1½–2 percent of GDP would provide an upfront signal to investors that progress toward the medium term objective is well under way, encouraging a more rapid private sector response to boost FDI and growth. While adopting major reforms could be challenging with the approaching elections—as evidenced by the delays in the property tax—staff encourages the authorities to continue taking measures such as strengthening tax compliance and reducing the cost of subsidy abuse, and also to resist pressures for additional spending.

Monetary Policy

7. **While 12–month inflation is expected to decline in the coming months, the CBE should stand ready to tighten monetary conditions if inflation does not abate.** As inflation ceased declining and output growth picked up, the recent decisions to keep rates stable were appropriate. Increases in headline inflation have been driven largely by fruit and vegetable prices. Such pressures are likely to be mostly idiosyncratic and not demand-induced. But persistently high headline inflation risks generating inflationary momentum through its effect on expectations. Bringing down inflation toward partner country levels should remain a key objective for the coming years. Staff welcomes progress in strengthening the monetary policy framework. The new core inflation measure and publishing the planned monetary policy reports will allow a better understanding of the CBE's monetary policy decisions, and help improve its effectiveness.

8. **Capital inflows, if continued, will complicate monetary policymaking.** As the CBE has done in the past, sterilized intervention is the first option for hot money inflows,

although this is expensive and unlikely to be effective if inflows persist. The CBE should also continue to allow greater exchange rate variability to limit one-way bets. Egypt's real effective exchange rate is estimated to be slightly more appreciated than equilibrium, although these estimates are subject to uncertainties. The possibility that capital inflows could exert longer-lasting pressures for real appreciation reinforces the need for fiscal adjustment and productivity-enhancing reforms.

Reforms for Sustained Growth

9. **Continuing the reform momentum and reducing fiscal vulnerabilities remain the key medium-term challenges.** Rapid growth is crucial to tackling poverty and the high level of unemployment. In this context, reinvigorating the structural reform agenda should help raise productivity and reinforce Egypt's competitiveness.

- **Prioritizing reforms that promote macroeconomic stability and improve the investment climate will support the resumption of foreign direct investment.** As noted, the planned fiscal adjustment and tax reforms are an important element of generating confidence, improving the business environment, and ensuring space for the private sector. Resumption of privatization and development of public-private partnerships (PPPs) will help mobilize private sector financing and know-how. Contingent liabilities associated with PPPs, however, should be monitored closely.

- **Reinforcing financial soundness and promoting financial sector deepening will help mobilize savings needed to finance private sector-led growth.** The stability of the financial sector during and since the crisis is a testament to reforms since 2004. Staff supports the continuation of reform efforts with the CBE's Phase II agenda. Introducing Basel II standards and supporting financial sector development will help facilitate intermediation of savings and increase private sector access to credit. Staff supports plans to adopt additional prudential measures to contain vulnerabilities that will arise with greater integration with the global economy and the introduction of new asset classes. Close coordination between the new nonbank supervisory authority and CBE will be a priority, and consideration should be given to introducing forward-looking risk management and developing global standards on liquidity and leverage.

- **Strengthening data quality and transparency will help improve the policy debate and business environment, and enhance Fund surveillance.** The need for greater transparency and higher frequency data was underscored by the global financial crisis, and enhancements would help ensure that data availability is on par with other emerging markets. In particular, there is a need for more robust CPI and GDP deflators, and for publishing higher-frequency aggregate financial soundness indicators (as planned), and encouraging banks to make available detailed performance and soundness indicators.

10. **It is expected that the next Article IV consultation will be held on the standard 12–month cycle.**

I. Background and Analysis: Crisis Management

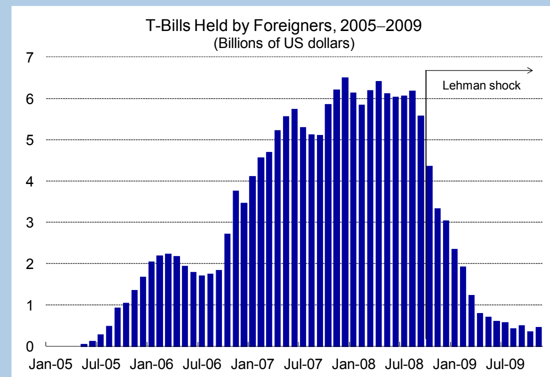
11. **Egypt made significant progress in wide-ranging structural reforms that accelerated after 2004.** This spurred rapid output growth—averaging 7 percent a year during FY2005/06–FY2007/08—underpinned by foreign investment-driven productivity gains and the favorable external environment. Reforms also reduced fiscal, monetary and external vulnerabilities, leaving some room to maneuver on macroeconomic policies in the event of negative shocks.

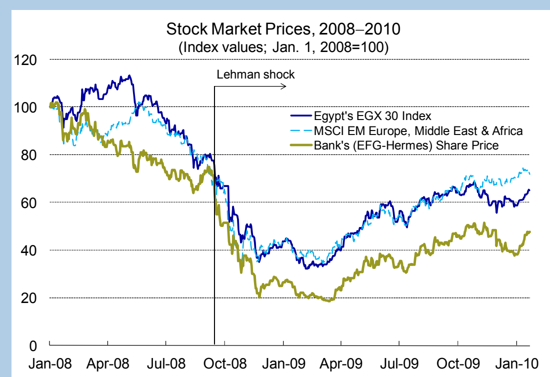
12. **Egypt weathered the global financial crisis relatively well.** Financial market pressures eased after the initial outflow in late 2008/early 2009.

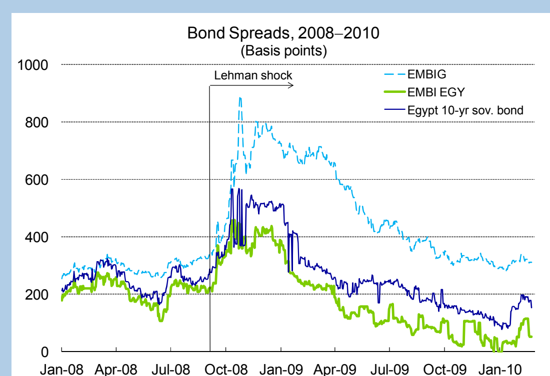
Following the Lehman shock, foreign investors withdrew from Egypt's equity and government debt markets, with foreign T-bill holdings declining by over 80 percent by April 2009.

The stock market decline continued through February 2009, with losses reaching 70 percent relative to the April 2008 peak. Having recovered over half these losses by November 2009, equity prices have plateaued in recent months, but withstood the initial Dubai World fallout.

After peaking in late 2008, Egypt's sovereign and CDS spreads tightened during 2009 and, in early 2010, remain well below their pre-Lehman levels and, on average, below other emerging markets.







13. **The temporary financial outflow was met mostly with a drawdown in reserves**, reversing the buildup in 2006–07 and limiting the impact on the Egyptian pound and real economy.

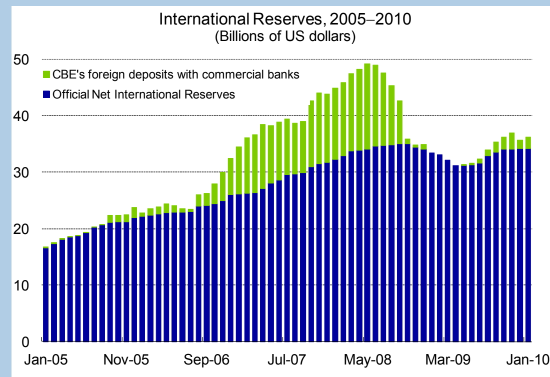
Cumulative outflows reached about US$14 billion. They were financed by a drawdown in net international reserves and the central bank's foreign currency deposits with commercial banks. The exchange rate depreciated by about 6 percent during October 2008–March 2009.

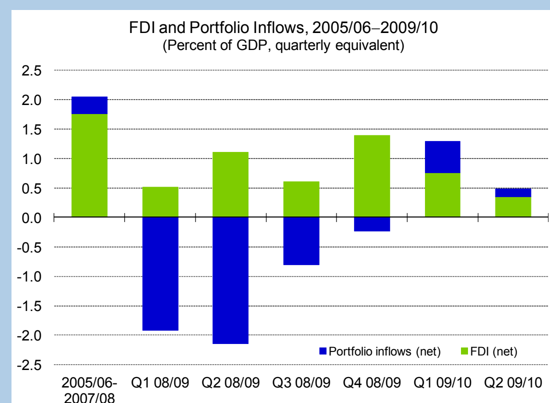
Capital inflows resumed in April 2009 and official reserves (alone) have been rebuilt to pre-Lehman levels (US$34 billion at end-January 2009).

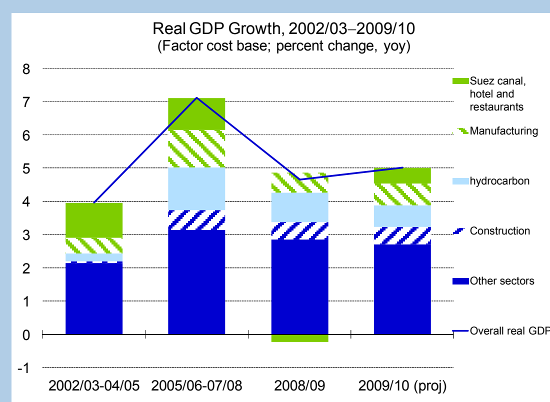
14. **The real economy held up relatively well in the face of weaker external demand.**

Crisis-related spillovers appear relatively smaller for Egypt than other countries with similar income levels, partly reflecting lower global economic integration and financial sector resilience (Box I). Similarly, the immediate financial impact of developments in Dubai last November was minor and temporary, and the direct real effects appear limited.

Although the current account moved into deficit (2.4 percent of GDP in FY2008/09) as service receipts and remittances declined, and investment and activity softened in exposed sectors, growth still reached 4.7 percent in FY2008/09, down from 7 percent in FY2007/08.







BOX I. SPILLOVERS OF THE GLOBAL CRISIS TO EGYPT

Declining export demand, remittances, and capital inflows are the principal channels through which crises in advanced economies affect emerging market economies like Egypt. Using a model capturing all three routes by the Generalized Method of Moments using quarterly data from 2002–09, staff estimated the spillovers of the recent global crisis to Egypt. "Spillovers" are defined as the negative contribution of external factors—increased financial stress in advanced economies and the slow-down in trading partner growth—to output growth after the Lehman shock. The external demand channel is proxied by economic activity in trade partners, and the Fund's financial stress index (FSI, presented in Chapter 4 in Spring 2009 WEO) can help somewhat capture the latter two channels.

While spillovers explain most of the declines in output growth in Egypt and other countries with similar income levels, the estimated spillovers have been relatively smaller for Egypt.[1] This appears to be due, in part, to:

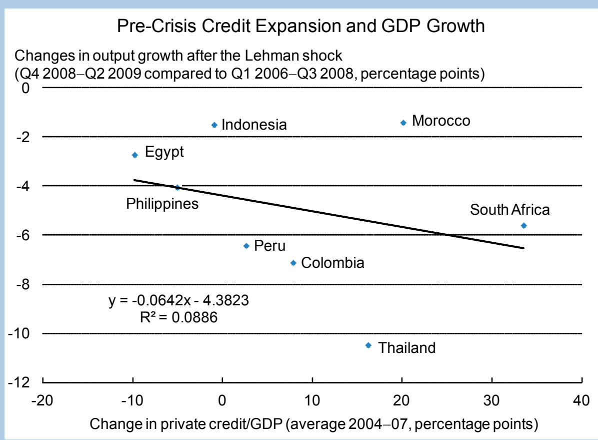
- **relatively low private credit growth** in Egypt prior to the crisis (partly reflecting banking sector asset restructuring during 2004–07), while cross-country experience suggests that too rapid credit growth has tended to magnify the impact of negative external shocks (chart, below left) and

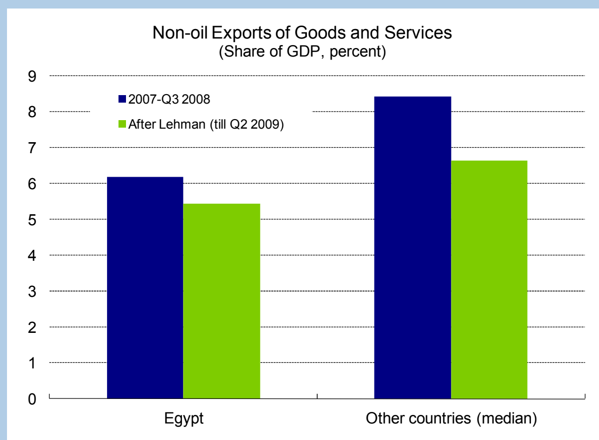
Estimated Spillovers of the Global Crisis 1/
(Change in output growth, percentage points)

	Decline in output growth after the Lehman shock	Spillovers		Other factors
		FSI in advanced economies 2/	Growth in trade partners 3/	
Egypt	-2.7	-2.5	-0.1	-0.1
Other countries	-5.2	-5.3	-0.5	0.6

1/ "Spillovers" are defined as negative contribution of external factors (increased financial stress in advanced economies, decline in economic activity in trade partners and any other global factors) to the declines in growth after the Lehman shock.
2/ Including spillovers of increased financial stress in advanced economies through a decline in output growth in trade partners, because of the strong correlation between financial stress in advanced economies and growth in the trade partners.
3/ Excluding a decline in output growth caused by increased financial stress in advanced economies.

- **Egypt's exports of goods and services were less sensitive to declining global economic activity**, including in such sectors as tourism, fertilizers, and clothing, despite no substantial difference in trade partners' output growth (chart, below right).





[1] Colombia, Indonesia, Morocco, Peru, Philippines, South Africa, and Thailand based on the following criteria: GNI per capita in 2007 between US$1,500 (Egypt) and US$6,000; and the financial stress index estimated by the IMF's Research Department (http://www.imf.org/external/pubs/cat/longres.cfm?sk=23039.0).

Resilient domestic consumption demand, and production in the construction, communications, and trade sectors, helped sustain growth and the pick-up to nearly 5 percent in the first half of FY2009/10. The buoyancy of household expenditures during the crisis may reflect a more limited impact on permanent income given confidence in Egypt's strong future growth prospects, and the relatively low level of private credit to businesses and households as a percentage of GDP.

15. **Fiscal policy helped cushion the impact of the crisis.**

The government reacted quickly by providing a sizable fiscal stimulus in the second half of FY2008/09, while temporarily postponing key fiscal reforms. The stimulus focused mainly on accelerating investment projects (about 1 percent of GDP) and public-private partnership (PPP) investments (1 percent of GDP).[2]

With mid-year expectations of comfortably overperforming the budget target by 0.7 percent of GDP, the government used this space to implement the stimulus while keeping the annual deficit in line with the 6.8 percent of GDP target.[3]

POLICY RESPONSES TO THE GLOBAL FINANCIAL CRISIS

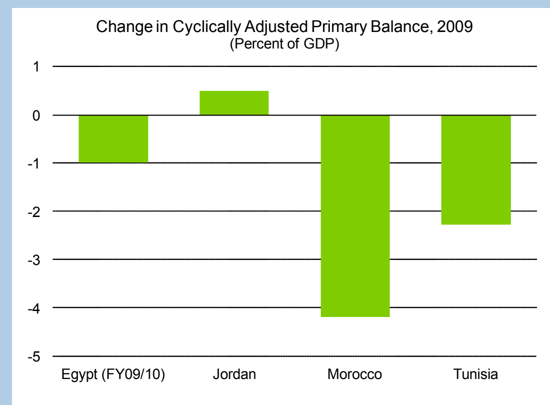
The Egyptian authorities responded swiftly to cushion the impact of the global financial crisis and emerging slowdown.

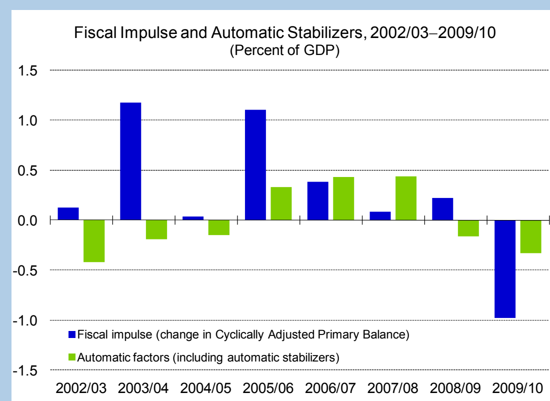
- *In FY2008/09, the government undertook additional (mainly infrastructure) expenditure of about 1 percent of GDP. In FY2009/10 fiscal policy remains supportive, with an expected widening of the budget deficit by 1½ percentage points of GDP.*
- *In October 2008, the CBE reiterated the 100 percent guarantee of local bank deposits to help maintain confidence, and imposed reporting requirements on overseas deposits and investment balances to help monitor unexpected movements in financial flows.*
- *The CBE cut overnight deposit and lending rates six times between February and September 2009, by a cumulative 325 bps and 375 bps, respectively.*
- *The authorities allowed some additional nominal exchange rate flexibility, with the pound depreciating by about 6 percent between September 2008 and March 2009, and subsequently appreciating (with resumed capital inflows) almost to its pre-crisis level.*

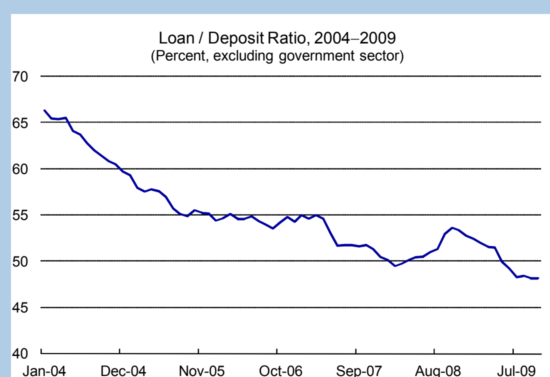
[2] The first PPP project for a power plant was awarded in July 2009. The government also launched a tender invitation for a Build, Operate, and Transfer contract for a wind farm for which 32 companies prequalified.

[3] The FY2008/09 budget outturn includes one-off transactions—both revenue and expenditure (each about 3½ percent of GDP)—with public entities, associated with the settlement of fuel subsidy and pension arrears, and the corresponding revenues.

The government also postponed key fiscal reforms—introducing the property tax, broadening the VAT, and phasing out energy subsidies—although these were not budgeted to have an impact in FY2008/09.







Sufficient banking sector liquidity and banks' appetite for T-bills after the crisis allowed the government to continue relying on shorter-term domestic securities to finance the deficit without major rollover difficulties, albeit with a temporary increase in the average yield during October-November last year.[4]

16. **The FY2009/10 budget continues to support economic activity,** reflecting a moderate deterioration in the cyclically adjusted primary balance relative to comparable countries in the region (see figure).

The budget targets a wider deficit of 8.4 percent of GDP largely reflecting a substantial projected cyclical fall in revenue (particularly from trade and Suez Canal traffic), as well as the impact of wage increases adopted before the crisis and higher post-crisis debt service costs.

The government is seeking parliamentary approval for additional infrastructure spending (0.8 percent of GDP) to be carried out by the autonomous urban development agency over 5 years. Investments by the urban development agency are commercial activities and do not affect the budget deficit.

[4] About three-quarters of T-bills issued through primary dealers are held by the banking system.

17. **Comprehensive pension and health reforms are underway.**

Pension reforms aim to strengthen the system's sustainability and efficiency by establishing a new defined-contribution system, plus substantial parametric reform of the existing defined-benefit system.

Health reform seeks to improve quality, and unify the fragmented financing and delivery of health services by adopting universal health insurance.

The focus on self-financing schemes, with limited and well-targeted government subsidies should help avoid jeopardizing fiscal consolidation. Pending cabinet discussions, the reforms could be submitted to parliament within the next two years.

18. Supportive monetary policy and a legacy of banking reforms also helped resist crisis-related pressures.

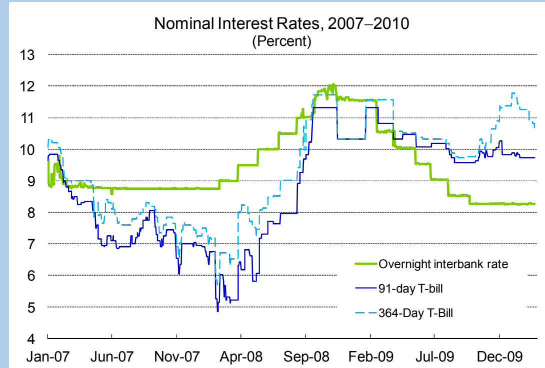
The CBE cut policy rates six times between February and September 2009. Consistent with lower commodity prices and weaker demand, both headline and core inflation[5] declined rapidly from peaks in August 2008 to single digits (9 percent and 5.8 percent, respectively) by August 2009.

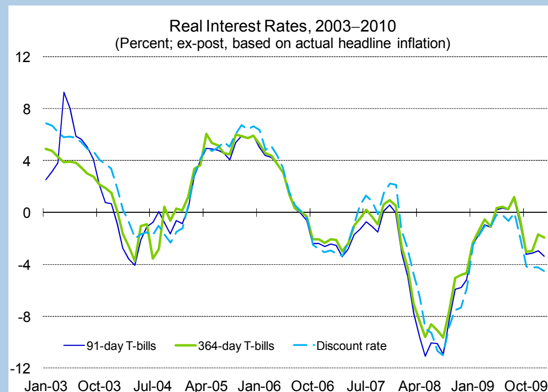
The deceleration of inflation stalled, with headline inflation rising above 13 percent since October 2009. However, this outturn is related to supply shocks in several food

CBE Monetary Policy Committee Decisions, 2009–10

	Overnight Deposit Rate		Overnight Lending Rate	
	Rate (%)	Change (bps)	Rate (%)	Change (bps)
12-Feb-09	10.5	-100	12.5	-100
26-Mar-09	10.0	-50	12.0	-50
14-May-09	9.5	-50	11.0	-100
18-Jun-09	9.0	-50	10.5	-50
30-Jul-09	8.5	-50	10.0	-50
17-Sep-09	8.25	-25	9.75	-25
5-Nov-09	8.25	-	9.75	-
24-Dec-09	8.25	-	9.75	-
4-Feb-10	8.25	-	9.75	-

Source: Central Bank of Egypt.



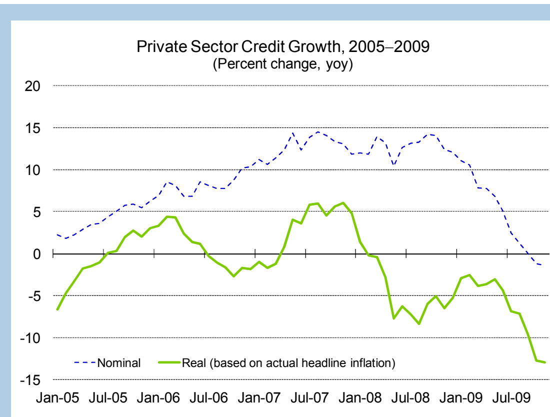


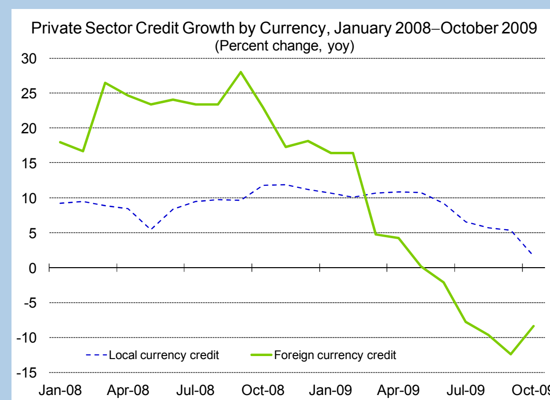
[5] The CBE launched its core inflation index in October 2009. See http://www.cbe.org.eg/Monetary-Policy/Monetary-Policy-E.htm.

categories, and core inflation remains in single digits and inside the CBE's comfort zone.[6] Accordingly, the CBE shifted to a more neutral stance, keeping rates unchanged in the past three Monetary Policy Committee meetings.[7]

Real ex-post policy rates remain negative—although close to zero—and bank lending and deposit rates remained largely unchanged despite cuts in policy rates. Nevertheless, the growth of private sector credit slowed substantially—falling to 5 percent in FY2008/09 compared to 12½ percent in FY2007/08—driven largely by weaker demand for credit, as exporters faced lower external demand and businesses deferred investment expenditures. Liquidity remains ample, with a loan to deposit ratio holding at around 50 percent and substantial excess reserves (despite having declined since mid–2008).

The CBE's Phase I reforms (2004–08)—strengthened supervision, restructuring and consolidation, and a cleanup of NPLs—reduced financial vulnerabilities. Also, limited reliance on short-term wholesale funding channels and relatively traditional portfolios, allowed Egyptian banks to sidestep many of the detrimental effects of the crisis. While the financial system remains stable, the CBE's Phase II reforms (2009–11) will implement the Basel II framework, along with other prudential measures designed to limit excessive risk build up within the financial sector.





Banking Sector Indicators

	2004	2008	Sept–09
Number of banks	57	39	39
Number of operative branches	1,795	2,345	3,462
Banking sector's net worth (LE billions)	35	70	…
Financial soundness indicators (percent; end of fiscal year 1/)			
Bank Regulatory Capital to Risk-Weighted Assets	11.4	14.7	15.3
Bank Nonperforming Loans to Total Loans	23.6	14.8	14.7
Bank Provisions to Nonperforming Loans	60.2	92.1	94.5

Source: Central Bank of Egypt

1/ Fiscal years ends June 30 for public sector banks, and December 31 for other banks.

[6] See the CBE's January 2010 *Inflation Note* (http://www.cbe.org.eg/Monetary-Policy/Inflation-Press-Release_EN.htm).

[7] November and December 2009, and February 2010.

II. Changing Policy Gears Post-Crisis

19. **The near-term macroeconomic outlook appears favorable.**

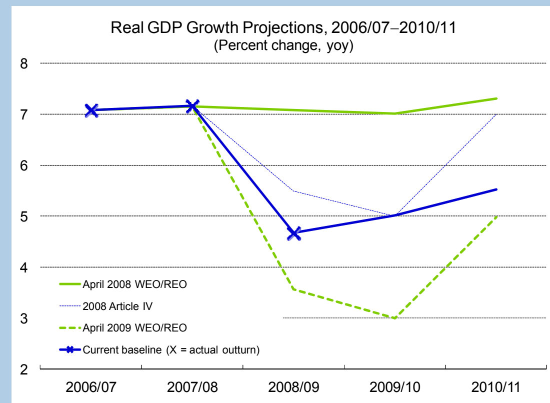
Growth is projected to pick up further to 5 percent and 5.5 percent for FY2009/10 and FY2010/11, respectively), reflecting the nascent recovery in global demand and investment in Egypt, and continued strength in household consumption.

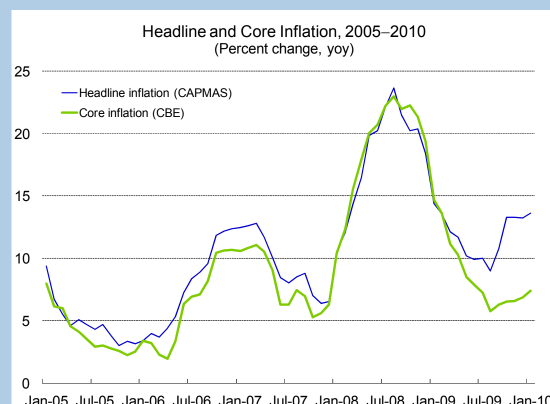
Following recent declines in monthly inflation, headline inflation should continue to ease over the remainder of FY2009/10, particularly in the absence of any pronounced demand pressures, or further supply shocks or regulated price adjustments. This should narrow the wedge with core inflation, which should remain within the CBE's comfort zone.

While the recovery in external demand should help stabilize exports including tourism, domestic demand driven imports will likely keep the current account in deficit (2.6 percent of GDP). The continued, albeit gradual, resumption of FDI and portfolio inflows should see official reserves increase slightly over the remainder of the fiscal year.

20. **As output growth picks up and approaches potential growth, the need for policy stimulus will wane.**

Egypt's potential growth is currently estimated at around 5–6 percent (about 1 percentage point lower than pre-crisis), reflecting the fallout from lower potential output in advanced economies post-crisis (Box II).





With growth continuing to surprise on the upside, higher-than-expected inflation, capital flows resuming, and the output growth approaching potential, the authorities will need to shift policy gears.

Rather than containing the negative spillovers of the crisis, the focus of policy should be addressing fiscal vulnerabilities and structural rigidities, thus positioning the economy to take advantage of the global recovery and its position of economic strength starting this year.

Box II. Potential Output Growth in Egypt

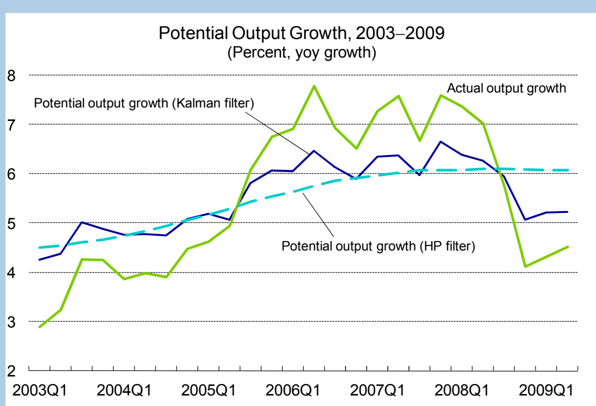
The global crisis affects Egypt's medium-term growth prospects through lower demand for Egypt's exports (goods and services) and tighter financing conditions for investment. The latter slows capital accumulation and technology transfers associated with lower FDI inflows, and results in lower labor productivity growth.

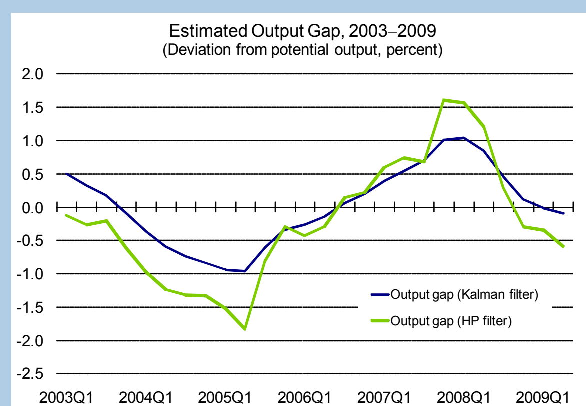
Estimated potential output derived from the univariate Kalman filter, assuming AR(2) process in the output gap and a drift in potential output (to incorporate changes in potential output caused by external factors),[1] indicates;

- **Potential output growth increased from below 5 percent before 2004 to over 6 percent in FY2005/06–07/08**, reflecting increased productivity due to the economic reforms since 2004, strong external demand, large private capital inflows, and a competitive real exchange rate after the large devaluation in 2003;

- **Potential output growth declined after the Lehman shock from over 6 percent to slightly above 5 percent**, in line with declines in potential output in advanced economies;

- **The output gap—defined as the deviation of actual output from its potential level—narrowed after its peak of about one percentage point in the middle of FY2007/08**, reflecting a decline in potential output growth after the Lehman shock; and



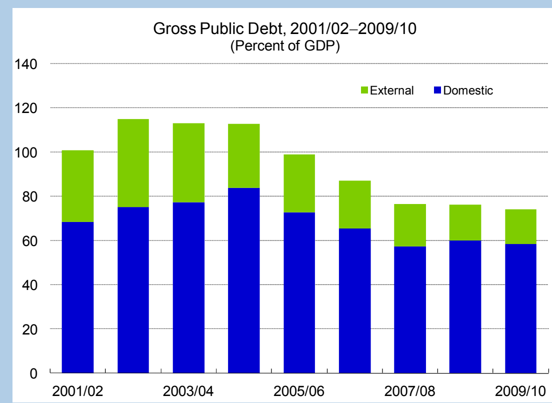


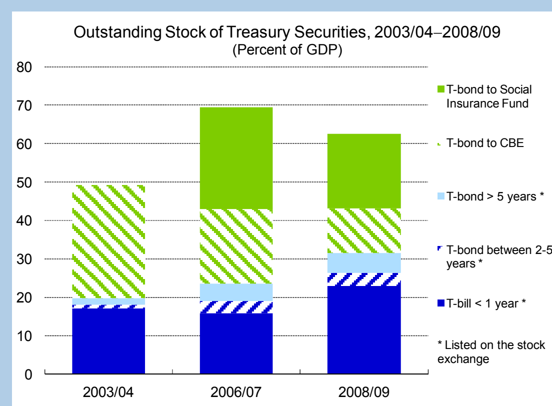
- **The decline in potential growth in the near term reduces the level of potential output in the near term, but not the medium term growth rate of potential.** The slowdown in potential output growth will reduce the output level by about 5 percentage points by 2014 (compared to potential output growth during FY2005/06–07/08), assuming that potential growth gradually returns to 6 percent by 2014.

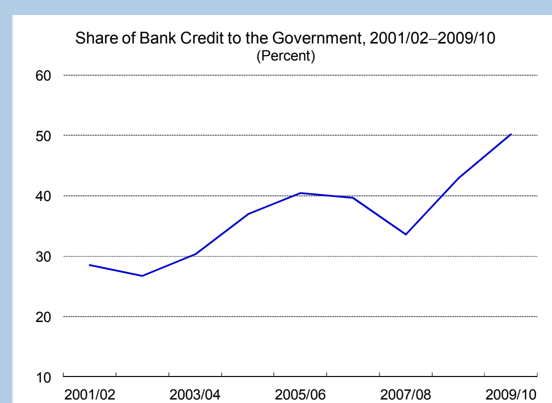
1/ Potential output (y_t^p) is specified as $y_t^p = y_{t-1}^p + \mu_t + \varepsilon_t^p$, where μ_t is a drift factor capturing exogenous factors (external financing conditions) for Egypt, and ε_t^p represents other shocks.

21. **Recent fiscal policy has been geared toward supporting growth.**

The FY2009/10 budget struck a reasonable balance. Premature withdrawal of the fiscal stimulus could undermine the recovery. But the risks posed by the high debt and fiscal financing requirement, and better-than-anticipated growth prospects, weaken the case for further stimulus.







At this stage, saving any revenue over-performance (projected near 0.3 percent of GDP)—together with renewing fiscal reform efforts—would help manage the appropriate pace of withdrawing the fiscal stimulus and ameliorate the fiscal risks. With higher spending on fuel subsidies financed with transfers from the state-owned petroleum company, and lower-than-budgeted spending on wages and interest payments largely offsetting an unanticipated fall in grants, it should be feasible to contain the deficit to 8.1 percent of GDP.

22. **Fiscal adjustment should resume with the FY2010/11 budget.**

The FY2010/11 budget should aim to begin delivering substantive fiscal adjustment—of about 1½–2 percentage points of GDP)—to help engender confidence in the authorities' commitment to medium-term adjustment and help provide the buffer for future shocks. The budget, currently being prepared by the authorities, is likely to target a smaller adjustment, with a deficit in the order of 7.9 percent of GDP, as planned reforms (including the real estate tax and VAT) have been postponed until after the presidential elections. Staff considers that, even without major policy measures, the deficit could be contained to 7.6 percent of GDP. It will also be important to resist pressures in the context of the forthcoming elections, both on expenditures or further delays of key fiscal reforms.

23. **Changes in debt management will also help reduce risks associated with the large rollover requirement.**

The substantial and rising short-term rollover requirement (above 20 percent of GDP) is a source of potential risk, should Egypt's financing conditions deteriorate. Increasing the average maturity of government debt issues is already under way. Also, with Egypt's relatively small external debt ratio, seeking external financing on favorable terms would help to lower financing costs and lengthen maturities, and reducing reliance on the banking system could free resources for the private sector.

THE AUTHORITIES' VIEWS:

The authorities assured on the importance of resuming fiscal consolidation in FY2010/11 provided sustained stability and improved growth prospects in the world economy. The Ministry of Finance is currently working on reducing the targeted deficit ratio for next year below the 8.4 percent deficit target for FY2009/10, while taking additional measures where possible during the year, including by rationalizing the consumption of subsidized butane. The authorities highlighted the fact that the debt-to-GDP ratio was successfully maintained in midst of the global crisis and despite the adoption of countercyclical fiscal policy measures for two consecutive fiscal years.

24. **Absent further declines in inflation, the CBE may need to consider raising policy rates to avoid inflationary pressures becoming more generalized**.

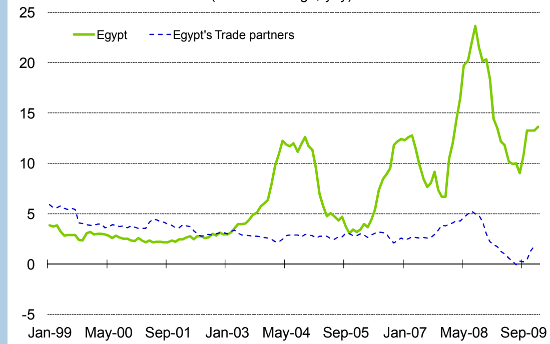
The recent interruption in cuts to policy rates was appropriate. As fruit and vegetable prices, and movements in regulated prices account for about two-thirds of recent headline inflation, staff considers that the CBE's new core inflation provides a better measure of underlying inflationary pressures. This suggests that events underlying recent headline inflation have not yet spilled over into more widespread inflationary pressures. In this regard, the CBE should continue to communicate to the public that recent increases in headline inflation are temporary. But given the uncertainty, and that output growth is approaching potential, further increases in policy interest rates may prove necessary if sustained high headline inflation begins to fuel inflationary expectations.

25. **Further reductions in inflation are needed over coming years to help align Egypt with its trading partners.**

The CBE's inflation reports and informal comfort zone are providing a guide for expectations, although the exchange rate will continue to play an important role in expectations formation for some time to come.

The higher level and variability of inflation since 2004 (chart) attests to the importance of moving to full inflation targeting as fiscal pressures abate. In this context, low and stable inflation should be the primary objective of policy in the coming years. This would also require allowing more exchange rate flexibility and full operational autonomy of the CBE.

Headline Inflation, 1999–2010
(Percent change, yoy)



EXCHANGE RATE ASSESSMENT

The real effective exchange rate appreciated by over 25 percent since the benchmark period for the last exchange rate assessment (end–2007) and now appears somewhat overvalued under each of the standard metrics.

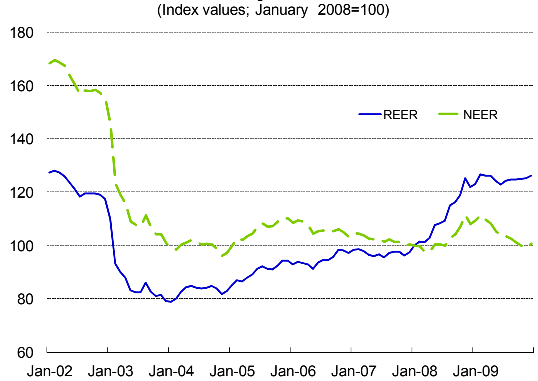
Given uncertainties surrounding these estimates—particularly with recent and prospective structural changes in the economy—and that the authorities expect inflation to abate further in the coming months, this does not yet pose a clear-cut threat to competitiveness.

Egypt: Assessment of the Real Effective Exchange Rate

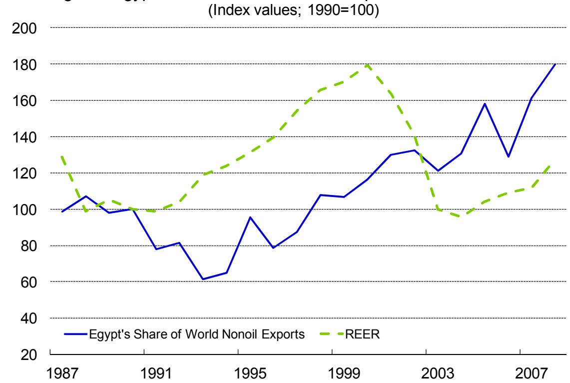
I. End-December 2009 REER difference against:		II. Macroeconomic balance	III. External sustainability 1/	IV. Equilibrium real exchange rate 2/
10-year average	15-year average	2013/14		
(Misalignment as percentage deviation from estimated equilibrium, overvaluation (+), undervaluation (-)).				
14.0	7.1	2.6	3.5	9.2

1/ Estimates the adjustment needed to stabilize Egypt's net foreign assets to GDP ratio at its end-FY2008/09 level, using CBE data sourced from IFS.
2/ Based on data for Egypt's financial year (July 1–June 30), including for the real effective exchange rate.

Effective Exchange Rates, 2002–2009
(Index values; January 2008=100)



Changes in Egypt's Share of World Nonoil Exports & REER, 1987–2008
(Index values; 1990=100)



Non-oil export performance has been impressive in recent years, gaining market share even as the real exchange rate has appreciated, suggesting that reforms have helped productivity growth. Moreover, survey-based competitiveness indicators suggest that, notwithstanding remaining weaknesses, impediments have been reduced in recent years (also see paragraph 30).

26. **Continued capital inflows would pose a challenge for monetary and exchange rate policy.**

Egypt's attractive T-Bill yields have encouraged a resumption of short-term capital inflows, albeit less than in 2007 and 2008 (see chart on page 7). While competitiveness is not yet a problem, further real appreciation driven by short term capital flows could weaken medium-term growth prospects.[8]

Sterilized intervention—the main recourse during the 2006–07 inflows—is an appropriate response to short-term inflows while they remain small and potentially temporary. Maintaining exchange rate flexibility will be an important element of the response, to limit the perception of one-way bets. If inflows are large and sustained, then other options may need to be considered, including assessing the adequacy of prudential measures to deal with associated risks. Fiscal consolidation, by reducing interest rates, will help reduce pressure for inflows over time.

THE AUTHORITIES' VIEWS:

The authorities are of the view that recent price pressures were driven largely by isolated events—including some related to supply side rigidities—and inflation should begin to trend down in the period ahead. They emphasized that, in the past 6–12 months, these price shocks had not spilled over into underlying inflation pressures. Nevertheless, the CBE stands ready to tighten monetary conditions should generalized inflation pressures emerge.

The authorities expressed their commitment to a flexible exchange rate arrangement, pointing to the additional flexibility observed in the wake of the crisis and especially in the past six months. At the same time, they underscored the importance of protecting the economy from excessive volatility, including if driven by hot money inflows, and agreed with the merits of sterilized intervention as a temporary response.

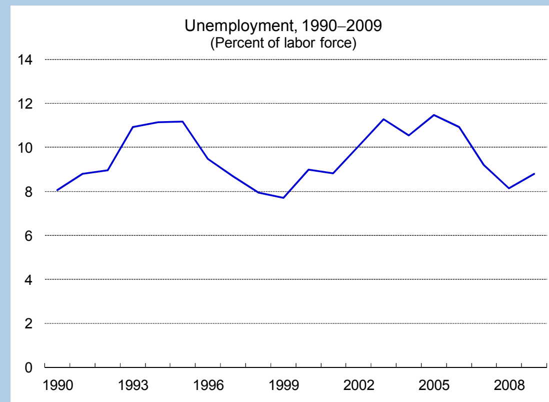
[8] The surge in capital inflows, from which Egypt benefited during 2004–07, occurred at a time when the REER was significantly undervalued following the pound's large devaluation in 2003. However, on the tail of the strong appreciation in 2008 and to a lesser extent in 2009, the current level of the REER may not be as conducive to Egypt benefiting from future capital inflows.

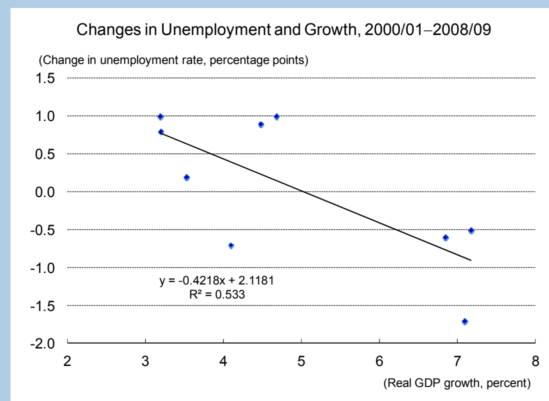
III. Improving Medium-Term Growth Prospects

27. **Continued broad-based reforms are needed to generate inclusive, employment-generating growth.**

A return to sustainable rapid growth of 6–7 percent—supported by raising total factor productivity—is needed to address Egypt's persistent high unemployment rate and continue to make in-roads into reducing poverty.[9]

A revitalized reform agenda should be framed around two broad pillars: addressing fiscal vulnerability and ensuring macroeconomic stability to help maintain confidence and prevent imbalances; and broad-based structural reforms to strengthen the economy's dynamism. Attracting more FDI and the associated technology transfers, will boost productivity and potential output growth, allowing Egypt to realize higher growth rates accommodating real appreciation pressures that could undermine competitiveness and be counter-productive.





[9] World Bank estimates suggest that strong growth during 2005–08 contributed to a 14 percent decline in the proportion of the population living below the (upper) poverty line in Egypt.

A. Managing a Large Fiscal Adjustment

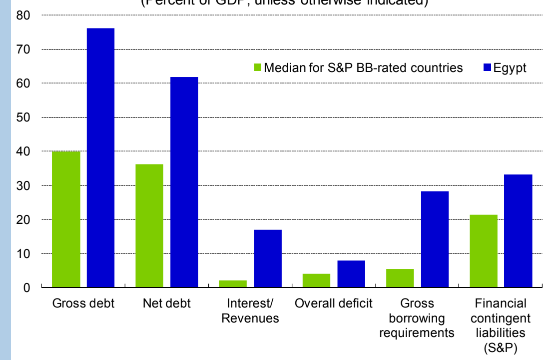
28. **Resuming medium-term fiscal consolidation is crucial to addressing fiscal vulnerabilities and encouraging private investment.**

Fiscal vulnerabilities are Egypt's main macroeconomic risk. Gross public debt remains high by emerging market standards and fiscal financing requirements have averaged around 25 percent of GDP in recent years. If the current stimulus is not unwound, sustained high fiscal deficits could add to inflation, curtail the scope for future countercyclical fiscal policy, increase rollover risks, and put upward pressure on financing costs and the real exchange rate. Also, continued heavy reliance on domestic bank financing could impede financial sector development, raise the cost of financial intermediation, and limit private sector access to financing.

While staff would have preferred a more front-loaded adjustment, the planned 5 percentage point of GDP reduction in the budget sector deficit by FY2014/15 (three years later than envisaged pre-crisis), should reduce gross public debt substantially to about 60 percent of GDP (Appendix I).

Increased tax revenues (3 percentage points of GDP) will be central to the adjustment, supported by adopting a full-fledged VAT, modernizing the property tax, and broadening the income tax base. In this regard, peak of adjustment should come in FY2012/13, with the full year effect of the VAT, following its introduction in late FY2011/12.

Debt Burden Indicators, 2009
(Percent of GDP, unless otherwise indicated)

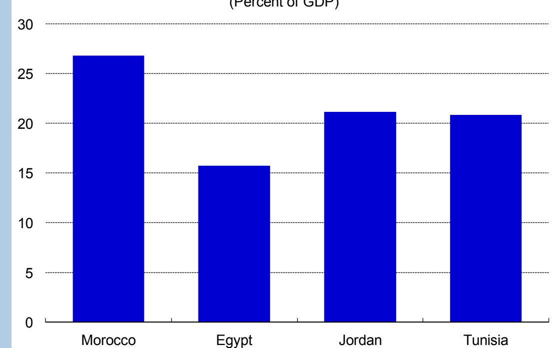


Summary of Budget Sector Fiscal Operations, 2008/09–2014/15

	2008/09 Est.	2009/10 Proj.	2010/11 Proj.	2011/12 Proj.	2012/13 Proj.	2013/14 Proj.	2014/15 Proj.
	(In percent of GDP)						
Revenue	**27.2**	**21.0**	**20.8**	**20.6**	**20.7**	**20.4**	**20.3**
Tax revenue	15.7	13.8	14.9	14.7	14.8	14.6	14.5
Nontax revenue	10.7	7.0	5.7	5.7	5.7	5.6	5.6
Grants	0.8	0.2	0.2	0.2	0.2	0.2	0.2
Expenditure	**33.8**	**29.0**	**28.8**	**28.5**	**28.0**	**27.3**	**26.9**
o/w: Interest	5.1	5.8	5.9	5.7	5.6	5.4	5.4
Subsidies/social benefits	12.2	8.2	8.3	8.3	8.3	8.2	8.1
Investment expenditure	4.2	3.0	2.7	3.0	3.0	3.0	3.0
Measures	…	…	**0.0**	**1.4**	**2.6**	**3.0**	**3.3**
o/w: identified on revenue	…	…	0.0	0.4	1.9	2.2	2.6
Net acquisition of financial assets	0.3	0.1	-0.4	0.1	0.1	0.1	0.1
Overall fiscal balance	**-6.9**	**-8.1**	**-7.6**	**-6.6**	**-4.9**	**-4.1**	**-3.3**
Financing	-6.9	-8.1	-7.6	-6.6	-4.9	-4.1	-3.3
O/w net domestic financing	7.9	8.3	7.6	6.8	5.2	4.2	3.4
Memorandum items:							
Primary balance	-1.8	-2.3	-1.7	-0.9	0.7	1.3	2.1
Gross public debt	76.2	74.1	72.0	70.5	67.7	64.7	61.0

Source: Ministry of Finance and Fund staff estimates.

Average Tax Revenue Ratio, 2008–09
(Percent of GDP)



Ongoing energy subsidy reform (Box III) would help reduce spending inefficiencies and provide more room for spending on priority social and infrastructure needs. The government is also reforming the pension and health systems[10] with a view to strengthening their long-term sustainability and efficiency.

29. **While challenging, the medium-term fiscal strategy seems feasible** especially based on international experience with successful fiscal adjustments (Box IV).

Feasibility hinges on the prompt resumption of key reforms, and containing the fiscal costs of pension and health reforms as final design choices are made. Given the relatively sizeable adjustment, the intended gradual approach set in a broader reform agenda should lend credibility to the feasibility and durability of the change in the direction of fiscal policy. In this regard, reliance on tax revenue-enhancing measures should help build confidence.

Despite past efforts to rationalize fuel subsidies, domestic fuel prices remain well below international prices[11] and prices in selected neighboring countries (Box III). Subsidy reforms should be a priority and, if done in conjunction with adopting an automatic price adjustment mechanism or price liberalization (Jordan and Lebanon, respectively), their credibility would be enhanced.

Reforming the fiscal framework could reinforce confidence, foster wider buy-in, and facilitate monitoring of the consolidation process. These could include: broadening the focus of fiscal policy to incorporate economic authorities conducting non-commercial operations currently outside the budget coverage; implementing a full-fledged medium-term budget framework; and tightening expenditure controls.

THE AUTHORITIES' VIEWS:

Despite improvements in receipts of several tax types as achieved by recent tax reforms, the authorities acknowledge that constraints are still posed by low tax revenue-to GDP ratio for several other tax types. In order to meet their objective of reducing the overall budget deficit to about 3 percent of GDP, the authorities point to the need for a balanced adjustment, composed of further revenue and spending measures. They look forward to broadening the tax base, with the full impact of adopting a full-fledged VAT expected in FY2012/13, following its planned submission and approval in late 2011. They also hope to resume the reform of fuel subsidies in 2011, after crisis impacts will have fully subsided.

The authorities stressed their commitment to careful due diligence in the decision making and monitoring process for PPPs, with particular regard to containing potential fiscal risks.

[10] The authorities have received extensive technical assistance (including from the Fund, World Bank and USAID) on the tax, pension and health reforms, and the PPP program.

[11] During 2009, domestic fuel prices were 30 to 75 percent below international prices, with LPG the most subsidized (75 percent below international prices) and fuel oil and gasoline the least subsidized (around 30 percent below international prices).

Box III. Energy Subsidies in Egypt

A large share of government spending consists of inefficient and costly energy subsidies.[1] Notwithstanding the recent (and temporary fall) in international oil prices, more than a quarter of primary spending and about two-thirds of government subsidies are attributable to a few petroleum products (gasoline, diesel, LPG, kerosene, and fuel oil). In addition to crowding out priority spending on social and infrastructure needs, subsidies are highly regressive. Studies by the World Bank and the USAID provide evidence of the disproportionate benefits to higher income households (almost twice as much for low income households).

Energy Subsidies in Egypt, 2005/06–2008/09

	2005/06	2006/07	2007/08	2008/09 1/ est.
Total subsidies at international prices (percent of GDP)	6.5	5.5	7.1	3.9
Gasoline	0.7	0.6	0.8	0.4
Kerosene	0.1	0.0	0.0	0.0
Diesel	3.2	2.6	3.6	1.9
Fuel oil	1.6	1.1	1.6	0.7
LPG	0.7	0.6	0.8	0.4
Natural Gas	0.3	0.6	0.4	0.4
Budget spending, as a share of:				
Total subsidies	77.0	74.4	71.6	67.7
Primary spending	24.4	23.0	26.0	21.6

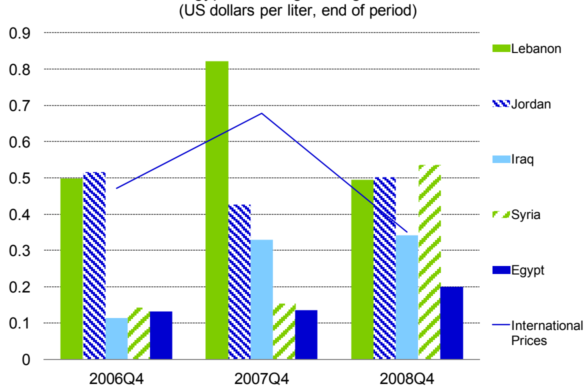
Sources: Ministry of Petroleum, Ministry of Finance, EGPC, EGAS, CBE, and Fund staff estimates.

1/ The budget spending for 2008/09 also reflects the repayment of debt due to the deficits of EGPC from the previous years. Therefore despite the fact that the cost of subsidies is lower, the budget spending remains high.

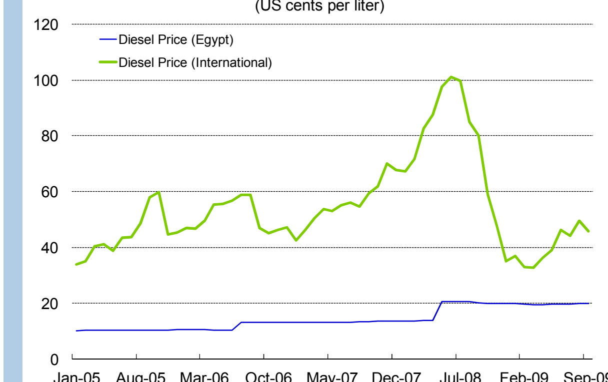
Restructuring energy subsidies has been a key objective of the government's post–2004 reforms. In addition to several ad-hoc domestic fuel prices adjustments since 2004, the government launched in late 2007 a plan to bring energy prices close to actual costs by 2010. The plan entailed an immediate increase in the energy prices for energy-intensive industries and a one-year grace period for non-energy intensive industries. However, during late 2008 and in the context of the crisis, the government extended this grace period until early 2010 and announced that the elimination of fuel subsidies would be postponed to 2014. At the same time, the government announced a coupon scheme to improve the targeting of the LPG subsidy.

Notwithstanding the restructuring efforts, products consumed by higher income families—such as diesel and regular gasoline—remain highly subsidized. Successive ad-hoc increases in domestic prices have fallen short of passing through international price increases and some prices remain well below international prices and prices in selected neighboring countries.

Diesel Prices in Egypt and Neighboring Countries, 2006–2008
(US dollars per liter, end of period)



Egyptian and International Diesel Prices, 2005–2009
(US cents per liter)



1/ Since FY2005/06, the government started to report notional expenditures on fuel subsidies which are financed directly by the Egyptian General Petroleum Company out of its required transfers to the budget for income taxes, royalties and dividends.

Box IV. Successful Fiscal Adjustments Around The World: Lessons for Egypt

A rich literature identifies factors underlying successful fiscal adjustments.[1] Several studies have examined many episodes of fiscal consolidation undertaken by industrial, emerging market, and developing countries over the past four decades, using statistical and econometric analyses as well as case studies. "Fiscal adjustments" are usually defined as successive improvements of the cyclically adjusted primary balance or the primary balance over 3 years and "successful adjustments" as episodes associated with sustained improvements in the (cyclically adjusted) primary balance or durable declines in public debt.

Six key lessons for Egypt emerge from the empirical evidence about successful fiscal adjustments:

Lesson 1: Engaging in an ambitious medium term fiscal adjustment, which is less likely to be reversed, may signal a government's commitment to address fiscal problems and change the direction of fiscal policy. Successful fiscal adjustments in Brazil, Ireland, Lebanon, Lithuania, Russia, and South Africa in the late 1990s/early 2000s targeted fiscal deficit reductions between 6–11 percent of GDP (Tsibouris et. al., 2006; Purfield, 2003).

Lesson 2: Adopting a gradual consolidation strategy, rather than sharp and short adjustments, allows the introduction of higher quality and more durable measures with lower political resistance and highlights the existence of lags between adoption and full impact of adjustment measures. Successful adjustments in Finland, Sweden, and Spain during the late 1990s were carried out over periods of up to a decade (Kumar et. al., 2007).

Lesson 3: Expanding the tax base to boost revenue through policy measures and improved tax compliance helps enable long-lasting consolidations and address a key fiscal vulnerability of narrow tax bases (prevalent in low income countries). Increases in VAT and excises accounted for a large share of Ireland's fiscal consolidation in the early 2000s (Kumar et. al., 2007).

Lesson 4: Relying on core current expenditure cuts—such as reducing the public sector wage bill and inefficient transfers—raise credibility of a government's ability to tackle key spending pressures and address fiscal imbalances in a sustainable manner. Brazil's successful adjustment in late 1990s entailed reducing generous pension benefits and strengthening social safety nets (Tsibouris et. al., 2006).

Lesson 5: Strengthening fiscal institutions—i.e., medium-term fiscal frameworks and effective expenditure control—can provide a road map for consolidation and support implementation. Medium-term fiscal policy frameworks were instrumental in Brazil, Lithuania, and New Zealand, and strengthened expenditure management supported adjustment in Lebanon, Russia, and South Africa (Tsibouris et. al., 2006).

Lesson 6: Fiscal consolidation, accompanied by a broader package of structural reforms will boost credibility and sustainability given the need for political consensus and the more permanent changes in revenue and spending triggered by reforms. Structural reforms both on revenue and spending side played a key role in the consolidation strategies of several EU member states ahead of the inception of the economic and monetary union (Larch et. al., 2008).

[1/] Studies include: Alesina, A., et. al., 1997, "*Fiscal Adjustments in OECD Countries: Composition and Macroeconomic Effects,*" IMF *Staff Papers*; Kumar, M., et. al., 2007, "*Fiscal Adjustments: Determinants and Macroeconomic Consequences*," IMF WP/07/178; Tsibouris, G., et. al., 2006, "*Experience with Large Fiscal Adjustments*," IMF, OP 246; OECD, 2007, "*Fiscal Consolidation: Lessons from Past Experience*," Economic Outlook, No.81; Larch, M., et. al., 2008, "*Received wisdom and beyond: Lessons from fiscal consolidation in the EU*," EC; Gupta, S., et. al, 2004, "*The persistence of fiscal adjustment in developing countries,*" Applied Economic Letters 11; Purfield, C., 2003, "*Fiscal adjustment in transition countries: evidence from the 1990s,*" IMF WP. 03/36; Gupta, S., et. al., 2004, "*What sustains fiscal consolidation in Emerging Markets*?," IMF WP 03/224.

B. A More Competitive Economy

30. **Further improving the investment and business environment will be crucial to achieving a competitive edge in the post-crisis global economic environment.**

The post-2004 reform agenda has begun to pay dividends. The World Bank's 2010 *Doing Business* report identifies Egypt as among the top reformers, emphasizing improvements in starting a business and regulation, and access to credit. Also, Egypt moved up 11 places in the World Economic Forum's *2009–10 Global Competitiveness Report* (GCR), reflecting mainly "recent liberalization efforts" including improvements in infrastructure.

However, its relative position still remains at 70 (of 133 countries). The GCR identified macroeconomic stability and banking system solidity as key structural impediments. Transparency International cites accountability and transparency, and weaknesses in the legal/regulatory system as key reasons for Egypt remaining 111th of 180 countries on its Corruption Perception Index.

Decisive action to continue the earlier reform momentum should focus on addressing the remaining structural weaknesses. In addition to sound macroeconomic policies, efforts should focus on:

- Resuming privatization and increasing the role of carefully structured and appropriately priced PPPs should assist fiscal adjustment and mobilize private resources for infrastructure investment. Shifting out of business

RISKS

The planned medium term fiscal consolidation tackles the central fiscal vulnerabilities. While the large domestic debt rollover requirement (about 20 percent of GDP) remains a potential risk, the banking system remains liquid. However, slower implementation of key fiscal reforms and adjustment path would delay the reductions in debt and rollover requirements, and could hinder the response of private sector-led growth.

While PPPs can help mobilize private sector financing and know-how for infrastructure investment, these projects will need to be carefully managed and structured to contain risks, including limiting potential contingent liabilities, within a sound institutional framework as the one provided in the PPP law that is now before Parliament.

Direct banking sector risks are well contained following the banking reform. NPLs stood at 14.7 percent of total loans in September 2009, virtually unchanged from before the crisis. However, several potential risks—including market concentration and the prospective use of more sophisticated products—will require careful watching to ensure sound financial sector development, including the ability to increase and effectively allocate private sector credit, and diversify risks.

activities better suited to the private sector should also help give greater credibility to the government's efforts to instead focus on establishing a sound legal and regulatory framework.

- Reforms supported by the Bank, including further improving the financial sector and infrastructure, and raising human capital.

31. **Continued financial sector reforms are needed to help contain risks, build investor confidence, and support private sector-led growth**.

Increasing financial competition, lowering risk, and providing regulatory certainty will make Egypt a more attractive destination for investment, deepen markets, and facilitate the access to capital needed to support future growth.

Improving intermediation and competition within the sector—not well developed compared to other emerging markets (private sector credit has averaged around 40 percent of GDP in the past 5 years)—is needed to effectively and productively channel resources to the private sector. Over time, this will serve as an important source of financing for private investment to complement the current heavy reliance on FDI and self-financing.

To this end, the CBE's Phase I reforms made considerable progress in increasing the efficiency of, and reducing risks in, the banking sector. By continuing with a forward-looking approach to risk assessment and other measures to limit risk as the sector evolves (Box V), Phase II reforms should further enhance financial sector soundness and efficiency, and its role in supporting growth.

THE AUTHORITIES' VIEWS:

The authorities highlighted their successful track record in implementing financial sector reforms and their continued commitment to Phase II reforms, emphasizing the role of banking system stability and access to financing in promoting growth. They identified the comprehensive implementation of Basel II standards, along with some additional prudential measures focused on risk mitigation and capacity building, as key pillars. They also expressed their intention to publish in the coming year higher frequency aggregate financial soundness indicators and, over time, encourage banks to make available detailed performance and soundness indicators.

32. **Further improvements are needed in the timeliness, coverage and availability of economic and financial statistics** to complement other improvements in Egypt's macroeconomic policy framework, and provide greater policy accountability and regulatory certainty. This is particularly important given general concerns about data gaps highlighted by the global financial crisis. Despite advancements in Egypt's data availability (e.g., core inflation, publication of the CBE's reserve template on the Fund's website), weaknesses linger in numerous areas (such as internal and time consistency of GDP data, quality and consistency of CPI and GDP deflators, lack of coverage of off-budget fiscal entities, lack of survey data for direct investment), and limited high frequency data across all sectors (e.g., retail sales and real estate prices).

BOX V. FINANCIAL SECTOR REFORM PRIORITIES FOR EGYPT

Phase I of the CBE's Financial Sector Reform Program (2004–08) has produced tangible results, with most recommendations of the 2002 FSAP being implemented. The financial sector has benefited, largely escaping the global financial crisis, and with increased investment by both local and foreign market participants, particularly as new segments (mainly securities) become active.

- **Comprehensive and coherent bank restructuring measures increased the efficiency of the banking sector, and reduced vulnerabilities and balance sheet burdens.** Most notably:
  - Enforcement of minimum capital requirements and other standards have reduced banks operating in Egypt by 31 percent through forced and voluntary mergers.
  - The soundness of remaining state owned banks has been assessed in line with international accounting standards. Functional and trained risk, information technology, and human resources departments have been established at banks to mitigate future risk and deterioration, and mandatory risk and performance reporting to the CBE is in full effect.
  - Significant resolution of non-performing loans has taken place and public sector entity debt resolution is under way.
- **The regulatory and supervisory framework has been transparently updated, with the stated aim of promoting competitiveness, and reducing risks.** For example:
  - Rules and regulations governing the financial sector are published regularly and clearly, including efforts to align accounting, disclosure, reporting and measurement standards with international codes.
  - The capacity of regulators and supervisors to address risks and transmission mechanisms is being enhanced. For example, consolidation of regulatory and supervisory authority over non-bank entities, as well as the training for regulators and supervisors to qualitative and quantitative techniques.

Building on these actions, **Phase II reforms (2009–11) will further modernize prudential oversight, spur competition, and support growth through increasing access to financing** (a key goal of Phase II). In addition to tackling the outstanding elements of Phase I and remaining 2007 FSAP update recommendations, the reform agenda should focus on a forward-looking approach to assessing the evolution and scope of potential risks. In this regard, implementation of a comprehensive Basel II framework is underway, along with prudential measures designed to limit excessive risk build up within the financial sector. Staff considers that other priorities should include:

- reducing banking sector concentration through further privatization or significant balance sheet reduction of state owned banks, with the goal of enhanced competition;
- increasing the detail, quality and frequency of publication of aggregate performance and soundness indicators, and encouraging additional transparency banks' reporting of key indicators (e.g., level and composition of Tier 1 capital/risk weighted assets, non-performing assets ratios);
- increased and systematic coordination, and consistent risk methodologies, between the CBE (bank supervision) and the new (nonbank) Egyptian Financial Supervisory Authority; and
- removing the remaining structural impediments to enhanced financial intermediation, while developing safeguards to limit potential new risks (e.g., divergent risk assessments amongst banks, emerging derivative-like structured products (particularly related to PPP financing)).

Table 1. Egypt: Selected Macroeconomic Indicators, 2005/06–2010/11 1/

(Quota: SDR 943.7 million)
(Population: 75.2 million; 2007/08)
(Per capita GDP: US$2,162; 2007/08)
(Poverty rate: 18.4 percent, 2005)
(Main products and exports: hydrocarbon products, cotton/textiles, iron and steel products, tourism; 2007/08)

	2005/06	2006/07	2007/08	2008/09	2009/10 Proj.	2010/11 Proj.
Output and Prices	(Annual percentage change)					
Real GDP (market price)	6.8	7.1	7.2	4.7	5.0	5.5
Consumer prices (end of period)	7.2	8.6	20.2	10.0	10.0	9.0
Consumer prices (average)	4.2	11.0	11.7	16.2	12.0	9.5
Investment and Saving	(In percent of GDP)					
Gross capital formation	18.7	20.9	22.4	19.3	19.4	19.5
Gross national saving	20.4	22.8	22.9	16.9	16.9	17.3
Public Finances (budget sector, unless otherwise indicated)	(In percent of GDP)					
Revenue (including grants) 2/	24.5	24.2	24.7	27.2	21.0	20.8
Expenditure 3/ 4/	32.6	31.5	31.5	34.1	29.1	28.4
Budget balance	-8.2	-7.3	-6.8	-6.9	-8.1	-7.6
Primary balance	-2.2	-0.9	-1.2	-1.8	-2.3	-1.7
Total public debt (general government, net)	79.8	71.4	61.9	61.8	61.7	61.2
Monetary Sector	(Annual percentage change, unless otherwise indicated)					
Credit to private sector	8.5	12.3	12.6	5.1	3.8	9.1
Reserve money	21.8	7.0	4.7	3.4	16.1	18.1
Broad money (M2)	13.4	18.3	15.5	8.4	18.8	17.9
Velocity of broad money (level)	1.1	1.1	1.2	1.2	1.2	1.2
Treasury bills (91-day rate, period average, in percent)	8.8	8.7	7.0	11.3	...	...
External sector	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in U.S. dollar, percentage change)	33.4	19.3	33.3	-14.3	0.3	14.9
Imports of goods (in U.S. dollar, percentage change)	25.8	25.3	38.4	-4.6	3.7	13.9
Merchandise trade balance	-11.2	-12.4	-14.4	-13.4	-12.5	-12.3
Current account including official transfers	1.6	1.9	0.5	-2.4	-2.6	-2.2
Current account excluding official transfers	1.1	1.3	0.0	-2.7	-2.9	-2.5
Foreign direct investment (net)	5.6	8.1	7.5	3.6	3.7	3.7
Total external debt (in US$ billions)	29.6	29.9	33.9	31.5	36.4	39.8
Gross official reserves (in US$ billions)	22.8	28.5	34.5	31.2	35.1	37.9
In months of next year imports of goods and services	5.8	5.3	6.7	5.8	5.8	5.5
In percent of short-term external debt	526	843	712	661	936	949
Memorandum items:						
Nominal GDP (in U.S. dollar billions)	107.4	130.3	162.4	188.0	215.8	248.1
Unemployment rate (percent)	10.9	9.2	8.1	8.8	…	…
Net hydrocarbon exports (in US$ billions)	4.9	6.0	4.9	4.0	4.0	4.7
Egyptian pounds per U.S. dollar (period average)	5.75	5.71	5.51	5.53	...	...
Real effective exchange rate (pd. average, percentage change)	8.2	4.4	3.5	20.9	...	...
Stock market index (EGX 30, end of period)	103.8	169.8	213.8	124.1	...	...

Sources: Egyptian authorities; World Bank (poverty rate); and Fund staff estimates and projections.

1/ Fiscal year ends June 30.
2/ Staff estimates based on revised data and new budget classification adopted in 2006.
3/ Series break in 2005/06, when fuel subsidies were explicitly recorded, and matched by an equivalent notional revenue (from the oil company (EGPC) and its foreign partners) line item.
4/ Includes acquisition of financial assets.

Table 2. Egypt: Summary of Budget Sector Fiscal Operations, 2005/06–2010/11 1/

	2005/06	2006/07	2007/08	2008/09	2009/10		2010/11
				Est.	Budget	Proj.	Proj.
	(In percent of GDP)						
Revenue	24.5	24.2	24.7	27.2	19.1	21.0	20.8
Tax revenue	15.8	15.3	15.3	15.7	12.3	13.8	14.9
Income and corporate tax	8.0	8.1	7.7	8.0	5.7	7.0	7.9
Personal income tax	1.5	1.3	1.3	1.4	1.2	1.4	1.4
Corporate income tax	6.3	6.6	6.2	6.3	3.7	5.0	5.6
EGPC	3.8	3.4	3.3	3.3	1.6	2.5	2.5
Other	2.5	3.1	2.9	3.0	2.2	2.5	3.1
Property		0.2	0.2	0.4	0.7	0.7	0.9
Goods and services	5.6	5.3	5.6	6.0	5.2	5.3	5.6
International trade	1.6	1.4	1.6	1.4	1.2	1.2	1.2
Other	0.6	0.6	0.5	0.3	0.3	0.3	0.2
Nontax revenue	8.3	8.3	9.2	10.7	6.1	7.0	5.7
Grants	0.4	0.5	0.2	0.8	0.7	0.2	0.2
Expenditure	33.6	29.8	31.5	33.8	27.4	29.0	28.8
Wages and other remunerations	7.6	7.0	7.0	7.3	7.4	7.1	7.1
Purchases of goods and services	2.3	2.3	2.1	2.4	2.3	2.4	2.4
Interest	6.0	6.4	5.6	5.1	6.0	5.8	5.9
Subsidies, grants and social benefits, *o/w* : 2/	11.2	7.8	10.3	12.2	6.2	8.2	8.3
fuel subsidy	6.8	5.4	6.7	6.0	2.9	5.1	5.1
food subsidy	1.5	1.3	1.8	2.0	1.2	1.1	1.0
transfers to SIF	1.8	0.0	0.3	2.6	0.4	0.4	0.6
Other current expenditure	3.2	2.8	2.7	2.6	2.4	2.5	2.4
Investment expenditure	3.4	3.4	3.8	4.2	3.1	3.0	2.7
Cash balance	-9.2	-5.6	-6.8	-6.6	-8.4	-8.0	-8.0
Net acquisition of financial assets	-1.0	1.7	0.0	0.3	0.1	0.1	-0.4
Overall fiscal balance	-8.2	-7.3	-6.8	-6.9	-8.4	-8.1	-7.6
Discrepancy above and below the line	1.3	0.1	0.0	0.0	0.0	0.0	0.0
Financing	9.5	7.5	6.8	6.9	8.4	8.1	7.6
Net domestic financing	8.8	4.5	4.6	7.9	9.3	8.3	7.6
Net external financing	0.6	0.5	1.3	-1.0	-0.9	-0.2	0.0
Memorandum items:							
Overall balance net of one-off items	-10.4	-9.1	-8.1	-9.2	0.0	-8.1	-7.6
Primary balance	-2.2	-0.9	-1.2	-1.8	-2.4	-2.3	-1.7
Nominal GDP (in billion LE)	617.7	744.8	895.5	1,038.6	1,181.0	1,197.6	1,377.1

Sources: Ministry of Finance; and Fund staff estimates.

1/ Staff projections. Budget sector comprises central government, local governments, and some public corporations. The fiscal year begins on July 1st. The data are presented on a cash basis consistent with the GFS 2001 classification.

2/ Beginning in 2005/06, the cost of domestic fuel subsidies and the notional revenues from EGPC are recorded on-budget.

Table 3. Egypt: General Government Fiscal Operations, 2005/06–2010/11 1/

	2005/06	2006/07	2007/08	2008/09	2009/9		2010/11
				Est.	Budget	Proj.	Proj.
				(In percent of GDP)			
Revenue	28.6	27.7	27.8	27.8	19.1	24.2	23.9
Tax revenue	15.8	15.3	15.3	15.7	12.3	13.8	14.9
Income and property	8.0	8.1	7.7	8.0	5.7	7.0	7.9
Goods and services	5.6	5.3	5.6	6.0	5.6	5.3	5.6
International trade taxes	1.6	1.4	1.6	1.4	1.6	1.2	1.2
Other taxes	0.6	0.6	0.5	0.3	0.5	0.3	0.2
Nontax revenue	12.4	11.8	12.3	11.3	9.2	10.2	8.8
Grants	0.4	0.5	0.2	0.8	0.2	0.2	0.2
Expenditure	36.3	32.9	34.1	34.4	27.4	31.9	31.6
Compensation to employees	7.7	7.1	7.1	7.4	7.4	7.2	7.2
Purchases of goods and services	2.3	2.3	2.1	2.4	2.3	2.4	2.4
Interest	5.8	5.3	4.6	4.2	6.0	5.1	5.3
Subsidies, grants and social benefits 2/	13.9	11.9	13.9	13.5	6.2	11.7	11.5
o/w: fuel subsidy	6.8	5.4	6.7	6.0	2.9	5.1	5.1
Other current expenditure	3.2	2.9	2.7	2.6	2.4	2.5	2.4
Investment expenditure	3.4	3.4	3.8	4.2	3.1	3.0	2.7
Cash balance	-7.7	-5.2	-6.4	-6.6	-8.4	-7.7	-7.7
Net acquisition of financial assets	1.4	2.4	1.4	0.4	0.1	0.3	-0.1
Overall balance	-9.2	-7.5	-7.8	-7.0	8.4	-8.0	-7.6
Discrepancy above and below the line	-1.5	-0.1	0.0	0.0	0.0	0.0	0.0
Financing Sources	7.7	7.5	7.8	7.0	8.4	8.0	7.6
Net domestic financing	8.3	7.3	4.5	6.3	9.3	7.3	6.9
Net external financing	0.6	0.5	1.3	0.7	-0.9	0.7	0.7
Memorandum items:							
Primary fiscal balance	-3.4	-2.3	-3.2	-2.8	-2.4	-2.9	-2.2
Nominal GDP (in billion LE)	617.7	744.8	895.5	1,038.6	1,181.0	1,197.6	1,377.1

Sources: Ministry of Finance; and Fund staff estimates.

1/ Staff projections. General government includes the budget sector, the national investment bank (NIB) and social insurance funds. The fiscal year begins on July 1st. The data are presented on a cash basis consistent with the GFS 2001 classification. The 2009/10 projections based on the budget for the central government.

2/ Beginning in 2005/06, the cost of domestic fuel subsidies covered by EGPC are recorded on-budget and notional revenues from EGPC are also recorded on-budget.

Table 4. Egypt: Monetary Survey, 2005/06–2010/11

	2005/06	2006/07	2007/08	2008/09	2009/10 Proj.	2010/11 Proj.
	(End of period, in billions of Egyptian pounds)					
Net foreign assets	133.6	218.8	303.8	253.9	318.8	366.6
Central bank (CBE)	129.5	160.2	182.0	173.1	194.7	210.0
Commercial banks	72.1	123.3	123.3	82.4	125.7	157.6
CBE medium- and long-term liabilities	-3.9	-2.0	-1.6	-1.6	-1.5	-1.1
Blocked accounts (Rescheduled loans) 1/	-64.0	-62.7	0.0	0.0	0.0	0.0
Net domestic assets	427.5	444.9	462.8	577.3	668.6	798.1
Net claims on government	173.0	176.4	155.4	248.2	335.5	427.2
Claims on public sector companies	32.9	24.4	26.9	33.1	33.4	31.9
Claims on private sector	292.5	328.5	369.9	388.9	403.7	440.4
Net other items	-70.8	-84.4	-89.4	-92.9	-104.1	-101.5
Broad money (M2)	561.2	663.8	766.7	831.2	987.4	1,164.6
Domestic currency component (M2D)	424.1	509.6	606.8	664.0	798.4	949.7
Foreign currency deposits	137.1	154.1	159.8	167.2	189.0	214.9
Memorandum items:						
Reserve money 2/	169.7	181.7	190.2	196.6	228.1	269.4
Net international reserves	129.5	160.2	182.0	173.1	194.7	210.0
	(Annual percentage change, unless otherwise indicated)					
Reserve money 2/	21.8	7.0	4.7	3.4	16.1	18.1
Broad money						
M2D	13.6	20.2	19.1	9.4	20.2	19.0
M2	13.4	18.3	15.5	8.4	18.8	17.9
Contribution to Broad Money Growth (M2)						
Net foreign assets	10.6	15.2	12.8	-6.5	7.8	4.8
Net domestic assets	2.8	3.1	2.7	14.9	11.0	13.1
Credit to the private sector	8.5	12.3	12.6	5.1	3.8	9.1
Credit to the public sector	13.3	2.0	-11.9	54.3	31.2	24.5
Velocity						
M2D/GDP (level)	1.5	1.5	1.5	1.6	1.5	1.5
M2/GDP (level)	1.1	1.1	1.2	1.2	1.2	1.2
Money multiplier (M2D/reserve money)	2.5	2.8	3.2	3.4	3.5	3.5
Foreign currency deposits (in percent of broad money)	24.4	23.2	20.8	20.1	19.1	18.5

Sources: Central Bank of Egypt; and Fund staff estimates and projections.

1/ Payments (on original schedule) of public enterprises on debt rescheduled by the Paris Club.
2/ Includes foreign currency deposits of commercial banks at the CBE.

Table 5. Egypt: Balance of Payments, 2005/06–2010/11

	2005/06	2006/07	2007/08	2008/09	2009/10 Proj.	2010/11 Proj.
	(In billions of U.S. dollars, unless otherwise indicated)					
Current account balance	1.8	2.5	0.9	-4.4	-5.5	-5.5
Trade balance	-12.0	-16.1	-23.4	-25.2	-27.0	-30.5
Exports	18.5	22.0	29.4	25.2	25.2	29.0
Of which: Oil	7.4	7.4	11.2	7.9	8.5	8.8
Gas	2.8	2.7	3.3	3.1	2.8	4.0
Imports	-30.4	-38.1	-52.8	-50.3	-52.2	-59.5
Of which: Oil 1/	-5.4	-4.1	-9.6	-7.0	-7.2	-8.1
Services (net) 1/	8.2	11.5	15.0	12.5	13.3	16.5
Of which: Tourism receipts	7.2	8.2	10.8	10.5	11.8	14.2
Suez canal dues	3.6	4.2	5.2	4.7	4.5	5.4
Transfers	5.5	7.1	9.3	8.2	8.2	8.5
Official grants	0.6	0.8	1.0	0.6	0.7	0.6
Private remittances	5.0	6.3	8.4	7.6	7.5	7.9
Capital account	4.6	4.3	6.4	4.2	8.5	8.2
Medium- and long-term loans (net)	1.5	-0.6	-1.9	-1.5	5.0	3.4
Drawings 2/	4.2	1.4	0.4	1.1	6.8	5.4
Amortization	-2.7	-1.9	-2.3	-2.6	-1.8	-2.0
Foreign direct investment (net)	6.0	10.5	12.1	6.8	8.0	9.2
Portfolio investment (net) 3/	2.1	3.7	-2.3	-9.6	2.1	1.3
Commercial banks' net foreign assets	-5.0	-9.1	-1.5	8.4	-7.9	-5.7
Errors and omissions (net)	-3.1	-1.1	-1.2	-3.0	1.0	0.0
Overall balance	3.2	5.6	6.0	-3.3	3.9	2.7
Financing	-3.2	-5.6	-6.0	3.3	-3.9	-2.7
Of which: Net international reserves 4/	-3.2	-5.6	-6.0	3.3	-3.9	-2.7
Memorandum items:						
Current account (in percent of GDP)	1.6	1.9	0.5	-2.4	-2.6	-2.2
Oil trade balance (in percent of GDP)	1.9	2.5	1.0	0.5	0.6	0.3
Gross official reserves (in U.S. dollar billions, end of period)	22.8	28.5	34.5	31.2	35.1	37.9
In months of next year imports of goods and services	5.8	5.3	6.7	5.8	5.8	5.5
Nominal GDP (in U.S. dollar billions)	107.4	130.3	162.4	188.0	215.8	248.1
External debt 2/	29.6	29.9	33.9	31.5	36.4	39.8
External debt service (in percent of exports goods and services)	9.7	6.4	5.6	6.8	5.1	5.0
FDI (in percent of GDP)	5.6	8.1	7.5	3.6	3.7	3.7

Sources: Central Bank of Egypt; Fund staff estimates and projections.

1/ Repatriation of oil company profits is classified as income payments as opposed to oil imports starting in 2009/10.
2/ Includes multilateral and bilateral public sector borrowing and private borrowing.
3/ As of 2007/2008, it includes net foreigners' transactions in LE government bonds floated abroad and their net transactions on Egyptian TBs and CDs.
4/ Counting additional SDR allocation by US$ 1.2 billion in August 2009.

Table 6. Egypt: Medium-Term Macroeconomic Framework, 2007/08–2014/15

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
			Projections					
Growth and prices			(Annual percentage change)					
Real GDP	7.2	4.7	5.0	5.5	5.7	5.9	6.2	6.5
Hydrocarbon	5.1	6.4	4.2	4.0	3.2	3.0	3.0	3.0
Nonhydrocarbon	7.7	4.4	5.1	5.8	6.1	6.4	6.7	7.0
CPI inflation (end of period)	20.2	10.0	10.0	9.0	8.0	7.0	7.0	6.0
CPI inflation (average)	11.7	16.2	12.0	9.5	8.5	7.5	7.0	6.5
Savings-investment balance			(In percent of GDP)					
Investment	22.4	19.3	19.4	19.5	19.8	20.1	20.6	21.1
Private investment	18.6	15.1	16.4	16.8	16.8	17.2	17.6	18.1
General government investment	3.8	4.2	3.0	2.7	3.0	3.0	3.0	3.0
Savings	22.9	16.9	16.9	17.3	17.7	18.4	18.9	19.5
Private savings	25.5	19.3	21.6	22.3	21.1	20.1	19.9	19.6
General government savings	-2.5	-2.4	-4.7	-5.0	-3.4	-1.7	-1.0	-0.1
Government accounts (budget sector, unless otherwise indicated)								
Revenue	24.7	27.2	21.0	20.8	20.6	20.7	20.4	20.3
Expenditure (incl. net acquisition of financial assets)	31.5	34.1	29.1	28.4	28.6	28.1	27.4	27.0
Measures 1/	…	…	…	0.0	1.4	2.6	3.0	3.3
Overall fiscal balance	-6.8	-6.9	-8.1	-7.6	-6.6	-4.9	-4.1	-3.3
Total public debt (general government, gross)	76.6	76.2	74.1	72.0	70.5	67.7	64.7	61.0
Total public debt (general government, net)	61.9	61.8	61.7	61.2	60.9	59.2	57.1	54.3
External Accounts			(In percent of GDP, unless otherwise indicated)					
Non-hydrocarbon balance	-17.4	-15.5	-14.4	-14.2	-14.5	-14.7	-15.0	-15.3
External current account balance	0.5	-2.4	-2.6	-2.2	-2.1	-1.8	-1.6	-1.6
Foreign direct investment	7.5	3.6	3.7	3.7	3.9	4.3	4.7	5.1
(in US$ billions)	12.1	6.8	8.0	9.2	10.7	12.8	15.2	18.1
Official reserves (in US$ billions)	34.5	31.2	35.1	37.9	41.3	46.4	54.3	64.6
(in months of imports)	6.7	5.8	5.8	5.5	5.4	5.3	5.5	5.8
External debt (in US$ billion)	33.9	31.5	36.4	39.8	39.8	44.5	46.2	47.7

Sources: Egyptian authorities; and Fund staff estimates and projections.

1/ Measures yet to be implemented, including the real estate tax, VAT and subsidy reform.

Table 7. Egypt: Selected Vulnerability Indicators, 2005/06–2009/10

	2005/06	2006/07	2007/08	2008/09	2009/10 Proj.
Key economic and market indicators					
Real GDP growth (annual percentage change)	6.8	7.1	7.2	4.7	5.0
CPI inflation (period average, annual percentage change)	4.2	11.0	11.7	16.2	12.0
Short-term interest rate (91-day Treasury bill rate, percent)	8.8	8.7	7.0	11.3	...
JP Morgan Emerging Market Bond Spread: Egypt (basis points, end of period)	103	51	201	150	...
Exchange rate (LE per dollar, end of period)	5.8	5.7	5.3	5.6	...
External sector					
Current account balance (in percent of GDP)	1.6	1.9	0.5	-2.4	-2.6
Net FDI inflows (in percent of GDP)	5.6	8.1	7.5	3.6	3.7
Exports of goods and services (percentage change of US$ value, GNFS)	21.2	16.5	35.0	-11.7	3.5
Real effective exchange rate (1991=100)	108.2	112.9	116.9	141.3	…
Gross international reserves (GIR) (US$ billions)	22.8	28.5	34.5	31.2	35.1
GIR in percent of debt at remaining maturity 1/	526	843	712	661	936
Net international reserves (in US$ billions)	22.8	28.4	34.5	31.2	35.1
Total gross external debt (in percent of GDP)	27.6	22.9	20.9	16.8	16.9
Of which: short-term external debt (original maturity, in percent of total)	6.8	5.8	5.1	8.0	7.2
Total gross external debt (in percent of exports of GNFS)	87.3	75.7	63.6	67.0	74.8
Gross external financing requirement (in US$ billions) 2/	1.0	-0.6	1.4	7.0	7.3
Public sector 3/					
General government balance (in percent of GDP)	-9.2	-7.5	-7.8	-7.0	-8.0
Primary balance (budget sector, in percent of GDP)	-2.2	-0.9	-1.2	-1.8	-2.3
Public sector gross debt (general government, in percent of GDP)	98.8	87.1	76.6	76.2	74.1
Public sector net debt (general government, in percent of GDP)	79.8	71.4	61.9	61.8	61.7
Banking sector 4/					
Capital adequacy ratio (percent) 5/	14.7	14.8	14.7	15.3	...
Nonperforming loans (NPLs, in percent of total loans) 5/	18.2	19.3	14.8	14.7	...
Provisions (in percent of NPLs) 5/	76.2	74.6	92.1	94.5	...
Return on average assets (percent)	0.8	0.9	0.8	...	...
Return on equity (percent)	14.3	15.6	14.1	...	...
Foreign exchange deposits (in percent of total deposits)	30.1	27.8	26.0	25.7	...
Foreign exchange loans (in percent of total loans)	27.6	30.9	34.0	31.2	...
Credit to private sector (annual percentage change)	8.5	12.3	12.6	5.1	3.8
Memorandum item:					
Nominal GDP (in US$ billions)	107.4	130.3	162.4	188.0	215.8

Sources: Egyptian authorities; and Fund staff estimates and projections.

1/ Debt at remaining maturity is defined as external short-term debt plus maturing medium- and long-term external debt.
2/ Current account deficit plus amortization of external debt.
3/ Public sector covers the general government.
4/ The banking sector includes commercial banks (public and private), business and investment banks, and specialized banks.
5/ Figures for 2008/09 are for end-September 2009.

APPENDIX I. DEBT SUSTAINABILITY ANALYSIS

A. Public Debt[12]

Under current policies, Egypt's gross public debt to GDP ratio is expected to remain broadly unchanged at 73 percent of GDP by FY2014/15. This public debt to GDP ratio—slightly lower than that recorded during the previous two years—is based on the FY2009/10 budget and assumes largely unchanged policies thereafter, involving primary deficits for the general government and the budget sector as percent of GDP of about 3 percent and 2.3 percent, respectively, over the medium term.

However, Egypt's gross public debt could decline by 15 percentage points to about 61 percent of GDP in FY2014/15, if the government adheres to its fiscal consolidation strategy (baseline). The government's consolidation strategy entails a reduction of 5 percent of GDP both in the general government and budget sector deficits over the next five years, bringing them down to about 3.7 and 3.3 percent of GDP by FY2014/15. The strategy also seeks to turn the general government and budget sector primary deficits into surpluses of about 1.5–2 percent of GDP by FY2014/15.

If key assumptions are held over the next five years at their historical averages, the general government primary deficit would be on average higher than the implied primary deficit in the government's consolidation strategy. Thus the decline in gross public debt would be slightly more moderate to 62.4 percent of GDP by FY2014/15.

The debt outlook remains moderately vulnerable to adverse shocks. Standard bound tests reveal the following (Figure I.1):

- As a quarter of the debt is foreign currency denominated, a 30 percent real exchange rate depreciation would increase the debt to GDP ratio by around 9 percentage points relative to the baseline in FY2014/15.

- With a contingent liabilities shock, the debt path would also increase throughout the projection period, raising the gross public debt to GDP ratio by about 9 percentage points above the baseline.

- Even under smaller shocks—individual one-half standard deviation shocks to real growth, interest rates, and the primary balance and a combined one-fourth standard

[12] Public debt is defined as gross general government debt. Netting out the government deposits in the banking system, the public debt is 62 percent of GDP, about 14 percent of GDP lower than the gross public debt.

deviation shock—the debt to GDP ratios would exceed the projections in the baseline scenario by 5–8 percent over the projection period.

B. External Debt

External debt sustainability risks have been reduced substantially in recent years and appear contained in the period ahead.

- External debt almost halved from 32 percent of GDP in FY2004/05 to around 17 percent in FY2008/09, reflecting in large part rapid nominal GDP growth.

- Under the baseline scenario, external debt is projected to decline slightly to around 13 percent of GDP by FY2014/15.

The composition and small size of Egypt's external debt makes it relatively resilient to adverse external shocks.

- External debt remains relatively low (at most around 22 percent of GDP in FY2014/15) under the alternative scenario and each of the bound tests (Table I.2). For example, a large depreciation or a persistent adverse shock to the current account would only raise the projected path of external debt by 5 to 9 percentage points of GDP by FY2014/15.

- Given the volatility of capital inflows to emerging market economies during the financial crisis and the importance of capital inflows for Egypt in recent years, a permanent one-half standard deviation shock to non-debt creating capital inflows was simulated. Even under this extreme risk scenario, external debt is projected to increase by only 8 percentage points of GDP relative to the baseline (see figure).

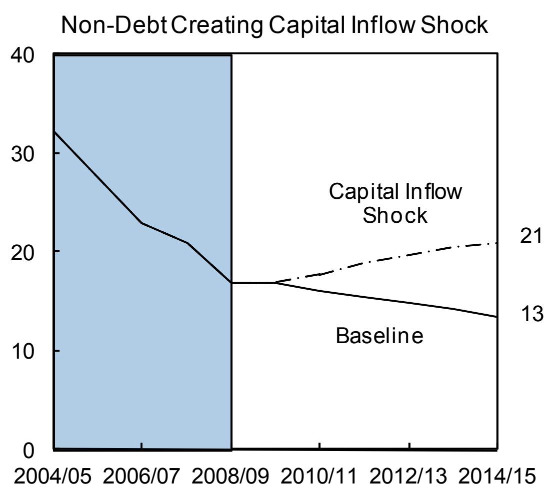


Table I.1. Egypt: Public Sector Debt Sustainability Framework, 2004/05-2014/15
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	112.8	98.8	87.1	76.6	76.2	**74.1**	**72.0**	**70.5**	**67.7**	**64.7**	**61.0**	**-1.8**
o/w foreign-currency denominated	31.6	28.1	24.5	21.6	18.5	18.0	17.5	17.1	16.5	15.7	14.8	
Change in public sector debt	-0.1	-14.0	-11.7	-10.6	-0.4	-2.1	-2.1	-1.5	-2.8	-3.1	-3.7	
Identified debt-creating flows (4+7+12)	-5.3	-12.9	-17.2	-11.1	-2.6	-2.1	-2.1	-1.5	-2.8	-3.1	-3.7	
Primary deficit	2.7	3.4	2.3	3.2	2.8	2.9	2.2	1.6	0.0	-0.6	-1.4	
Revenue and grants	24.8	28.6	27.7	27.8	27.8	24.2	23.9	23.5	23.4	23.0	22.8	
Primary (noninterest) expenditure	27.6	32.0	30.0	31.0	30.5	27.1	26.1	25.1	23.4	22.4	21.4	
Automatic debt dynamics 2/	-7.9	-8.8	-11.9	-11.4	-5.4	-5.0	-4.3	-3.1	-2.8	-2.5	-2.3	
Contribution from interest rate/growth differential 3/	-5.5	-8.7	-11.6	-10.1	-6.3	-5.0	-4.3	-3.1	-2.8	-2.5	-2.3	
Of which contribution from real interest rate	-0.9	-2.0	-5.8	-4.9	-3.3	-1.7	-0.8	0.5	0.9	1.2	1.4	
Of which contribution from real GDP growth	-4.5	-6.7	-5.8	-5.2	-3.1	-3.3	-3.6	-3.6	-3.7	-3.7	-3.7	
Contribution from exchange rate depreciation 4/	-2.4	-0.1	-0.3	-1.3	0.9	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	-7.5	-7.6	-2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-0.2	-0.2	-1.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	-7.3	-6.3	-2.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	5.3	-1.1	5.5	0.5	2.3	0.0	0.0	0.0	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	454.1	345.6	314.3	275.5	274.2	306.2	301.9	300.4	289.4	281.3	267.9	
Gross financing need 6/	24.6	29.6	24.0	25.4	27.7	28.9	28.5	28.1	26.5	25.8	25.0	
in billions of U.S. dollars	22.1	31.8	31.3	41.2	52.2	62.4	70.8	76.8	79.0	83.8	88.5	
Scenario with key variables at their historical averages 7/						**74.1**	**71.5**	**69.0**	**66.7**	**64.4**	**62.4**	**-3.3**
Scenario with no policy change (constant primary balance) in 2010-2015						**74.1**	**72.7**	**72.3**	**72.4**	**72.7**	**73.0**	**-2.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.5	6.8	7.1	7.2	4.7	5.0	5.5	5.7	5.9	6.2	6.5	
Average nominal interest rate on public debt (in percent) 8/	5.6	5.8	6.4	6.3	6.4	7.7	8.3	8.2	8.3	8.4	8.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.6	-1.5	-6.2	-5.9	-4.4	-2.1	-0.7	1.2	1.8	2.4	2.8	
Nominal appreciation (increase in US dollar value of local currency, in percent)	7.2	0.3	1.1	6.8	-4.7	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	6.2	7.4	12.6	12.2	10.8	9.8	9.0	7.0	6.5	6.0	6.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	2.3	24.1	0.4	10.7	3.1	-6.8	1.6	1.7	-1.2	1.7	1.6	
Primary deficit	2.7	3.4	2.3	3.2	2.8	2.9	2.2	1.6	0.0	-0.6	-1.4	

1/ Public sector refers to gross general government debt.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

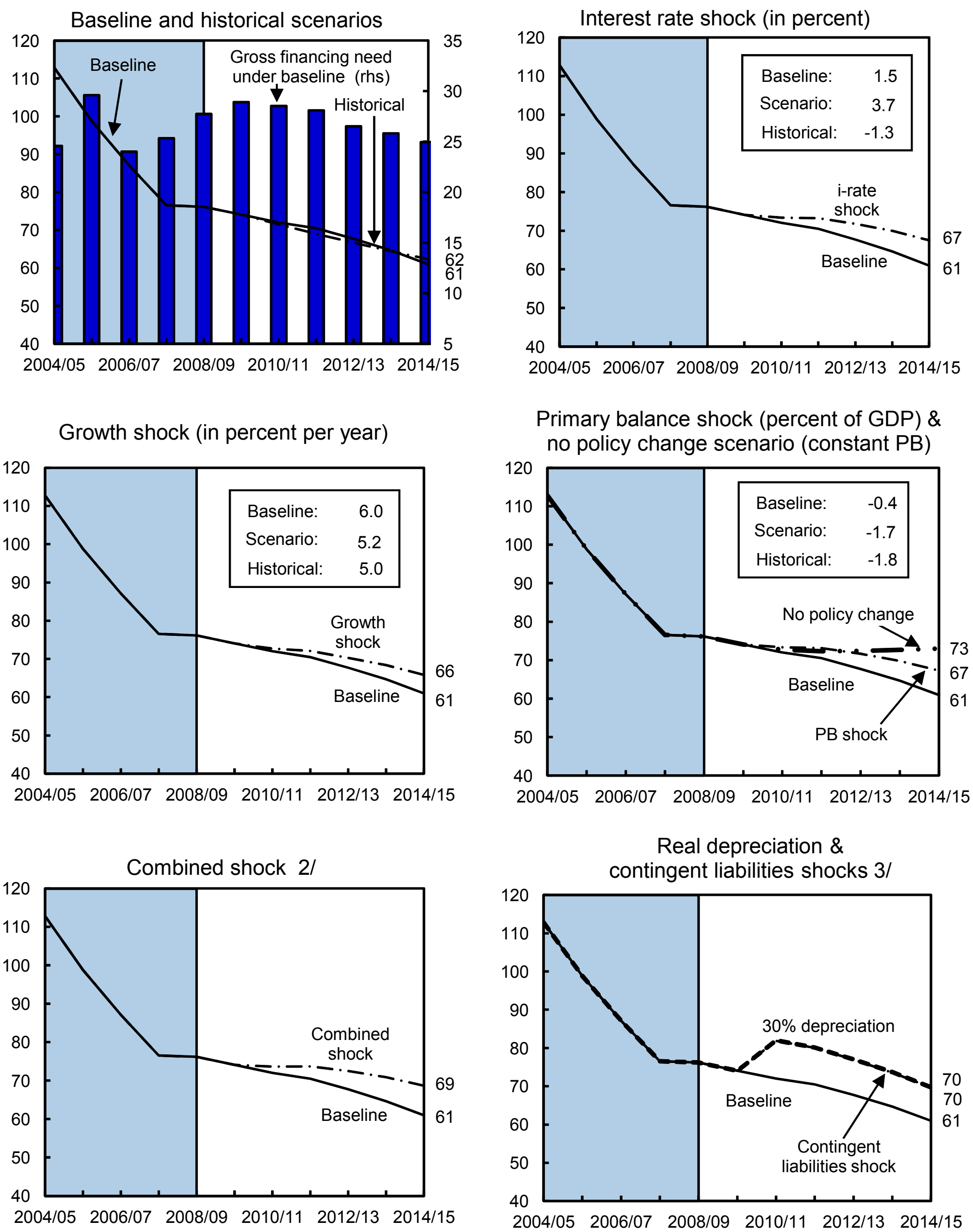
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure I.1. Egypt: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table I.2. Egypt: External Debt Sustainability Framework, 2006/07–2014/15
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2006/07	2007/08	2008/09			2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	22.9	20.9	16.8			**16.9**	**16.1**	**15.5**	**14.9**	**14.3**	**13.4**	**-6.2**
Change in external debt	-4.6	-2.1	-4.1			0.1	-0.8	-0.5	-0.6	-0.7	-0.8	
Identified external debt-creating flows (4+8+9)	-17.7	-11.1	1.0			-2.9	-2.8	-3.2	-3.8	-4.3	-4.8	
Current account deficit, excluding interest payments	-2.4	-1.0	2.0			2.2	1.9	1.7	1.4	1.2	1.1	
Deficit in balance of goods and services	4.4	6.0	6.8			5.5	4.8	4.7	4.5	4.4	4.4	
Exports	30.3	32.8	25.0			22.6	22.7	23.9	24.9	26.1	27.3	
Imports	34.7	38.8	31.9			28.0	27.6	28.6	29.4	30.5	31.7	
Net non-debt creating capital inflows (negative)	-10.9	-6.0	1.5			-4.7	-4.2	-4.4	-4.7	-5.1	-5.5	
Automatic debt dynamics 1/	-4.4	-4.1	-2.5			-0.4	-0.5	-0.5	-0.5	-0.4	-0.4	
Contribution from nominal interest rate	0.5	0.4	0.3			0.3	0.3	0.4	0.4	0.4	0.4	
Contribution from real GDP growth	-1.6	-1.3	-0.8			-0.7	-0.8	-0.8	-0.8	-0.8	-0.8	
Contribution from price and exchange rate changes 2/	-3.2	-3.2	-2.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	13.1	9.0	-5.1			3.0	2.0	2.6	3.2	3.6	3.9	
External debt-to-exports ratio (in percent)	75.7	63.6	67.0			74.8	70.6	65.2	59.9	54.6	49.2	
Gross external financing need (in billions of US dollars) 4/	1.1	2.9	9.5			9.4	9.5	10.0	9.9	9.5	9.8	
in percent of GDP	0.8	1.8	5.1			4.4	3.8	3.7	3.3	2.9	2.8	
Scenario with key variables at their historical averages 5/						**16.9**	**13.4**	**10.1**	**7.4**	**5.2**	**3.5**	**-4.6**
Scenario with non-interest current account is at baseline minus one-half standard deviations						**16.9**	**17.1**	**17.6**	**17.9**	**18.1**	**18.1**	**-6.5**
Scenario with a one time 30 percent real depreciation in 2009/10						**16.9**	**26.0**	**25.2**	**24.2**	**23.1**	**21.8**	**-10.1**
Scenario with net non-debt creating capital inflows is at baseline plus one-half standard deviations						**16.9**	**17.7**	**18.8**	**19.7**	**20.4**	**20.9**	**-4.9**
Key Macroeconomic Assumptions Underlying Baseline				10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	7.1	7.2	4.7	5.0	1.6	5.0	5.5	5.7	5.9	6.2	6.5	
GDP deflator in US dollars (change in percent)	13.4	16.3	10.5	3.1	10.7	9.4	8.9	4.2	2.9	2.5	2.6	
Nominal external interest rate (in percent)	2.0	2.3	1.8	2.2	0.3	2.3	2.3	2.5	2.7	3.0	3.4	
Growth of exports (US dollar terms, in percent)	16.5	35.0	-11.7	14.1	14.6	3.5	15.9	15.6	13.9	14.0	14.3	
Growth of imports (US dollar terms, in percent)	18.4	39.4	-5.1	12.1	17.0	1.0	13.2	14.2	12.0	13.0	13.5	
Current account balance, excluding interest payments	2.4	1.0	-2.0	1.7	2.1	-2.2	-1.9	-1.7	-1.4	-1.2	-1.1	
Net non-debt creating capital inflows	10.9	6.0	-1.5	4.4	3.4	4.7	4.2	4.4	4.7	5.1	5.5	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

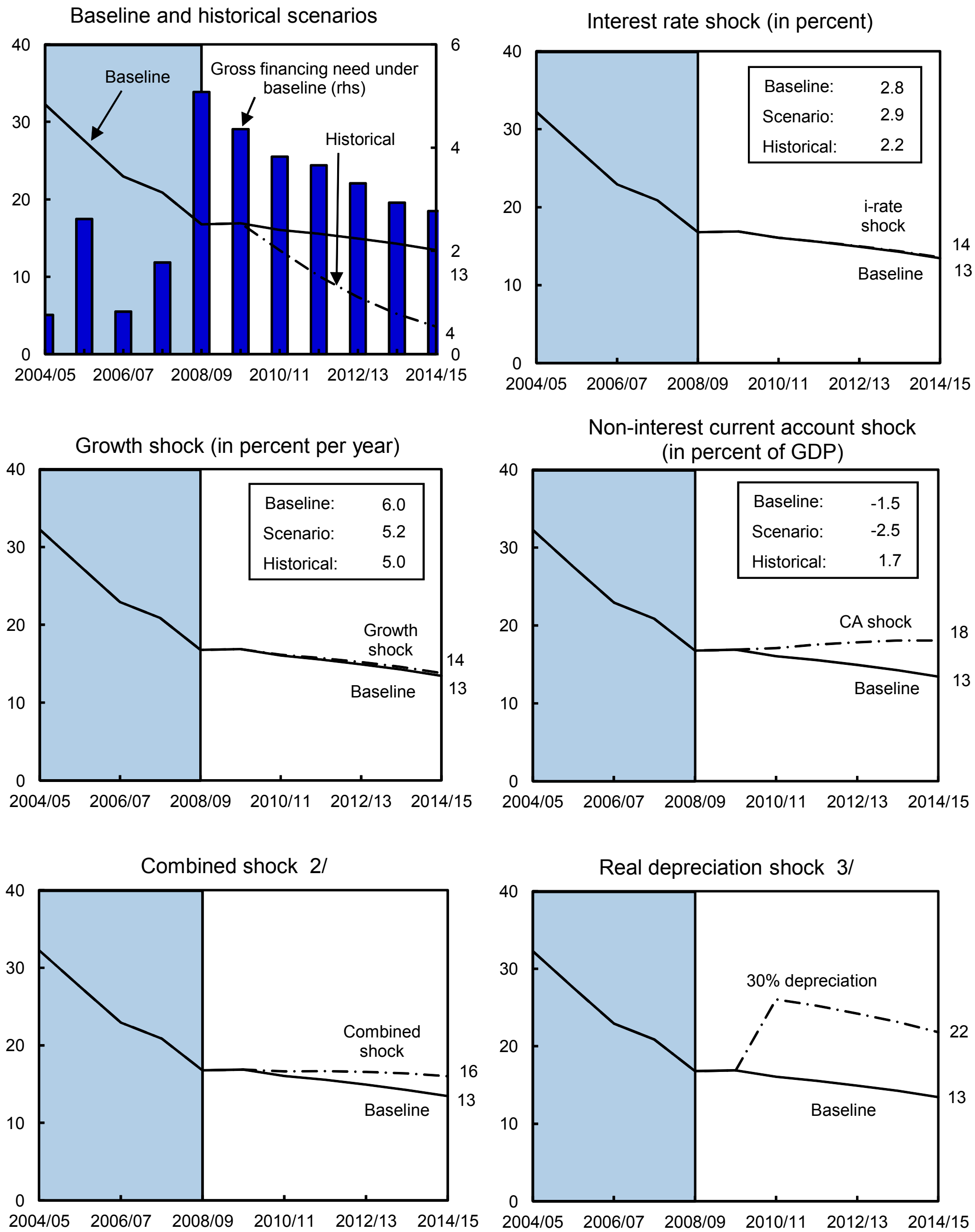
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure I.2. Egypt: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010/11.

INTERNATIONAL MONETARY FUND

ARAB REPUBLIC OF EGYPT

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by Middle East and Central Asia Department
(In consultation with other departments)

March 9, 2010

Contents **Page**

ANNEX I. ARAB REPUBLIC OF EGYPT: RELATIONS WITH THE FUND
(As of January 31, 2010)

I. Membership Status: Joined 12/27/45; Article VIII[13]

II. General Resources Account:

	SDR Million	Percent Quota
Quota	943.70	100.00
Fund holdings of currency	943.73	100.00

III. SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	898.45	100.00
Holdings	833.50	92.77

IV. Outstanding Purchases and Loans: None

V. Financial Agreements:

Type	Approval date	Expiration date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	10/11/96	9/30/98	271.40	0
EFF	9/20/93	9/19/96	400.00	0
Stand-by	5/17/91	5/31/93	234.40	147.20

VI. Projected Obligations to the Fund: [14]
(SDR million; based on existing use of resources and present holding of SDRs)

	Forthcoming				
	2010	2011	2012	2013	2014
Charges/interest	0.21	0.21	0.21	0.21	0.21
Total	0.21	0.21	0.21	0.21	0.21

[13] Egypt accepted the obligations of Article VIII, Sections 2, 3, and 4 on January 2, 2005.

[14] The projection of charges and interest assume that overdue principal at the report date (if any) will remain outstanding, but forthcoming obligations will be settled on time.

VII. **Exchange Rate Arrangement** (as of January 31, 2010):

Prior to January 29, 2003, the Egyptian pound was pegged to the dollar, with all foreign exchange transactions taking place within a ±3 percent range around the central rate, which was announced by the Central Bank of Egypt (CBE). Effective January 29, 2003, the Egyptian pound was allowed to float. As a result, the exchange arrangement of Egypt was reclassified to the category “managed float with no pre-announced path for the exchange rate,” from the category “pegged exchange rate within horizontal bands.” In December 2004, the CBE officially launched the foreign exchange interbank market with no controls on rates, governed by a formal interbank convention on foreign exchange trading. The CBE stands ready to purchase foreign exchange in the interbank market for banks to the extent they exceed prudential limits on net open positions at the prevailing market rate. Effective February 2, 2009, Egypt’s exchange rate was reclassified to other managed arrangement from a managed float with no predetermined path for the exchange rate. Egypt maintains a bilateral payment arrangement with Sudan which has been inoperative since the late 1990s.

Egypt maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions; however, Egypt has notified measures to the Fund, pursuant to procedures under Executive Board Decision 144-(52/51), which apply to measures imposed solely for national or international security reasons.

VIII. **Article IV Consultation:**

Consultations with Egypt are on a 12-month cycle. The last Article IV consultation discussions were held in Cairo from October 22 to November 6, 2008. The staff report (CR No. 09/25) was discussed by the Executive Board on December 22, 2008. The 2008 Article IV report and PIN were published on January 27, 2009.

IX. **Financial Sector Assessment Program (FSAP):**

An FSAP Update mission was conducted in May 2007.

X. **Review of Standards and Codes (ROSC):**

FAD	Fiscal module of ROSC	June 2001
MFD	Financial Sector Assessment Program (FSAP)	October 2002
STA	Data ROSC (published on July 21, 2005).	October 2003

XI. Technical Assistance (2006–09):

Dept.	Topic	Date
FAD/LEG	Tax policy-Agricultural land tax	March 2006
FAD	Tax administration expert (first of four visits)	May 2006
METAC	Balance of Payments and IIP	May, August 2006
LEG	Forum for compliance officers on AML/CFT	July 2006
FAD	Cash management expert (first of two visits)	August 2006
FAD	Tax administration expert (second of four visits)	August 2006
FAD	Revenue administration TA evaluation	September 2006
FAD	Fiscal Reporting	September 2006
METAC	Consumer price statistics	Nov 2006, Feb and April 2007
FAD/ METAC	Revenue administration	December 2006
FAD	Tax administration	December 2006, July 2007, April 2009
FAD	Macrofiscal advisory	December 2006
FAD	Macrofiscal advisory	February 2007
FAD	Tax administration expert (third of four visits)	March 2007
FAD	Cash administration expert (last of two visits)	March 2007
FAD/ METAC	Follow up mission on treasury single account implementation	March 2007
FAD	Macrofiscal advisory	June 2007
FAD/ METAC	Treasury single account establishment	August 2007
FAD	Review of tax reforms	November 2008
FAD	Pension and health care reforms	February 2009
FAD/METAC	Fiscal decentralization	April 2009
FAD/ METAC	Revenue administration	June/July 2009
LEG	Article VIII mission	May 2006
LEG	National workshop for insurance supervisor (AML/CBT)	April 2007
MCM	Monetary policy expert (last of seven visits)	March 2006
MCM	TA Assessment on Monetary Operations (inflation targeting)	June 2006
MCM / METAC	Inflation targeting (Two resident advisors, in situ for 3 months each)	2007/2008
STA	IIP statistics seminar	September 2006
STA	Government finance statistics	September 2006
STA/METAC	Foreign direct investment statistics	March/June 2009
STA	National account (quarterly)	December 2009

XII. Resident Representative:

The Resident Representative’s office in Cairo was closed in September 2008.

ANNEX II. ARAB REPUBLIC OF EGYPT: RELATIONS WITH THE WORLD BANK

1. **Partnership for Development**. In the FY2008–09 period, the government restated its commitment to pursuing the implementation of its national development agenda against the background of the current financial crisis. The national development agenda underpins the World Bank Group (WBG) engagement strategy articulated in the Country Assistance Strategy (CAS). Within the framework of this development agenda, the government decided to increase its short-term focus on social policies and social services delivery, while consolidating and deepening pro-growth reforms in a deteriorated global environment, so as to ensure that the benefits of the recent economic performance are broadly shared. The relationship between Egypt and the WBG has been transformed and markedly improved over the last few years as a result of the progress Egypt has made in implementing reforms and of the successful turnaround of the WBG program outlined in its FY2006−09 CAS. The WBG has been providing its support through an integrated package of knowledge, advisory services, technical assistance, and financing, in support of government priorities in given sectors such as the financial sector, energy, transport, and education. During that CAS period, the Bank and the government also collaborated on several pieces of analytical work that led to both a better and a shared understanding in such areas investment climate and financial sector, public expenditure, poverty, pensions and infrastructure. The government has signaled its interest in a significant increase in IBRD lending, as part of its response to the global crisis. The Bank is preparing for a year of even stronger delivery of IBRD lending, and is working closely with the government to help design and implement further reforms (including responding to the global crisis).

2. **World Bank Country Assistance Strategy**. The current Bank assistance to Egypt is anchored in a CAS initially for the period FY2006–09 which was extended to cover an additional two fiscal years, until end-FY2011 in June 2008. In line with the government's development and reform agenda, the current CAS identified and implements interventions that will (i) facilitate private sector development; (ii) enhance the provision of public services; and (iii) promote equity.

3. **IMF-World Bank Collaboration in Specific Areas**. The Bank and IMF continue to collaborate in supporting the government in the areas of macroeconomic framework and management; budget and public expenditure management; public sector reform; and private and financial sector development.

Table 1. Bank-Fund Collaboration

Area	Specialized Advice from Fund	Specialized Advice from Bank	Key Instruments
Economic Framework/ Management	Monetary, exchange rate, and fiscal, policies and economic statistics	Economic growth, economic statistics, analysis of public spending, and trade policies	IMF: Article IV consultations Bank: Economic work and technical assistance
Budget and Public Expenditure Management	Medium-term budget framework, tax policy and administration, public financial management	Budget management, debt management and statistics and public expenditure management	IMF: Technical assistance Bank: Sector work (PER, CFAA, CPAR) and technical assistance
Public Sector Reform	Decentralization	Civil service reform, anti-corruption agenda, decentralization.	IMF: Technical assistance Bank: Sector work
Private and Financial Sector Development	Banking supervision	Investment climate reforms, financial sector restructuring, mortgage market development	IMF: Bank: Sector work, technical assistance and lending

World Bank/IDA Portfolio

4. As of March 1, 2010, the Bank had approved 123 projects for Egypt (82 under IBRD including two additional financing and 41 under IDA), valued at about US$10.3 billion, of which about US$2 billion remain undisbursed. The current IBRD portfolio includes 16 projects with a total commitment of about US$2.4 billion. The sectoral composition of the current portfolio (by value) is as follows: 67 percent for infrastructure, 14 percent for financial and private sector development, 13 percent for agriculture and 6 percent for social sectors.

International Finance Corporation (IFC) Investments

5. As of March 1, 2010 Egypt remains as one of the two largest exposure countries for IFC in the MENA region with a total committed portfolio of US$643 million for 35 projects for its own account. Its portfolio includes operations in the financial sector, export-oriented manufacturing, ports, oil and gas, agribusiness, and healthcare. In March 2009 IFC disbursed US$197 million for a 9.75 percent stake in the Bank of Alexandria (BoA). The transaction represents IFC's largest equity investment in Egypt (and the second largest worldwide) and demonstrates its confidence in the Egyptian financial sector. IFC views BoA as a flagship investment and will work with the World Bank to help make a strong platform to implement important initiatives in scaling-up IFC's engagement in priority areas such as small and medium enterprises. IFC also has a large program of Advisory Services in Egypt, focusing primarily on issues of financial sector development, investment climate

improvements, capacity building of SMEs, and public private partnerships in infrastructure, health, and education.

Multilateral Investment Guarantee Agency (MIGA) Exposures

6. MIGA's most important contribution to date has been to support and enable investments by an Egyptian telecom company in two telecom projects in Pakistan and Bangladesh, with a combined gross exposure of US$152 million—an example of South-South investment. Requests for MIGA's guarantees with Egypt as a host country are relatively limited for now, since many bilateral agencies provide comparable services.

Bank Group Activities
As of March 1, 2010
(In millions of U.S. dollars)

	TOTAL
IBRD/IDA Lending Operations	
Disbursed[1]	8254.1
Undisbursed	2054.6
Number of closed loans/credits = **107**	
Number of ongoing loans/credits = **16**	
Operations Portfolio--Sectoral distribution (less cancellations)	
Infrastructure	1633.2
Financial Sector	337.1
Social Sector	150.5
Agriculture	306.4
Total	**2427.2**
IFC Exposure	643
MIGA gross exposure (inward)	196

[1]Includes US$1.984 billion of IDA disbursements.
Source: World Bank Group

ANNEX III. ARAB REPUBLIC OF EGYPT: STATISTICAL ISSUES

1. Data coverage and availability are broadly adequate for surveillance. However, notwithstanding improvements in recent years, addressing the remaining shortcomings would greatly enhance the effectiveness of surveillance. Priority areas for improvements are price statistics, national accounts and external sector statistics. The global financial crisis has also highlighted the importance of greater transparency and higher frequency data, particularly for the financial sector. Egypt has subscribed to the Special Data Dissemination Standard (SDDS), and an IMF Report on the Observance of Standards and Codes (ROSC), based on an October 2003 mission assessing the quality of Egypt's macroeconomic statistics, was published in July 2005.

2. **National accounts:** The National Accounts Department within the Ministry of Economic Development compiles annual and quarterly national accounts data based on the 1993 System of National Accounts (SNA 1993). Shortcomings, however, include: inconsistency within the dataset (discrepancies between quarterly and annual GDP estimates); inconsistency over time (the base year is often changed without an overlap with the preceding base); inconsistency with balance of payments statistics; weakness in inventory data (no negative inventory has been observed over 10 years); and the lack of export and import price deflators. In addition, the October 2003 data ROSC identified weaknesses in the source data (including limited use of surveys) and lack of an oversight body to provide guidance on the quality of national accounts.

3. **Price statistics:** The Central Agency for Public Mobilization and Statistics (CAPMAS) disseminates a monthly producer price index, bi-monthly CPI data for all Egypt, and monthly CPI data for eight geographic regions (Cairo, Alexandria, Upper Urban, Lower Urban, Canal Cities, and Frontier; and every other month for Upper Rural, Lower Rural). The CPI utilizes expenditure weights derived from a 2004−05 household expenditure survey, although the household survey and detailed weights are not publicly available. In October 2009, the Central Bank of Egypt (CBE) began releasing its measure of core inflation, which excludes prices for the most volatile food items and regulated prices, and issuing a monthly Inflation Note.

4. **Balance of payments statistics:** The CBE compiles balance of payments statistics based on the *Balance of Payments Manual, Fifth Edition (BPM5)*. The 2003 data ROSC mission noted that the robustness of balance of payments statistics are limited by: (i) source data that do not reasonably approximate an accrual basis; (ii) unreliable merchandise trade statistics from customs declarations compelling compilers to estimate using banks' foreign exchange records; (iii) limited coverage and classification of foreign exchange transactions: and (iv) lack of survey data for direct investment enterprises. In 2009, the CBE commenced publishing Egypt's Reserve Template on the Fund's website (having previously only been published on the CBE's website).

5. **Foreign direct investment:** Since March 2005, a series of METAC missions to the CBE and Ministry of Investment have provided advice on the measurement of FDI, and the development of an FDI survey and business register. In a June/July 2009 mission, METAC provided further technical assistance on improving the response rate and data quality of the

pilot FDI survey, and could consider additional assistance when the results of a full pilot FDI survey are tabulated.

6. **External debt and the international investment position (IIP).** Egypt reports IIP data for publication in the *International Financial Statistics* (*IFS*) and *Balance of Payments Statistics Yearbook (BOPSY)*. A 2006 STA mission encouraged the authorities to address gaps in the data, to connect stocks with flows and improve the reporting system on non-guaranteed debt. The authorities have not yet resolved these issues.

7. **Fiscal data:** The authorities have largely adopted the classification of the *Government Finance Statistics Manual 2001 (GSFM 2001)*, with FAD and STA advice. Nonetheless, the consolidation of general government operations (budget sector, National Investment Bank, and Social Insurance Funds) under this new classification is incomplete for "below-the-line" transactions. Annual government finance statistics based on *GFSM 2001* are reported for publication in the *Government Finance Statistics Yearbook (GFSY)*. Quarterly data on the budgetary central government are reported for publication in the *IFS*. Currently, data on external and domestic debt are compiled by the CBE and Ministry of Finance, respectively. More comprehensive coverage of government and government-guaranteed debt data, within one debt database, could help further improve debt management.

8. **Monetary and financial statistics:** Monthly monetary and financial statistics are comprehensive and generally reported within two months after the reference period. Egypt reports monetary data to STA using the Standardized Report Forms (SRF) based on the *Monetary and Financial Statistics Manual*. The coverage of data reported in the SRF form needs to be expanded to include "other financial corporations." The data ROSC mission raised the issue of potential overstatement of foreign assets and foreign liabilities of the banking sector, as recorded in the monetary statistics, because an offshore bank located in Egypt is erroneously treated as a nonresident entity. The lack of comprehensive and regular financial soundness indicators (FSIs) is problematic, with significant lags in some areas (such as non-performing loans and provisioning). Improvements in this area should be given a high priority given structural changes in the banking system and the importance of greater transparency and higher frequency data underscored by the global financial crisis.

Egypt. Table of Common Indicators Required for Surveillance
(As of February 28, 2010)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality – Methodological soundness[8]	Memo Items: Data Quality – Accuracy and reliability[9]
Exchange Rates	real time	real time	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jan-10	Feb-10	M	M	M		
Reserve/Base Money	Dec-09	Feb-10	M	M	M	O,O,LO,LO	O,O,O,O,O
Broad Money	Dec-09	Feb-10	M	M	M		
Central Bank Balance Sheet	Dec-09	Feb-10	M	M	M		
Consolidated Balance Sheet of the Banking System	Dec-09	Feb-10	M	M	M		
Interest Rates[2]	real time	real time	D	D	D/I		
Consumer Price Index	Jan-10	Feb-10	M	M	M	O,O,O,O	LNO,LNO,LN, LO,LO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4 2009	Feb-10	Q	Q	Q/I	LO,LO,O,O	LO,O,O,O,O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Q4 2009	Feb-10	Q	Q	Q/I		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q3 2009	Feb-10	I	I	A/Q		
External Current Account Balance	Q4 2009	Feb-10	Q	Q	Q	O,LO,LO,LO	LNO,O,O,O,O
Exports and Imports of Goods and Services	Q4 2009	Feb-10	Q	Q	Q		
GDP/GNP	Q3 2009	Nov-09	Q	Q	Q	O,O,O,LO	LO,LO,LO,O, LO
Gross External Debt	Q3 2009	Feb-10	I	I	Q		
International Investment Position [6]	2008	Oct-09	A				

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the data ROSC (published on July 21, 2005, and based on the findings of the mission that took place during October 7-20, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[9] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/49
FOR IMMEDIATE RELEASE
April 14, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with the Arab Republic of Egypt

On March 24, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Egypt.[1]

Background

Egypt made significant progress in wide-ranging structural reforms that accelerated after 2004. This spurred rapid output growth—averaging 7 percent a year during FY2005/06–FY2007/08—underpinned by foreign investment-driven productivity gains and the favorable external environment. Reforms also reduced fiscal, monetary and external vulnerabilities, leaving some room to maneuver on macroeconomic policies in the event of negative shocks.

Egypt weathered the global financial crisis relatively well and financial market pressures eased after the initial outflow. Equity prices plateaued in recent months, after having recovered over half of the losses since the April 2008 peak. Egypt's sovereign spreads tightened during 2009 and, in early 2010, remain well below their pre-Lehman levels. The temporary financial outflow was met mostly with a drawdown in the central bank's foreign currency deposits with commercial banks, reversing the buildup in 2006–07 and limiting the impact on the Egyptian pound and real economy. The authorities allowed some additional nominal exchange rate flexibility, with the pound depreciating by about 6 percent between September 2008 and March 2009, and subsequently appreciating (with resumed capital inflows) almost to its pre-crisis level.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

The real economy held up relatively well in the face of weaker external demand. Although the current account moved into deficit (2.4 percent of GDP in FY2008/09) as service receipts and remittances declined, and investment and activity softened in exposed sectors, growth still reached 4.7 percent in FY2008/09. Resilient domestic consumption demand, and production in the construction, communications, and trade sectors, helped sustain growth and the pick-up to nearly 5 percent in the first half of FY2009/10.

The government reacted quickly to the crisis by providing a sizable fiscal stimulus in the second half of FY2008/09 based mainly on accelerating investment projects. Key fiscal reforms such as introducing the property tax, broadening the Value Added Tax (VAT), and phasing out energy subsidies were postponed. The FY2009/10 budget continues to support economic activity and targets a wider deficit of 8.4 percent of GDP largely reflecting a substantial projected cyclical fall in revenue (particularly from trade and Suez Canal traffic), as well as the impact of wage increases adopted before the crisis and higher post-crisis debt service costs.

Reducing the fiscal deficit and public debt are key medium term objectives. Egypt's public debt remains high in comparison with many other emerging market countries. While much of the debt is denominated in local currency, the maturity structure is short, creating an annual rollover requirement of 20 percent of GDP. To address this vulnerability and help spur private sector-led growth, the government has announced its intention to reduce the deficit to about 3 percent of GDP by FY2014/15.

Supportive monetary policy helped resist crisis-related pressures. The Central Bank of Egypt (CBE) cut policy rates six times between February and September 2009 as both headline and core inflation declined rapidly to single digits by August 2009. The deceleration of inflation stalled since October 2009, with headline inflation rising above 13 percent, mainly due to supply shocks in several food categories. In the absence of demand pressures, the pick-up in headline inflation has not become more widespread, and core inflation remains in single digits and inside the CBE's informal comfort zone. Accordingly, the CBE has kept rates unchanged in the past three Monetary Policy Committee meetings.

The CBE's Phase I banking reforms (2004–08)—strengthened supervision, restructuring and consolidation, and a cleanup of NPLs—reduced financial vulnerabilities. Also, limited reliance on short term wholesale funding channels and relatively traditional portfolios, allowed Egyptian banks to sidestep many of the detrimental effects of the crisis. While the financial system remains stable, the CBE's Phase II reforms (2009–11) seeks to implement Basel II standards and improve access to credit.

Executive Board Assessment

Executive Directors agreed with the thrust of staff's assessment. They commended the authorities' sound macroeconomic management and the reforms implemented since 2004, which had strengthened the resilience of the Egyptian economy in the face of the global financial crisis.

Directors praised the authorities' policy responses to the crisis. The targeted fiscal stimulus and successive cuts in interest rates helped cushion the impact of the global slowdown. Directors observed that economic performance held up well, with growth falling less than in many other emerging markets during 2008/09, and picking up further in recent quarters. Financial market conditions have improved and some capital inflows have resumed since the initial downturn. However, inflation remains elevated despite falling substantially from the peaks experienced in 2008.

As the recovery gains strength, Directors underscored the importance of shifting policies back toward fiscal consolidation and other reforms. They supported the authorities' objective of reducing the fiscal deficit to about 3 percent by 2014/15, in light of the still high public debt and large financing requirement. Directors encouraged the authorities to make a substantive step to reduce the fiscal deficit at an early stage—to lessen vulnerability, boost confidence in the fiscal adjustment strategy, and speed the response of private investment. Increasing the low tax revenue-to-GDP ratio with a full-fledged VAT, and improving the efficiency of public spending by reforming energy subsidies and pensions will be crucial to achieving the authorities' fiscal objectives. Directors saw merit in strengthening public debt management through lengthening debt maturities and diversifying the debt structure.

Directors agreed with recent decisions to keep policy interest rates stable. However, if inflation does not abate as expected, they encouraged the CBE to consider tightening monetary conditions to prevent a buildup of inflationary momentum. They also saw further reductions in inflation toward partner country levels as a key objective for the coming years. Directors noted that continued short-term capital inflows could challenge monetary policy making, and encouraged continued increases in exchange rate flexibility.

Directors agreed that continued broad-based reforms are needed to foster inclusive, employment-generating growth. Priority reforms should focus on improving the investment climate and raising productivity. Developing public-private partnerships can help mobilize private sector financing and know-how, but associated contingent liabilities should be monitored closely. Fiscal adjustment and productivity-enhancing reforms also will reduce the risk of real exchange rate appreciation and help maintain competitiveness. Directors supported ongoing financial sector reforms to help contain risks and improve private sector access to credit. They encouraged forward-looking risk management and in this respect welcomed plans to introduce Basel II standards.

Directors also pointed to the need to enhance data quality and availability to help improve the policy debate and business environment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2010 Article IV Consultation with Egypt is also available.

Arab Republic of Egypt: Selected Economic Indicators 1/

	2005/06	2006/07	2007/08	2008/09 Est.	2009/10 Proj.
Real Sector					
Real GDP growth (annual percentage change)	6.8	7.1	7.2	4.7	5.0
CPI inflation (12-month change, average)	4.2	11.0	11.7	16.2	12.0
Unemployment rate (in percent)	10.9	9.2	8.1	8.8	…
Public Finances					
Real GDP growth (annual percentage change)	-9.2	-7.5	-7.8	-7.0	-8.0
Net public debt (general government, in percent of GDP)	79.8	71.4	61.9	61.8	61.7
Money and Credit					
Broad money growth (annual percentage change)	13.4	18.3	15.5	8.4	18.8
Credit to the private sector (annual percentage change)	8.5	12.3	12.6	5.1	3.8
Interest rates on 91–day treasury bills (period average, in percent)	8.8	8.7	7.0	11.3	...
External sector					
Trade balance (in percent of GDP)	-11.2	-12.4	-14.4	-13.4	-12.5
Current account balance (in percent of GDP)	1.6	1.9	0.5	-2.4	-2.6
Gross official reserves (in US$ billions)	22.8	28.5	34.5	31.2	35.1
(in months of next year imports of goods and services)	5.8	5.3	6.7	5.8	5.8
Gross external debt (in percent of GDP)	27.6	22.9	20.9	16.8	16.9
Exchange rates					
Egyptian pounds per U.S. dollar (period average)	5.75	5.71	5.51	5.53	...
Real effective exchange rate (period average, percentage change)	8.2	4.4	3.5	20.9	...

Sources: Egyptian authorities; and IMF staff estimates.

1/ Egyptian fiscal year ends June 30.

Statement by Shakour Shaalan, Executive Director for Egypt
March 24, 2010

Background

1. Reflecting steady implementation of wide-ranging reforms since 2004, Egypt's economy was well-positioned to withstand the global financial crisis and associated economic downturn. In the years immediately prior to the crisis, macroeconomic reforms were aimed at reducing fiscal and financial vulnerabilities, while far-reaching structural reforms substantially improved the investment climate as highlighted in previous staff reports. Looking forward, the authorities remain firmly committed to continue with fiscal and growth-promoting reforms to strengthen the economy's dynamism, boost productivity, and place the country on a strong footing in the post-crisis global environment.

Recent performance and policy response

2. Crisis-related spillovers to Egypt were mild, particularly when compared with similar countries, demonstrating the financial sector's renewed resilience and the authorities' swift policy responses. Growth declined to 4.7 percent in 2008/09 from an average of 7 percent in the previous three years. The magnitude of this decline, by 2½ percentage points, represented about one half of the impact in comparable countries. Foreign direct investment flows continued albeit at a slower rate, equity markets have rebounded and so far regained about half of their losses, and the bout of capital outflows of late 2008 has since begun to reverse. Egypt's diversified export receipts (tourism, fertilizers, and clothing) were less sensitive to the downturn in global economic activity, as shown in Box 1 of the staff report, reflecting a sound competitive edge. Household demand also remained buoyant, attesting to public confidence in future growth prospects and aided by a sizeable fiscal stimulus and supportive monetary policies. The fiscal stimulus was focused on accelerating investment projects to lay the ground for further private sector activity and postponing some tax measures, notably the VAT. Meanwhile, the Central Bank of Egypt (CBE) reiterated its 100 percent deposit guarantee of local banks, cut overnight rates six times by a over 300 cumulative basis points, and allowed the exchange rate to depreciate by about 6 percent in the six months following the Lehman incident.

Outlook and medium term policies

3. The authorities consider the key medium-term objective is to persist with reforms aimed at solidifying macroeconomic stability while raising productivity and competitiveness of the economy. Fiscal consolidation will continue to aim at strengthening the system's sustainability, controls, and efficiency. In addition to the ongoing fiscal adjustment, the aim is to further develop infrastructure and boost private sector and foreign direct investment to raise employment opportunities. Meanwhile further financial deepening is viewed as key to mobilize savings needed to finance private sector-led growth. The authorities believe that continuation of such policies may allow for a more rapid recovery in potential growth back to around 6 percent, well ahead of 2014 as staff projects in Box II. It could also allow resumption of the upward trend in potential growth that has occurred since the 2004 reforms (from around 3½ percent to around 6 percent within three years).

Fiscal Policy

4. With vigilant monitoring and cautious fiscal management, the budget outcome is expected to remain within the 2009/10 fiscal target of 8.4 percent of GDP, in spite of a substantial drop in tax proceeds**.** As the global recovery takes firm hold, the authorities intend to resume fiscal consolidation measures that were interrupted by the onset of the crisis. For the remainder of this year and in 2010/11, options are being explored such as rationalizing the consumption of subsidized butane, and bolstering tax administration to contain evasion. They remain committed to containing the ratio of gross public debt to GDP, which has so far been held in check to below pre-crisis levels.

5. The authorities' medium-term strategy of reducing the fiscal deficit to 3 percent of GDP aims to maintain investor confidence, preserve macroeconomic stability and create fiscal scope for future counter-cyclical policies. The strategy involves a balanced adjustment, encompassing both revenue and spending measures. On the revenue side, the proposal for replacing the sales tax by a comprehensive VAT is to be submitted to parliament in 2011, and further measures to close loopholes in the income tax legislation are under consideration. On the expenditure side, the reform of fuel subsidies will also be resumed as soon as the crisis has fully abated. Moreover, the cabinet is discussing pension and health care reforms to improve efficiency and sustainability.

Monetary and exchange rate policies

6. The CBE has gradually strengthened the monetary policy framework and enhanced its transparency. During the transition toward an eventual inflation-targeting regime, the central bank meets its inflation objectives by steering the interest rate corridor, keeping in view developments of monetary aggregates, as well as a host of other factors that may influence the underlying rate of inflation. A core inflation index has been used by the central bank to supplement the CPI published by the statistical authorities, and the public launching of the core inflation index in October 2009 was well-received. Monetary policy notes will soon be published to enhance the understanding of CBE's monetary policy decisions and its effectiveness.

7. Headline and core inflation declined in February 2010**.** After peaking at 23.7 percent in August 2008, headline inflation declined to around 9 percent in August 2009, but subsequently rose in October and remained elevated at above 13 percent until January 2010 due to a series of one-off factors. These factors did not spill over to underlying inflation, as core inflation remained subdued at around 7 percent throughout the period. The February 2010 CPI, released on March 10 after issuance of the staff report, dropped to 12.8 percent, while core inflation declined to 6.9 percent. The authorities expect inflation to continue to trend downward during the year, but remain watchful of developments and start ready to adjust policies as needed to keep inflationary expectations in check.

8. The authorities view the current exchange regime as appropriately flexible, taking into account market forces while avoiding disruptive fluctuations due to speculative forces. The exchange rate depreciated by 6 percent in the few months following Lehman Brothers' collapse,

and while it has since recovered, it fluctuates daily in response to market demand. Service and remittance receipts are expected strengthen as the global recovery takes hold, reducing the current account deficit to below the 2½ percent of GDP that emerged in 08/09. As staff rightly points out, there is no evidence of competitiveness concerns and non-oil export performance has been impressive. Once the temporary factors driving headline inflation have abated, price developments are expected to become more aligned with trading partners, reversing the temporary real appreciation, which in any case is relatively small and within the possible margin of error in the calculations.

Financial sector reforms

9. Building on the tangible results observed from Phase I financial sector reforms, the authorities have now embarked on the Phase II agenda to further modernize prudential oversight and facilitate intermediation and increase access to credit. As highlighted in Box V, a comprehensive restructuring has forged a solid foundation for the Egyptian banking system. Nonperforming loans have been significantly resolved, the supervisory framework has been updated, and mandatory reporting of risk and performance is being enforced. A new Law 10/2009 was introduced to regulate the growing non-bank financial markets and instruments and the Egyptian Financial Supervisory Authority was established to oversee the sector. Increased competition among banks in retail banking activity will help improve access to credit, but the authorities are under no illusion that this will be a rapid process. For example, compared to only two banks offering mortgage finance in 2004/05, now 10 companies and 19 banks are offering mortgages, the total value of which remains relatively small at less than 1 percent of GDP.

Other structural reforms

10. The authorities intend to proceed with their broad-based structural reform agenda aimed at attracting FDI, and boosting productivity, employment, and potential growth. Recent improvements in infrastructure, as well as the regulatory framework and access to credit, have propelled FDI from below $1 billion annually pre-2004 to $13 billion in 2007/08 (around 8 percent of GDP). A bill is before congress to launch a Public Private Partnership program, under the auspices of the Ministry of Finance, aiming to attract private resources for infrastructure investment with cautious pricing of risks, and while limiting contingent liabilities.

11. The authorities thank the staff for a valuable and constructive exchange of views, including during the useful presentations on selected issues of current policy relevance. They also wish to express their appreciation for the continued provision of timely and effective technical assistance and look forward to working together to further strengthen the statistical framework.