Selected Economic And Financial Indicators
(June2000- 2005)

The Economy At A Glance

Recent Trends

Recent Economic Development

Status of Recent Economic Legislation

Overview of Selected Recent Economic Legislation

Table 1: Selected Economic and Financial Indicators (June 2000 - 2005)

	Jun-00 [1/]	Jun-01	Jun-02	Jun-03	Jun-04	Sep-04	Dec-04	Mar-05	Jun-05 Estimated
GNP (L.E. Billions)	**356.1**	**373.6**	**393.1**	**430.7**	**502.4**	**NA**	**NA**	**NA**	**576.5**
GDP at Market Prices (L.E. Billions)	**340.1**	**358.7**	**378.9**	**417.5**	**485.0**	**136.5**	**113.3**	**123.6**	**558.0**
Real GDP (% Growth Rate)	**5.9**	**3.4**	**3.2**	**3.1**	**4.2**	**4.8**	**4.7**	**5.2**	**4.9**
Real Per Capita GDP Growth Rate (%)	3.8	1.4	1.1	1.2	2.1	NA	NA	NA	NA
Average Per Capita Income (L.E.)	n.a.	n.a.	5,789	6,395	7,276	NA	NA	NA	7,972
Share of Private Sector in GDP	**70.4**	**70.0**	**73.6**	**72.9**	**71.4**	**63.5**	**63.5**	**60.6**	**71.3**
Fiscal Balance (% GDP)	-3.9	-5.6 [2/]	-10.2	-10.5	-9.5	NA	NA	NA	-10.6
Average Annual Inflation (% Growth Rate)	**2.8**	**2.4**	**2.4**	**7.1**	**9.5**	**NA**	**NA**	**NA**	**NA**
Inflation Rates									
CPI (% Growth Rate yoy)	2.5	2.2	2.7	4.0	11.7	11.9	11.4	5.7 [3/]	NA
WPI (% Growth Rate yoy)	1.8	1.3	3.5	18.0	15.9	15.6	13.9	4.8 [4/]	NA
Exchange Rates									
Official Exchange Rate (L.E / US$)	3.4	3.9	4.5	6.0	6.2	6.2	6.1	5.8	5.8
Parallel Exchange Rate (L.E / US$)	n.a.	4.1	5.1	6.2	6.3	6.3	6.2 [5/]	5.8	5.8
Interest Rate on T-Bills (91 days)	**9.04**	**9.06**	**7.20**	**10.27**	**11.28**	**10.74**	**9.89**	**9.89 [6/]**	**NA**
Broad Money (% Growth Rate yoy)	**8.8**	**11.6**	**15.4**	**16.9**	**13.2**	**12.4**	**14.0**	**14.0 [7/]**	**NA**
Current Account Balance (% GDP), including Official Transfers	**-1.18**	**0.00**	**0.70**	**2.40**	**4.30**	**2.00**	**0.90**	**0.90**	**NA**
Foreign Debt (% GDP)	**28.2**	**28.5**	**33.7**	**42.5**	**38.1**	**32.9**	**34.2**	**31.4**	**NA**
Total Debt (% Exports of G&S)	**156.0**	**141.5**	**171.2**	**157.6**	**127.5**	**NA**	**NA**	**NA**	**NA**
Debt Service (% Current Receipts)	**7.6**	**7.3**	**9.7**	**10.1**	**9.2**	**8.4**	**5.7**	**8.8**	**NA**
Debt Service (% Exports of G&S)	**9.6**	**8.7**	**12.2**	**12.1**	**10.8**	**9.6**	**6.6**	**11.1**	**NA**
Reserves / Months of Imports	**10.2**	**10.4**	**11.6**	**12.0**	**9.7**	**7.9**	**8.3**	**9.7 [8/]**	**NA**
Unemployment Rate (%)	**9.0**	**8.8**	**9.1**	**9.8**	**9.9**	**NA**	**NA**	**NA**	**NA**
Population (% Growth Rate)	**2.12**	**2.13**	**2.00**	**2.00**	**2.00**	**NA**	**NA**	**NA**	**NA**
New Employment Opportunities (Thousands)	**NA**	**NA**	**537**	**550**	**600**	**NA**	**NA**	**NA**	**NA**
Domestic Savings (L.E. Billions)	**44.0**	**48.0**	**51.0**	**59.9**	**78.8**	**NA**	**NA**	**NA**	**92.0**
National Savings (L.E. Billions)	**60.0**	**64.0**	**65.2**	**73.1**	**96.2**	**NA**	**NA**	**NA**	**110.5**

Source: Ministry of Planning, Ministry of Finance, CAPMAS and Central Bank of Egypt

[1/] June 2000 refers to the Fiscal Year July 1999-June 2000

Break in Series [2/] Starting 2001/2002 the budget is presented according to the IMF 2001 GFS Standards, modified to cash principles. (See Appendix C: Recent Economic Developments.), The new classification was adopted by the Egyptian Ministry of Finance by Law 97/2005.

[3/] In May 2005 the CPI growth rate was 5.0 percent

[4/] In May 2005 the WPI growth rate was 4.2 percent

[5/] The parallel market disappeared in 2005

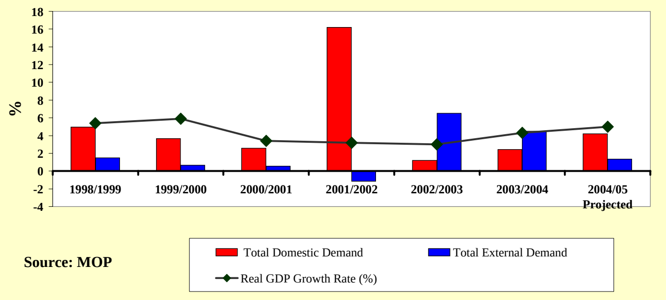
[6/] In April 2005 the interest on T-Bills (91 days) was 10.2 %

[7/] In May 2005 broad money grew at 13.4 percent

[8/] In May 2005 reserves covered 9.9 months of imports

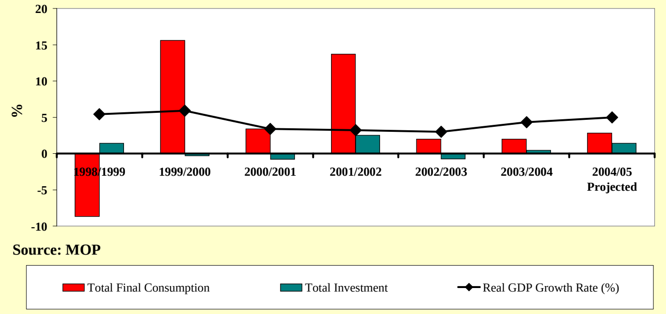
THE ECONOMY AT A GLANCE

Figure 1: Percent Contribution of Total Domestic and Total External Demand to GDP Growth (1998/1999-2004/2005)



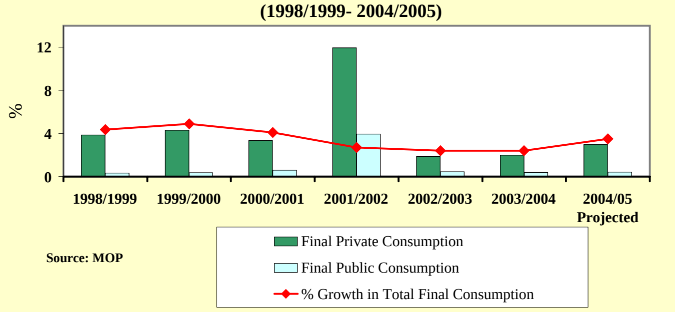
After a slowdown at the beginning of the millennium, the economy has started to recover. Economic growth was 5 percent in real terms in June 2005. The improvement was primarily driven by a marked increase in the contribution of domestic demand to GDP growth. As projected in the previous issues of the Monitor, domestic demand gathered speed in 2004/2005 as a spill-over of the external impulse of last year. Growth in in 2003/2004 had for the most part been propelled by export revenues, increased receipts from the Suez Canal and resurgent tourism. While a possible deceleration in global growth coupled with the recent appreciation of the pound could dampen growth in merchandize exports, there should be no significant impact on either tourism or the Suez Canal receipts.

Figure 2: Percent Contribution of Total Investment and Total Final Consumption to GDP Growth (1998/1999-2004/2005)



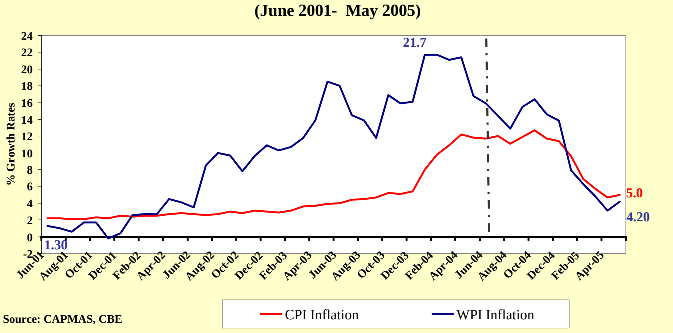
Consumption growth led domestic demand in 2004/2005. Investment demand also continued to grow at a faster pace over last year. Both consumption and investment levels are still below their levels in 2001/2002

Figure 3: Percent Contribution of Public and Private Consumption Demand to Total Consumption Demand (1998/1999- 2004/2005)



The recovery in consumption demand in 2003/2004 and 2004/2005 owed mainly to a stronger private sector as the contribution of public sector consumption to total consumption and GDP growth weakened.

Figure 4: Percent Changes in the CPI and WPI (June 2001- May 2005)



Domestic prices continue their strong recovery. Both CPI and WPI inflation have subsided as the exchange rate pass-through subsequently worked itself out. CPI inflation was 5 percent in May 2005 compared to 11.8 percent in May 2004, and a record high of 12.7 percent in October 2004.

" Series Break. Starting July 2004, CPI data were based on the weights derived from the 1999/2000 income and expenditure survey, and using 1999/2000 as a base year. Prior to this date, the basket as well the weights were derived from the 1995/96 income and expenditure survey which used 1995/96 as a base year.

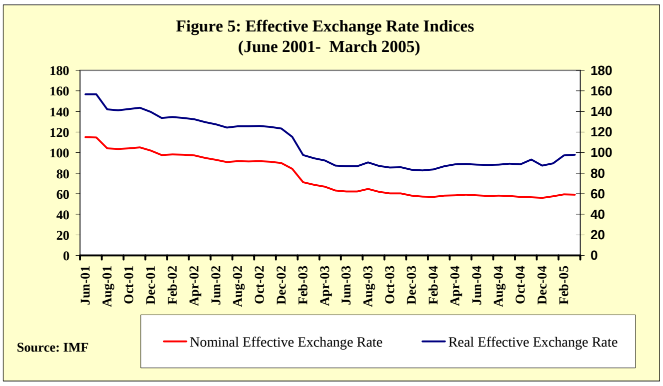


Figure 5: Effective Exchange Rate Indices (June 2001- March 2005)

Following the stabilization of the pound and the convergence of the official and parallel market rates in December 2004, both the nominal and real effective exchange rates continue their downward trend, (albeit at a smaller pace during the third quarter of the current fiscal year), reflecting a real depreciation of the pound, and increased competitiveness.

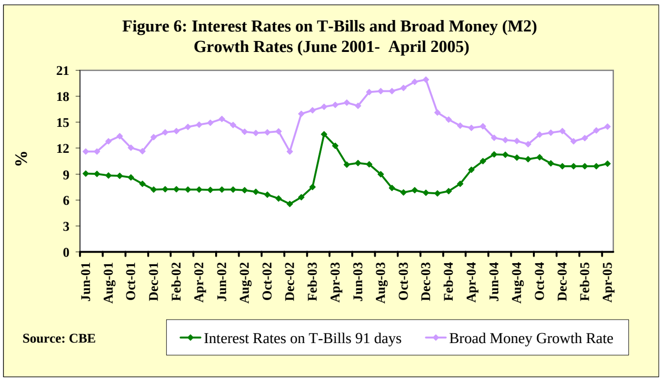


Figure 6: Interest Rates on T-Bills and Broad Money (M2) Growth Rates (June 2001- April 2005)

Interest rates are falling as the foreign exchange market stabilizes.

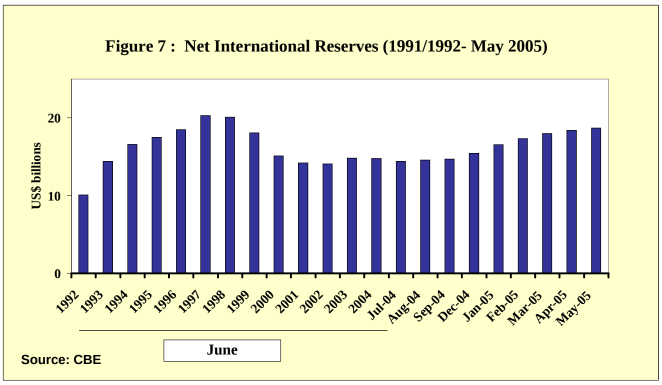


Figure 7 : Net International Reserves (1991/1992- May 2005)

The CBE continues to build its net international reserves (NIR), which are gradually approaching their late 1990's levels. The robust NIR position owes to a strong current account and to the real depreciation of the pound that served to increase the competitiveness of Egypt's exports of goods and services.

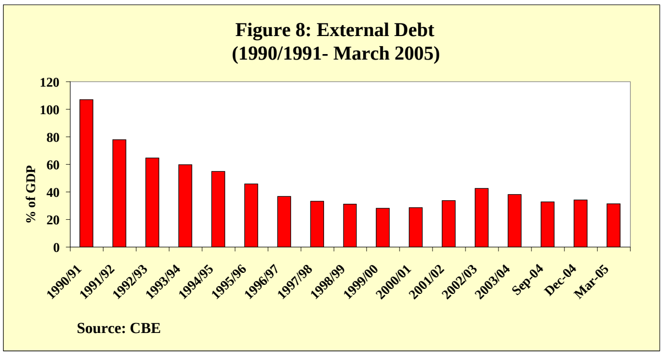


Figure 8: External Debt (1990/1991- March 2005)

Egypt's external debt position continues to be strong.

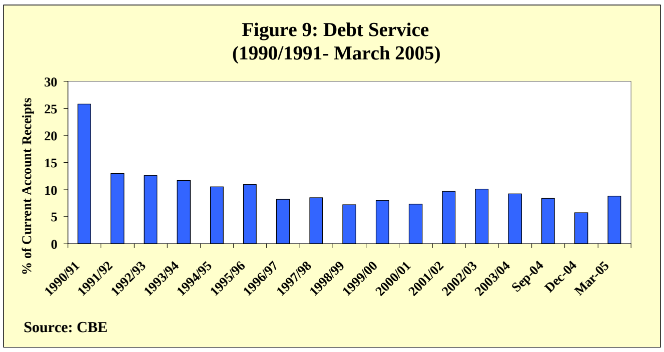
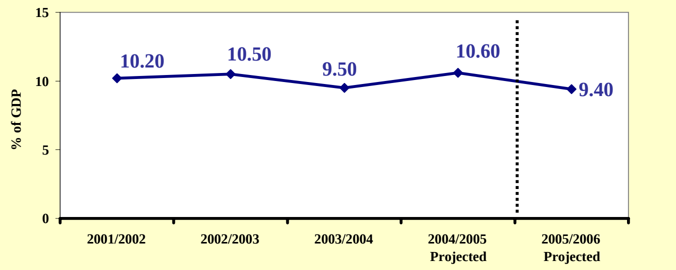


Figure 9: Debt Service (1990/1991- March 2005)

External debt service continues to be low.

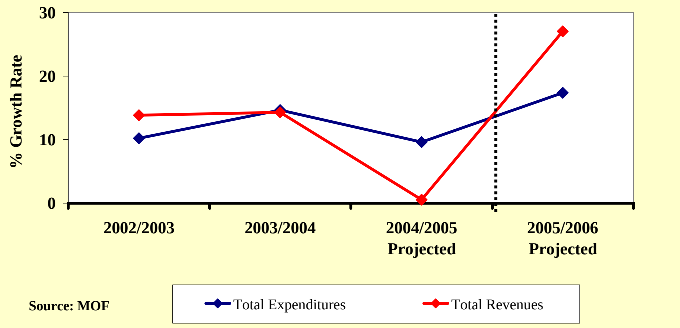
Figure 10: Budget Sector Deficit (2001 GFS Standards) (2001/2002- 2005/2006)



Source: MOF

In 2004/2005 the budget deficit is expected to reach 10.6 percent of GDP, according to the new IMF 2001 GFS standards. (See Annex C: Recent Developments.) The budget deficit is projected to decline by more than one percentage point during the next fiscal year.

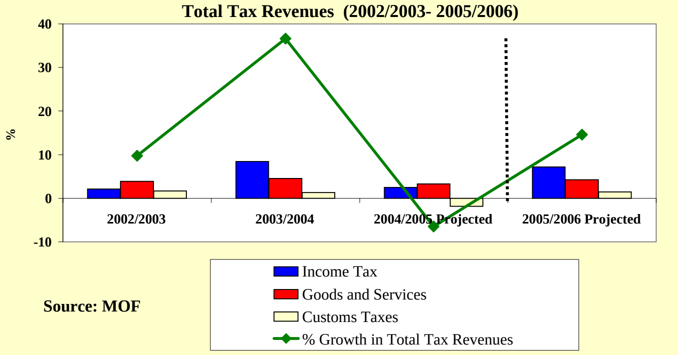
Figure 11: Total Expenditures and Total Revenues (2002/2003-2005/2006)



Source: MOF

In 2004/2005 growth in both revenues and expenditures decelerated, with revenues declining at a faster pace. As tax and customs reforms take their toll in 2005/2006, total revenues should increase at a faster pace.

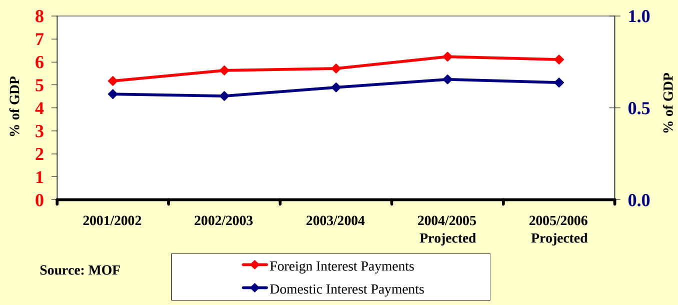
Figure 12: The Contribution of Income Tax, Sales Tax and Customs Duties to the Growth of Total Tax Revenues (2002/2003- 2005/2006)



Source: MOF

According to the new GFS budget, total tax revenues fell by 6.5 percent in 2004/2005. This was in large part due to a 14.2 percent drop in customs duties following the recent tariff reductions. Income and sales taxes also grew at slower rates compared to previous years. As tax and trade reforms take their toll, total tax revenues should increase by 14.6 percent during 2005/2006. Income and sales tax receipts are expected to drive this growth. Nevertheless, customs proceeds should pick up by a good 15 percent next year.

Figure 13: Domestic and Foreign Interest Payments (2001/2002-2004/2005)



Source: MOF

The rise in domestic interest payments reflects increased reliance on non-inflationary financing of the budget. Fiscal consolidation during 2005/2006 is expected to contain the growth in domestic interest payments.

The Budget is presented according to the IMF 2001 GFS Standards, modified to cash principles. (See Appendix C: Recent Economic Developments.), The new classification was adopted by the Egyptian Ministry of Finance by Law 97/2005.

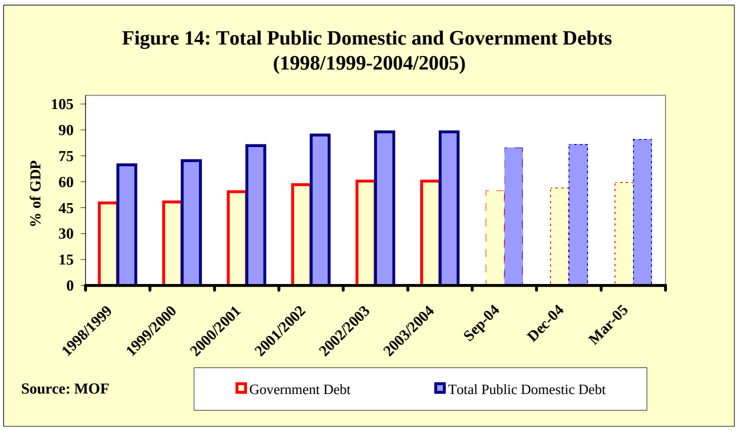


Figure 14: Total Public Domestic and Government Debts (1998/1999-2004/2005)

March 2005 debts calculated as a percent of GDP projected for June 2005 (LE 558.0 billion)

With more reliance on non-inflationary financing since 1999/2000, government and total public debts have increased.

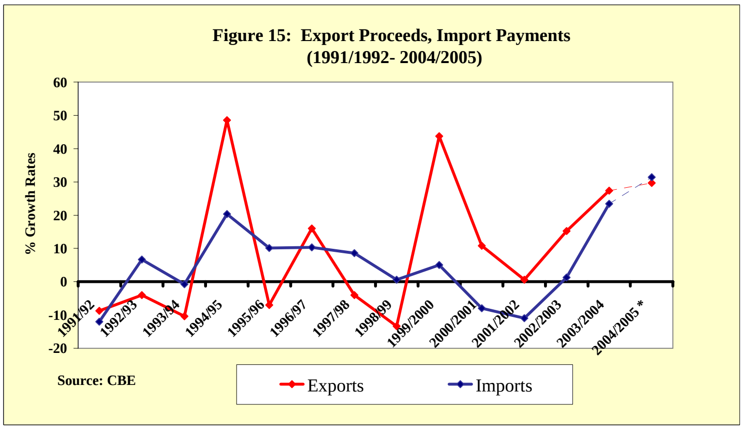


Figure 15: Export Proceeds, Import Payments (1991/1992- 2004/2005)

* July- March 2005 over July - March 2004

As dicussed in Figure II.1, domestic demand in 2004/2005 gathered speed as a spill-over of the external impulse of last year. Higher investment demand associated with the recovery in economic growth rates, lower customs duties and a strong current account surplus is reflected in a rise in the growth rate of imports in 2005. Exports growth is showing mild signs of deceleration.

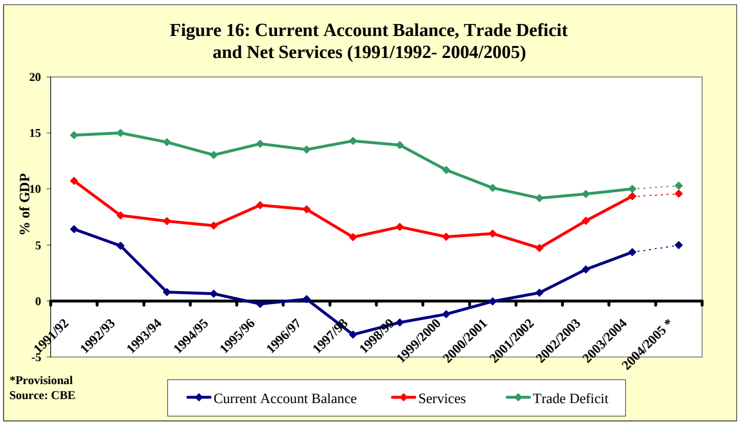


Figure 16: Current Account Balance, Trade Deficit and Net Services (1991/1992- 2004/2005)

* July- March 2005

The rise in the current account surplus during the past four years has been driven by a significant improvement in the services balance. The fall in the value of the Egyptian pound has made Egypt an attractive tourist destination.

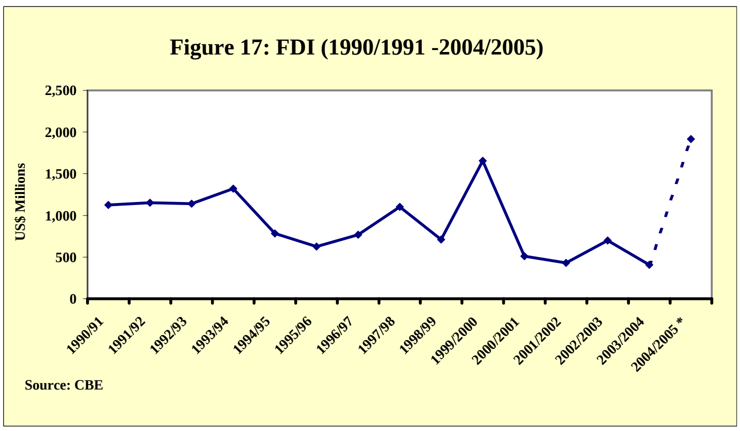
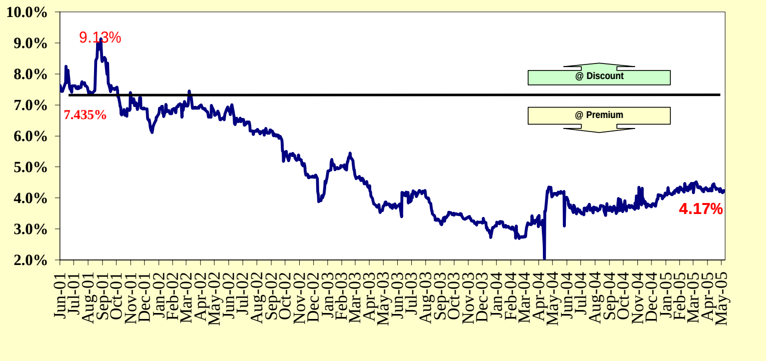


Figure 17: FDI (1990/1991 -2004/2005)

* July- March 2005

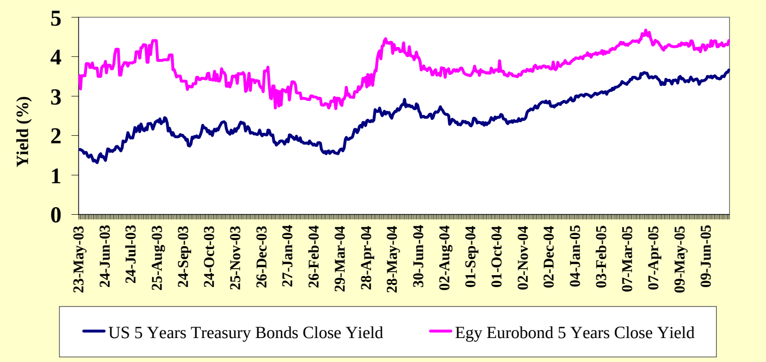
The recent policy initiatives in the areas of trade reform, taxation and privatization have served to inrease FDI flows to Egypt.

Figure 18: Yield to Maturity on the 2006 Egyptian Eurobond (June 2001-May 2005)



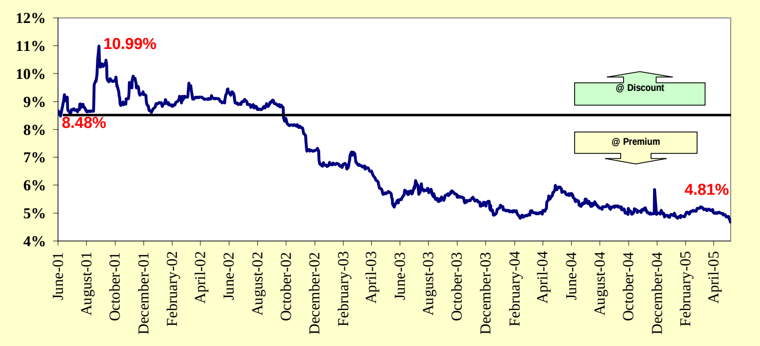
The YTM on the 2006 issue increased from 4.1 percent in May 2004 to 4.4 percent in May 2005. Over the same period, and as the 2006 bond approaches its maturity, the price of the bond fell from US$107 to US$104, approaching its par value.

Figure 19: Difference between Yield to Maturity of the 2006 Eurobonds and Comparable Treasury bonds (May 2003- June 2005)

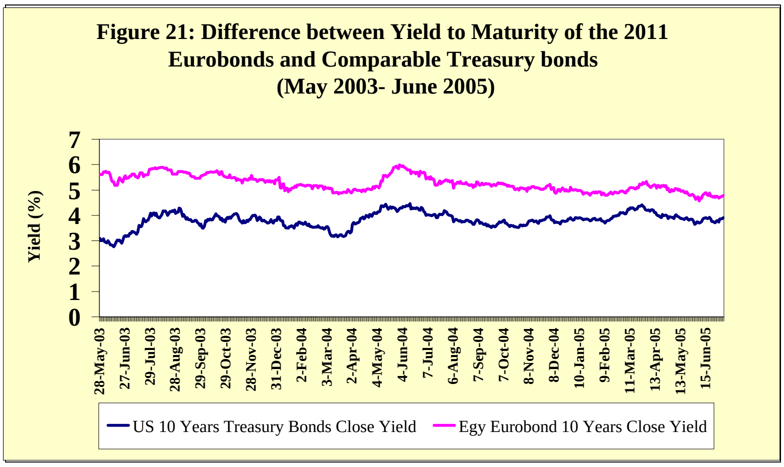


Over the same period, the YTM on the 5-year US Government bond has been relatively unchanged.

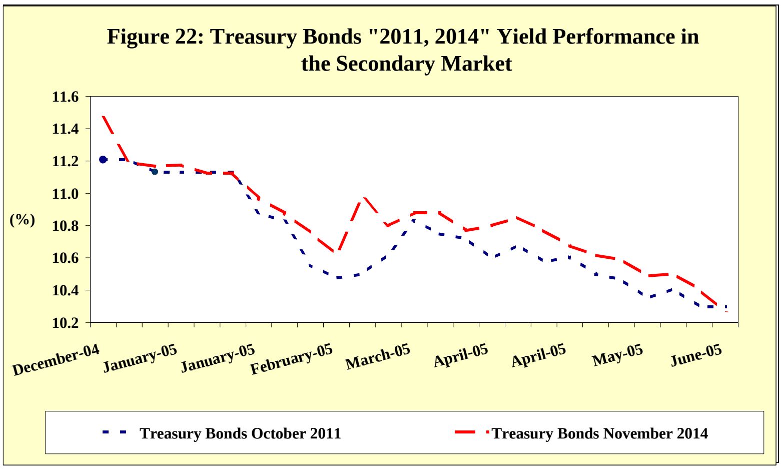
Figure 20: Yield to Maturity of the 2011 Egyptian Eurobond (June 2001- April 2005)



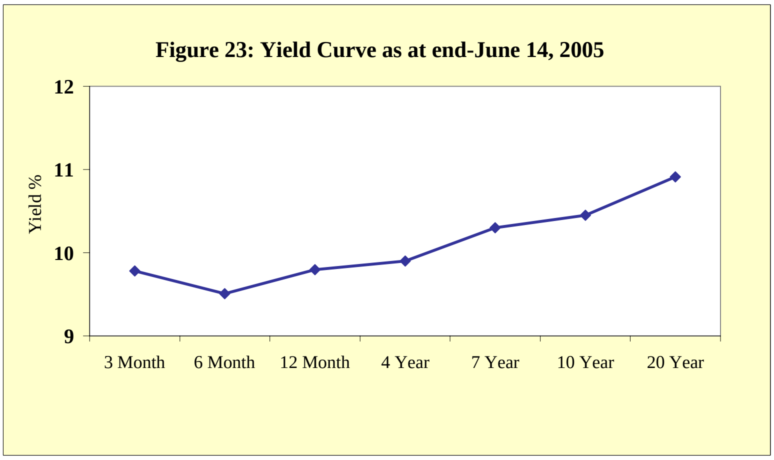
The YTM on the 2011 issue fell from 5.84 percent to 4.81 percent during the same period. At the same time, the price of the bond rose from US$116.8 to US$ 120.63. On the other hand, the YTM on the 10-year US Gvernment bond dropped from 4.66 percent to 3.99 percent



The spread over US Treasury for the 2011 bond issue tightened to 82 basis points in May 2005 compared 180 basis points last year.

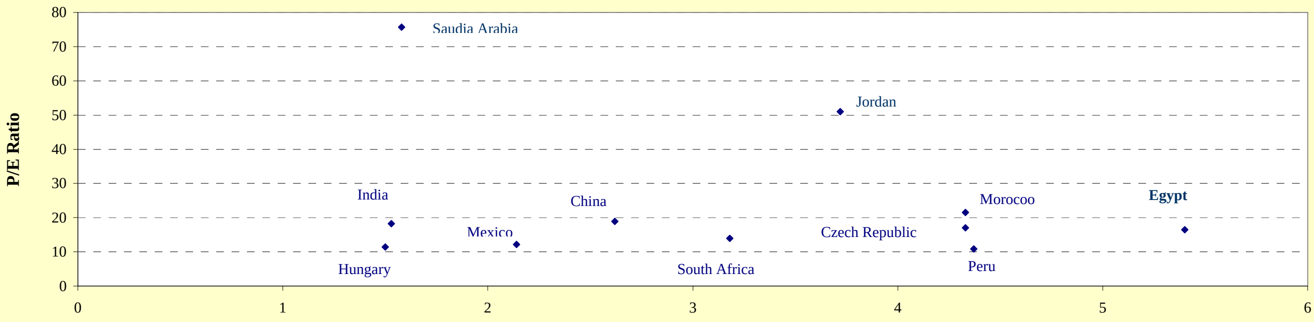


Due to the fall in domestic inflation rates, the yield on government bonds has been steadily softening.



Our regular issuances of government bonds have helped create an upward sloping yield curve.

Figure 24:Comparing Valuations of the S&P/IFCG Indices P/E Ratio vs. Dividend Yield (DY) (as at end May 2005)



Source: S&P/IFC

Table 2: Egypt vs. Emerging Markets: S&P/IFCG Price Index Performance Summary (US$)

Rank	**Emerging Markets**	**1-Month (Apr 05 - May 05) %Change**	**YTD (Jan 05 - May 05) %Change**
1	Argentina	11.9	17.1
2	Oman	9.4	42.8
3	Turkey	9.2	(0.5)
4	India	8.2	0.2
5	Mexico	7.3	2.3
6	Brazil	6.9	5.6
7	Saudi Arabia	6.1	49.2
8	Indonesia	5.8	7.2
9	Israel	5.2	6.6
10	Korea	5.2	10.6
11	Sir Lanka	4.6	37.9
12	Philippines	3.8	11.3
13	Taiwan	3.8	(0.1)
14	**Egypt**	**3.5**	**79.2**
15	Poland	2.1	(10.7)
16	Morocco	1.1	(5.0)
17	Russia	0.9	2.0
18	Chile	0.8	(0.7)
19	Nigeria	(1.2)	(7.5)
20	Thailand	(1.5)	(5.3)
21	Bahrain	(1.6)	15.0
22	Czech Republic	(1.6)	4.4
23	Peru	(2.1)	0.9
24	Hungary	(2.3)	1.6
25	Colombia	(2.6)	14.7
26	Malaysia	(2.8)	(7.3)
27	South Africa	(3.1)	(12.5)
28	China	(3.3)	(6.3)
29	Jordon	(3.3)	64.7
30	Venezuela	(4.2)	(18.1)
31	Pakistan	(5.3)	8.5
32	Zimbabwe	(40.4)	78.0

Source: S&P / IFC

OVERVIEW OF THE ECONOMY

RECENT TRENDS

The solid economic recovery in 2003/2004 has pursued its course into 2004/2005

The Egyptian economy has established a good track record in terms of macroeconomic stability over the past fifteen years. In contrast, growth performance was less even, averaging some 3.2 percent between 2000/2001 and 2002/2003, the lowest growth rate in more than a decade. The slowdown was due to a series of external economic shocks at the beginning of the millennium: the fallout of September 11, oil price shocks, the bursting of the equity price bubble, the abrupt slowdown of world trade in 2001, and regional conflict.

Economic activity recently witnessed a turnaround however, accelerating to 4.3 percent in real terms in 2003/2004 and to 5 percent in 2004/2005. Economic growth is expected to maintain a faster pace during the course of 2005/2006, in response to bold trade and tax reforms.

The recovery in 2004 was led by external demand

Most of the growth momentum between 2003 and 2004 was derived from the external sector. (Figure 1) During these two years, the contribution of external demand to GDP growth was consistently driven by export revenues, increased receipts from the Suez Canal, resurgent tourism, and improved confidence. During the same period, the contribution of domestic demand to economic growth grew more timidly (Figure 1) as a result of sluggish private consumption and uneven capital formation. (Figure 2)

However growth in 2005 was mostly driven by domestic demand, specifically consumption demand

The recent slump in world trade slightly dampened the growth in external demand and its contribution to GDP growth during 2004/2005. Economic growth was however underpinned by an upturn in domestic demand (Figure 1), particularly consumption demand, which gathered speed sharply as a spill-over of the external impulse of the past years. (Figure 2)

Because the Egyptian economy is still in the early stages of recovery, consumption demand will continue to drive economic growth in 2005/2006, in response to stronger economic activity and increases in disposable income following recent trade and fiscal reform initiatives[Error! Bookmark not defined.]. (Figure 2)

Meanwhile, investment demand is showing signs of recovery, albeit at a slower pace than consumption demand. (Figure 2) The stronger the contribution of consumption demand to growth, the more likely it will trigger strong secondary effects on investment consumption. Thus as capital formation increases in response to economic policies that target domestic demand and economic growth, capital formation will become more even.

While external demand has played a crucial role in bolstering the economy during the past two years, it is the strength of growth in domestic demand, particularly investment demand that will essentially determine the resilience of economic growth in the medium term. This should help reduce concerns about external vulnerability.

Towards this end, the Government implemented significant tariff reductions in September 2004, followed by a second round of cuts in

December. Other measures include customs reforms; a new tax code (passed in June 2005) that reduces personal and corporate taxes by 50 percent; and ongoing efforts to modernize Egypt's budget classification[1], treasury cash management and tax administration.

The macro-economy will be more favorable to private sector led growth in 2005. As a result, private sector growth will dominate the uptake in consumption demand

Although private sector growth was negatively affected by the economic slowdown during the early years of the millennium, the acceleration of consumption demand in 2003/2004 (which has carried into 2004/2005) owed mainly to a stronger private sector, as public sector consumption weakened. In real terms, total consumption is almost exclusively driven by private consumption demand. (Figure 3)

In the meantime, inflation rates are still falling ...

Inflation rates have maintained a single digit rate for the fifth month since January 2005. CPI inflation continued to slide, reaching 5 percent in May, compared to 11.8 percent in May of last year.

Following the flotation of the Egyptian pound at end-January 2003, the CPI growth rate had increased steadily to reach 8 percent in January 2004. By April 2004 CPI growth rates had spiraled to 12.2 percent. The recent drop in the inflation rate suggests that the exchange rate pass-through is working itself out. This is more evident in the case of wholesale prices whose growth rates were slashed from a high of 16.8 percent in May 2004 to 4.2 percent May 2005.(Figure 4)

In addition, ongoing monetary policy reforms—including steps towards anchoring inflation expectations— will enable the Central Bank to deal with inflationary pressures more efficiently.

as the pound stabilizes ...

Following the stabilization of the pound and the convergence of the official and parallel market rates in December 2004, both the nominal and real effective exchange rates continue their downward trend, (albeit at a smaller pace during the third quarter of the current fiscal year), reflecting a real depreciation of the pound, and increased competitiveness. (Table 1; Figure 5)

in response to a number of factors. Two key ingredients were:

the establishment of an interbank market

The stability of the foreign exchange market was aided by the establishment of a formal well functioning interbank market for foreign exchange. This helped create a very liquid foreign exchange market. In addition, confidence in the economy has spurred substantial foreign inflows that supported a large current account surplus. (Figure 16)

and the elimination of surrender requirements

The Prime Minister issued Decree No. 2059/2004 rescinding Decree No. 506/2003 that required exporters to surrender 75 percent of their foreign exchange proceeds. This step helped enhance the liquidity of the market because it gave confidence to the international community that Egypt will pursue sound economic policies that preclude the need to use such a restriction.

Egypt's external debt position continues to be strong

Total external debt, as a percent of GDP, dropped from 43 percent in 2002/2003 to 31 percent in March 2005. External debt service also fell

[1] See Appendix C: Recent Economic Developments

from 10.1 percent to 8.8 percent over the same period.

The fiscal deficit has recently increased but is under control

The projected budget deficit of 10.6 percent for 2004/2005 — according to the new GFS budget standards[2] — is in large part due to a sharp decline in customs receipts following the September 2004 tariff cuts. (Figure 10) By end-June 2005, customs proceeds should reach LE 7.3 billion, which represents only 62.7 percent of the projected LE 12.6 billion for the year. [Table I.2.1.] The budget deficit is projected to decline by more than one percentage point during the next fiscal year as the economy picks up and the taxable base widens. The contribution of income and sales taxes and customs proceeds to total revenues GDP growth should witness significant increases. (Figure 12)

Thus after a period of sluggish growth, revenue growth is expected to outpace expenditure growth in 2005/2006

After a period of sluggish growth (and almost no growth in 2004/2005), revenues growth is expected to outpace expenditure growth in 2005/2006. (Figure 11) The upsurge in tax revenues next year is explained by two factors: First, under the new budget classification, petroleum subsidies are for the first time treated as explicit budget lines, and are thus also reflected as in the revenue lines. Second, the effects of tax transformation, which should gradually increase FDI flows, manufacturing exports and manufacturing value added[3].

Income and sales tax receipts are expected to drive the growth in tax revenues. While the contribution of customs revenues to GDP growth and total tax revenues will be relatively smaller, customs proceeds should pick up by 15 percent compared to a 14.2 percent drop in 2004/2005.

Public and government debts have slightly increased

With more reliance on non-inflationary financing since 1999/2000, government and total public debts have increased. As a percent of GDP, government debt was some 60 percent of GDP in June 2004 compared to 58 percent in June 2002. During the same period, total public debt was 91.7 percent of GDP compared to 87.1 percent. (Figure 14)

Furthermore, as the expected economic recovery takes hold and growth rates strengthen domestic debt ratios will go down. Egypt's debt dynamics will benefit from expected strong nominal GDP growth, negative real interest rates, the resumption of privatization; and the stabilization of the exchange rate. Furthermore, better tax compliance under the new simplified tax system could help improve the fiscal position and public indebtedness.[4]

The improvement in the competitiveness of the Egyptian economy will be further spurred by recent trade reforms

Exports growth rates have been on an upward trend since 2001/2002. (Figure 15) The competitiveness of Egypt's exports was prompted by the devaluation of the pound in 2003.

As discussed earlier, indications for 2004/2005 are that real external demand is showing signs of waning. (Figure 1) In nominal terms, exports have increased by 29.7 percent during the first three quarters of 2004/2005 compared to 27.4 and 15.2 percent during the corresponding quarters of 2003/2004 and 2002/2003 respectively. The expected deceleration in global growth, the continued rise in oil prices, and the

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[2] IMF 2001 GFS Classification. See Appendix C: Recent Economic Developments.

[3] UNCTAD (United Nations Conference on Trade and Development. April 2005. Note on Country Experiences with Tax Harmonization.

[4] Fitch Ratings. January 2005. Arab Republic of Egypt: International Credit Update.

recent appreciation of the pound could, slightly dampen the demand for merchandize exports. Ongoing trade and fiscal reforms are however expected to stimulate export-oriented growth.

while the current account surplus continues

Higher investment demand associated with the September 2004 reduction in tariffs and the recent recovery in economic growth rates was reflected in a rise in imports (31 percent in 2004/2005 compared to 23 percent last year). The rise in the current account surplus during the past four years has been driven by a significant improvement in the services balance. The fall in the value of the Egyptian pound has made Egypt an attractive tourist destination. (Figures 15&16)

The robust growth in imports could increase pressures on the trade deficit. However the services surplus should remain unaffected (the appreciation of the pound should not have a significant impact on either tourism or the Suez Canal receipts), and should more than make up for any pressures on the trade balance. Thus the current account remains in surplus, standing at 4.9 percent during the 2004/2005 compared to 4.4 percent last year. (Figure 16)

Turning to the stock market, the trend throughout the year has been bullish

Thus as 2005 began, the foundations for a sustained economic expansion were already in place. In response, a positive market sentiment has prevailed, pushing the stock market up. The bullish performance was driven by the continued improvement in the external accounts.

The upturn in equity prices forestalls a business recovery in anticipation of the imminent upturn in activity and profits. It should also help to hold down the cost of capital and support increased investment and growth.

Optimism and restored confidence in the economy has helped the CBE build up its NIRs ...

The CBE continues to build its net international reserves (NIR). NIRs reached US$ 18.7 billion in May 2005 compared to US$14.8 billion last year. (Figure 7) The CBE's robust NIR position owes to a strong current account and to the real depreciation of the pound that served to increase the competitiveness of Egypt's exports of goods and services.

and suggest that there is significant scope in attracting FDI to Egypt

The recent policy initiatives in the areas of trade reform, taxation and revived privatization have been directed towards realizing Egypt's potential in attracting FDI. Privatization will extend to the banking sector as part of a broader financial sector restructuring plan. Recent leadership changes in the General Authority for Investment (GAFI) also bode well for foreign direct investment (FDI). GAFI is intent on improving conditions for existing investors in order to attract new inflows. In addition, new optimism should reverse the downward trend of the past years. In the first three quarters of 2004/2005 FDI reached US$1.9 billion compared to US$407 million last year. (Figure 17)

RECENT ECONOMIC DEVELOPMENTS

1. Constitutional Reform

Parliament recently approved the amendment of article 76 of the Constitution to allow for direct, multi-candidate elections for the first time in Egypt's history. A committee to oversee the elections would be formed.

Under the old system that was abolished Parliament selected a candidate whose name was then submitted for a general yes/no referendum.

2. Improving Budget Classification

Law 97/2005 enacted the budget for 2005/2006 according to the IMF 2001 GFS (Government Finance Statistics) classification. The new system, which is consistent with international standards, will ensure more consistent reporting during the year. Under the new system the budget will in the medium term be guided by macroeconomic and financial objectives and constraints.

Under the new standard, which re-classified many budget lines, indirect petroleum subsidies are explicitly treated as budget lines. (This applies only to the 2005/2006 budget which makes the year incomparable to previous series.) The adoption of the new classification distinguishes between the economic, administrative and functional classification. There is a clear distinction between revenues, expenditures and financing transactions, as well as between transfers and exchange transactions. The fiscal policy stance is monitored on the basis of the cash/surplus deficit and the overall fiscal balance.

3. Automated Government Expenditure System (AGES)

The preparation of the budget is now fully automated according to the GFS classification. Budget implementation is currently being automated and will be become fully automated in 2005. The Ministry of Finance is in the process of implementing an Integrated Automation project (MOFIA) which includes and Automated Government Expenditure system (AGES). The MOFIS and AGES projects should eventually be subsumed within the framework of a Government Financial Management Information System (GFMIS), covering all ministries, service authorities, governorates and districts.

4. Public Expenditure Review (PER)

Moving forward with the decentralization of public expenditure and revenue mobilization, Egypt started in July 2004 to undertake a PER in four sectors namely: education, health, water and transport. The PER is closely related to work being undertaken to improve the budget classifications, budget execution, accounting and reporting, banking and payment arrangements, and the legal framework for budgeting.

Work in the PER is also closely related to the ongoing work on performance based budgeting (PBB). This involves pilot projects in education and health. The view is to establish a framework for developing performance management and budgeting within these sectors, and piloting the development of indicators and other performance data in selected entities.

5. Monetary Policy

5.1 Monetary Policy Committee (MPC)

To strengthen the monetary policy framework, the CBE is working to develop a cohesive and credible monetary policy framework that effectively anchors inflation expectations in the context of a flexible exchange rate that relies on a proactive interest rate policy.

The new framework for implementing monetary policy depends on steering the overnight inter-bank rate as operational target. The CBE provides two standing facilities (an overnight lending facility and an overnight deposit facility) as its main policy instruments. The rates of these instruments are the outer bounds of a corridor within which the overnight inter-bank rate fluctuates. The CBE continues to manage market liquidity through its open market operations.

The Monetary Policy Committee of the Central Bank convenes on the first Thursday of each month for the purpose of deciding on its policy rates and issues a communiqué immediately following its meetings. The first communiqué was issued on June 5 2005.

5.1.1 Monetary Policy Stance

The CBE adopted a non-expansionary monetary policy that was reflected in higher inter-bank interest rates (from about 6 percent at the beginning of 2004 to about 12 percent at the beginning of 2005). This non-expansionary monetary policy contributed to the containment of inflationary pressures.

In line with the reduction of the inflationary pressures, the monetary policy committee decided to set its key interest rates, the overnight deposit rate and the overnight lending rate, at 9.5 percent and 12.5 percent, respectively.

Box 1: Monetary Policy Statement

June 2, 2005

Monetary Policy Objective

Law no. 88 of 2003 of the “Central Bank, Banking Sector and Monetary System” entrusts the Central Bank of Egypt (CBE) with the formulation and implementation of monetary policy, with price stability being the primary and overriding objective. The CBE is committed to achieving, over the medium term, low rates of inflation which it believes are essential for maintaining confidence and for sustaining high rates of investment and economic growth. The Government’s endorsement of the objective of price stability and its commitment to fiscal consolidation is quite important for achieving this objective.

Monetary Policy Framework

The CBE intends to put in place a formal inflation targeting framework to anchor monetary policy once the fundamental prerequisites are met. This will further enhance the predictability and transparency of the monetary policy in Egypt. In the transition period, the CBE will meet its inflation objectives by steering short term interest rates, keeping in view the developments in credit and money supply, as well as a host of other factors which may influence the underlying rate of inflation. The CBE strongly believes that real negative interest rates are inconsistent with the ongoing effort to reduce inflation rates. The continued reduction of the inflation rates that Egypt has witnessed in recent months is important in order to guide long-tem inflation expectations.

Monetary Policy Implementation

Monetary policy decisions are taken by the CBE’s Monetary Policy Committee (MPC) which has nine members comprising of the Governor of the CBE, the two Deputy Governors, and six members of the Board of Directors. Decisions are implemented through a set of policy instruments and procedures. The CBE will use two standing facilities (an overnight lending facility and an overnight deposit facility) as its main policy instruments, providing the outer bounds of a corridor within which the overnight inter-bank rate will fluctuate. The CBE will continue to manage market liquidity through its open market operations.

Monetary Policy Decisions

The MPC will normally convene on the first Thursday of each month for the purpose of deciding on its policy rates and will issue a communiqué immediately following its meetings. Should a Thursday fall on a public holiday, the MPC will meet on the following business day.

5.1.2 Transparency

By the end of January 2005, Egypt subscribed to the IMF's special data dissemination standards (SDDS), and CBE publishes its data on the IMF's Dissemination Standards Bulletin Board (DSBB).

On January 31, 2005 Egypt subscribed to the IMF's Special Data Dissemination Standard (SDDS). The CBE now publishes its data on the IMF's Dissemination Standards Bulletin Board (DSBB).

This not only represents a major step for Egypt's official statistics and for its data users, but it also represents the July 2004 Cabinet's strong commitment to transparency and to implementing international best practices in statistics. These practices include the dissemination of timely and comprehensive statistics, thereby contributing to the pursuit of sound macroeconomic policies and the improved functioning of financial markets.

Data provided by countries according to this standard are made publicly available on the IMF's Dissemination Standards Bulletin Board (DSBB). The DSBB now provides comprehensive documentation in English on Egypt's statistical practices for SDDS data categories, hyperlinked to actual country data included in the Mandatory National Summary Page maintained by the Ministry of Planning[1].

The SDDS was established by the IMF in 1996. It is intended to guide member countries in their provision of their economic and financial data to the public. The SDDS identifies four dimensions of data dissemination:

- Data: coverage, periodicity and timeliness.
- Access by the public.
- The integrity of the disseminated data.
- The quality of the disseminated data.

5.2 Banking Sector Reforms

The CBE is undertaking a major banking sector restructuring program that aims at strengthening the banking sector and increasing its robustness. A strong banking sector would be able to face global and regional competition effectively and help achieve the targeted economic growth. The banking reform unit within the Central Bank of Egypt (BRU) has put forward a plan that entails addresses four main issues; (i) mergers, privatizations and weak banks; (ii) non-performing loans; (iii) financial and managerial restructuring of state-owned banks; and (iv) upgrading the CBE’s banking supervision capabilities.

The implementation of the plan commenced in September of 2004. Achievements to date include:

5.2.1 Mergers and Privatization to Address the Problem Banks

- The board of directors of the central bank of Egypt has approved and effected the implementation of Article 41 of Law 88/2003 (Central Bank and Banking Sector Law) which deals with the procedures and regulations of voluntary mergers among banks.
- The CBE has approved the acquisition of a 100% stake of the paid-in-capital of Misr America International Bank (MAIB) by Arab African International Bank. In addition, other decisions were made allowing the merger procedures to commence for:
    - Mohandess Bank in National Bank of Egypt.
    - Egyptian Arab Land Bank in Housing and Development Bank.
- Privatization procedures of Bank of Alexandria are in the pipeline. Specialized international audit and legal firms have been selected to carry out banks’ financial due diligence (expected

[1] See IMF website: http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=EGY

to be completed by June 2005). Preparation of 'Request for Proposal' documents has already begun.

- The merger of Credit Agricole Indosuez –Egypt and Credit Lyonnais branch in Egypt has taken place resulting in the creation of a new entity (Calyon-Egypt). In addition, the Egyptian American Bank has completed the financial and legal due diligence on American Express branches in Egypt in preparation for the prospective merger between the two entities.
- Commencement of the financial and legal due diligence for Nile Bank to assess the bank's current financial position.
- The National Bank of Egypt (NBE) has divested its stake in National Societe Generale Bank (NSGB) selling it to Societe Generale Bank (France). In addition, a number of steps have been taken in an effort to promote the selling of Banque Misr's stake in Misr International Bank (MIBank) to a strategic investor. Finally, the sale documents for the National Bank of Egypt's (NBE) stake in Commercial International Bank (CIB) have been prepared.

5.2.2 Restructuring and Risk Management of Public Sector Banks

- A detailed restructure plan has been prepared by the Banking Reform Unit (BRU), and approved by the World Bank. The plan was presented to state-owned banks in January 2005.
- The plan is designed in two phases. Phase 1 focuses on appointing key management positions and qualified personnel in business or support units. Phase II emphasizes time bound actions from each business unit to put the banks on the right track by mid-2006. This phase continues on an ongoing basis in the form of a five year plan.
- Banks have started submitting their templates for the first quarter according to BRU's methodology with a view to monitoring the process through monthly and quarterly reports.
- The BRU and the European Commission in Egypt (EC) have finalized the terms of reference and the international consultants' short listing in order to initiate the restructuring of National Bank of Egypt and Bank Misr in risk management, information technology/MIS and, human resources. International consultants are expected to start work by end-July 2005.

5.2.3 Non-Performing Loans (NPLs) in Banks

- The NPLs unit in the CBE has instructed all banks operating in Egypt to establish an independent unit to be staffed with qualified banking and legal experts. The unit in the CBE will be monitoring the achievements of the Workout units through monthly reports that are pre-designed in order to have a clear, adequate and objective plan.
- The conciliation and arbitration process has been finalized and approved by CBE Board of Directors. A team qualified of bankers and lawyers has been assigned the task of managing the process under the umbrella of BRU. “Conciliation and arbitration” will be up and running by mid June 2005.
- The BRU is working with the Ministry of Investment to finalize an agreement to swap debt by bonds issued by the holding companies of each nonperforming affiliate. These bonds are guaranteed by the Ministry of Finance. The' tenor of bonds will be 20 years at the CBE discount rate (capped at 10%).

5.2.4 Banking Supervision

- Discussions are in process with the European Central Bank to provide long term technical assistance for upgrading banking supervision according to international best practices. This is a two year project and is targeted to start by end-2005.

6. CUSTOMS REFORMS

- Bold tariff and customs measures: The government has slashed tariffs and continues to streamline red tape. The weighted average tariff rate was reduced from 14.6 percent to 9 percent and all surcharges and service fees were abolished.

Table 1: Weighted Average Tariffs before and after Reductions (Presidential Decree No.300/2004)

	Weighted Average	
	Before Reduction	After Reduction
TOTAL IMPORTS	14.60	9.10
Industrial supplies not elsewhere specified, primary	11.80	1.80
Parts and accessories for capital goods	17.30	7.70
Food and beverages, primary, mainly for industry	2.80	2.10
Food and beverages, primary, mainly for household consumption	19.20	8.50
Fuels and lubricants, primary	1.40	0.27
Capital goods (except transport equipment)	12.11	7.4
Parts and accessories for transport equipment	29.50	11.70
Industrial supplies not elsewhere specified, processed	15.80	8.70
Fuels and lubricants, processed motor spirit	10.30	7.50
Fuels and lubricants, processed motor spirit (not elsewhere specified)	9.70	5.60
Food, and beverages, processed, mainly for industry	4.30	3.50
Consumer goods not elsewhere specified, non-durable	15.50	13.80
Food and beverages, processed, mainly for household consumption	20.40	8.60
Consumer goods not elsewhere specified, semi-durable	32.60	26.40
Consumer goods not elsewhere specified, durable	34.80	30.60
Goods not elsewhere specified	23.50	21.70
Passenger motor cars	84.60	63.10
Transport equipment and parts and accessories thereof, other	39.00	28.00

Source: Ministry of Finance

The structure of customs had been complex and the rate schedule was ambiguous. This had led to disputes and delays in processing imports. As a first step towards greater transparency, distortions have been eliminated and tariffs have now been set according to standard principles. Tariff brackets have been reduced from 27 to only 6. The reductions in tariffs and elimination of exemptions have served to curtail the discretionary assessments of imported goods, resulting in further transparency and credibility of the system. The automation of customs is also an integral part of these reforms.

Table 2: New Tariff Rates for Some Commodities (Presidential Decree No.300/2004)

Sector	Item	Tariff rate (Before change)	Tariff rate (After-change)
Agriculture	Agricultural tractors	33% and 13%	5%
	Tractor spare parts and necessities	30% and 23% and 13%	2%
	Tractor tires	33%	5%
	Fertilizers	33% and 13% and 8%	2%
Transportation	Utility cars (up to 1600 cc)	104% and 44%	40%
	Components and spare parts	33% and 23%	12% and 5%
	Tires	37%	22%
Construction and Building	Cement	33% and 23%	2%
	Limestone	13%	2%
	Reinforced steel bars	8%	5%
	High durability ships for the high seas	8%	0%
Social Dimension	Fish (certain types)	33%	5%
	Grains	33%	5%
	Tea	33%	5%
	Sugar (raw)	5%	2%
	Wheelchair products for the disabled, and their parts	8%	0%
	Household, health tools and kitchenware	44%	12%
	Chemicals	8%	2%

Source: Ministry of Finance

A new Presidential Decree (No. 410/2004) further lowered tariffs on inputs with a view to increase the competitiveness of the domestic industry. For example, tariffs on inputs used in the car industry such as wires and rubber used in tires dropped from 12 percent to 2 percent. All tariffs on inputs for medical equipment, printing, foodstuffs, and poultry were slashed by 50 percent. Tariffs on inputs for the garments industry fell from 40 percent to 22 and 12 percent. Significant reductions on inputs for the leather industry were also introduced. Tariffs on inputs for the steel industry were eliminated.

Initially, the reductions are expected to lower customs revenue by some LE 3 billion. However, this is a stimulus reform. Reduced customs revenue will be offset by increased tax revenues arising from the expected export led economy. Wide growth will be stimulated by the reduced costs of importing essential raw materials and intermediate and capital goods. The reduction in tariffs and streamlining of customs procedures will help enhance Egypt's competitiveness in the global market. It will also help reinvigorate the business environment, give momentum to the domestic industry and hence give the needed push to growth and job opportunities.

In addition, the recent increases in some energy prices (electricity, fuel oil and, natural gas) that have brought domestic energy prices closer to their international prices also provide a budget offset to reduced customs revenue.

Other customs reforms include the following:

- Strengthening the institutional capacity of the Customs Authority to enhance its role as a trade facilitator and service oriented institution.
- Streamlining procedures to be at par with international standards and conventions (e.g., pre-arrival clearance)
- Introducing up to date techniques such as risk management and post audit.
- Expanding the electronic handling of documents.
- Streamlining customs procedures and minimizing discretionary exemptions and import controls.

7. Public Debt Management

7.1 Domestic Debt

The Egyptian Ministry of Finance is responsible for issuing government debt and making fiscal policy decisions. Fiscal policy decisions include determining the appropriate level of taxes, government spending and hence government debt. The Ministry of Finance is in the process of developing an efficient government securities market with a view to minimize over time refinancing risk and the cost of its public debt.

Towards this end, the Government of Egypt launched on July 4, 2004 its Primary Dealer System (regulated by Ministerial Decree 480/2002) for government bills and bonds. The principal provisions of the program include the designation of 13 banks, including Citibank, to be Primary Dealers. All bills and bonds have been dematerialized and transactions are recorded electronically within a system linked the Primary Dealers, Central Bank, the Stock Exchange and the clearing house Misr Clearing and Settlement Depository (MCSD).

Auction rules have been changed from a "subscription" to a "competitive" style auction in which the coupon is set at the average yields of accepted bids.

An issuance calendar is published quarterly, providing data on debt issuance during the quarter. Since 2004, debt issuances by the Egyptian Treasury amounted to:

First Quarter	(L.E.35 billion) bid to cover ratio 2.23
Second Quarter	(L.E. 37 billion) bid to cover ratio 2.32
Third Quarter	(L.E. 36.5 billion) bid to cover ratio 2.26
Fourth Quarter	(L.E. 21 billion) bid to cover ratio 3.10 [2]

During the third quarter ending March 2005, The Ministry of Finance issued a series of medium term bonds maturing in 2008, 2011 and 2014 respectively. The view is to build liquid yield curve. On January 18, 2005, the Government issued its first ever 20 year fixed rate bond bearing a coupon of 11.4 percent. The issue was oversubscribed with a bid to cover ratio 2.6 times. Furthermore, the concept of "bond re-opening" was introduced to create liquid benchmarks over time. During the second half of 2005, the Central Bank and the Capital Market Authority will introduce bond lending and short selling to improve both primary and secondary market pricing.

7.2 External Debt: The Eurobond

[2] Till 14/6/2005.

In July 2001, Egypt issued two sovereign Eurobond worth US$1.5 billion in two tranches (5 and 10 year-maturity). The 5-year bond, maturing in July 2006, has a nominal value of US$500 million. It was issued with a spread of 275 basis points over 5-year US Treasury and offered a fixed coupon of 7.625%. The 10-year Eurobond is due to mature in July 2011 and has a nominal value of US$1 billion. It was issued with a spread of 335 basis points over 10-year UST bonds and offered a fixed coupon of 8.75%.

The issues marked Egypt's first international bond issuance and firmly established Egyptian credit in international capital markets. Both issues were received with very strong demand, they were oversubscribed by international investors and are now held by international, regional and domestic investors. Both issues were lead managed by Morgan Stanley and Merrill Lynch and commanded a BBB+ investment grade rating by Standard and Poor's.

- Eurobond performance

Both Eurobonds have performed well since their issuance. For the bond maturing in 2006, the spread over comparable US Treasury has tightened, reaching 43 basis points in May 2005 compared to 150 basis points in May 2004.

The spread over US Treasury for the 2011 bond issue, as well, has tightened to 82 basis points in May 2005 compared to 180 basis points in May 2004. The YTM on the 2011 issue has fallen from 5.835% in May 2004 to 4.81% in May 2005, which in turn has caused a price rise from US$116.75 in May 2004 to US$120.625 in May 2005. On the other hand, the YTM on the 10 year US Government bonds decreased from 4.657% in May 2004 to reach 3.986% in May 2005. (3), (4)]

The decline in spread over US Treasury for both issues has been due to increased appetite for emerging market debt, in addition to the positive outlook for the Egyptian economy following the appointment of the new cabinet in July 2004 and the vigorous reform program that has been undertaken.

8. Qualified Industrial Zones (QIZs)

On December 14, 2004 Egypt, the United States and Israel signed a trade cooperation agreement. The QIZ agreement will enable Egyptian textiles and garments to gain free market access to the U.S. market. In order for a jointly produced Egyptian Israeli product to benefit from duty free treatment in the United States, Egyptian and Israeli companies should together contribute two thirds of the minimum 35 percent (11.7 percent from each side) of local content required under the QIZ legislation.

Five factories and eight industrial cities in Cairo, Alexandria and Port Said benefit from the agreement.

The signing of the agreement comes conveniently before the phasing out of the Multi-Fiber Agreement (MFA). By end-December 2004, the United States will eliminate the quotas that it has established under the Multi-Fiber Agreement (MFA) that have allowed Egyptian producers of textiles and garments to export duty free into the United States. With the phasing out of the MFA, Egypt loses the benefit of quota access to the U.S market, while low cost suppliers in Asia will no longer confront a significant barrier to their exports. Egyptian producers would thus be more likely to lose market share to more competitive producers elsewhere in the world. As a result, Egypt stands to lose over US$135 million in textile and garment exports to the United States when the quotas are eliminated with a potential loss of nearly 15,000 jobs.3

[3] Ministry of Foreign Trade and Industry (Assistance for Trade Reform Project (ATR)). Changing International Trade Rules for Textiles and Apparel: Egyptian Market Access. 2004

The QIZ agreement gives the Egyptian clothing industry the chance to counter the cost advantage of the Asian producers and increase exports to the United States. Although some 32 percent of Egypt's exports of garments go to the United States, these exports represent less than 1 percent of US imports of textiles and garments. Under the QIZ program, Egypt could double or triple its sales to the United States. This could lead to additional exports of US$1 billion a year[4] and jobs for 250,000 workers.[5]

9. Sovereign Ratings

9.1 Fitch Ratings

On December 15, 2004, Fitch Ratings revised the outlook on Egypt's long term local currency rating of BBB to stable from negative. The other ratings affirmed the long term foreign currency BB+ with a stable outlook and short-term B. The country ceiling was affirmed at BB+.

The change in outlook owed to the positive change in the direction and pace of economic policy since July 2004, as well as "the decisiveness of the new government and the speed with which it has acted." The new Government introduced major measures intended to stimulate private sector growth and increase foreign investment. These include significant tariff reductions and the announcement of a simplified tax system effective July 2005.

9.2 Standard and Poor's

In February 2005, Standard and Poor's revised Egypt's long term foreign and local currency outlooks to stable. Long term local currency ratings were lowered to BBB-. Standard and Poor's note the major rating factors as sound external liquidity underpinned by:

- Current account surpluses.
- Healthy reserves.
- Renewed progress with structural reforms.
- Moderate net public external debt and debt service payments.

10. Ministry of Investment

In July 28, 2004, a new Ministry of Investment was created by Presidential Decree No. 231 to promote investment and coordinate investment policies and regulations. The new Ministry oversees all investment authorities (the General Authority for Investment (GAFI), the Capital Market Authority (CMA), the Cairo and Alexandria Stock Exchanges (CASE), the General Authority for Real Estate Finance (GARF), and the Public Enterprise Office (PEO)) under one umbrella. In addition, a new Board of Directors for GAFI has been appointed. The Ministry is intended to provide for more coordinated and coherent investment policies and simpler procedures for establishing businesses in Egypt.

11. Privatization

The Government is applying a new approach to the privatization program. It will now offer a number of Law 203 companies for sale before completing their restructuring. In doing so, the price will reflect buyers' commitment to future investment, assumption of the liabilities of the company and

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[4] Ministry of Foreign Trade and Industry (Assistance for Trade Reform Project (ATR)). Impact of QIZs on the Egyptian Economy. 2004

[5] Al-Ahram Daily Newspaper. December 27, 2004.

commitment regarding the workers' future. This approach relieves the Government of the substantial investment costs required to upgrade and restructure these companies before their sale. An example of this new approach is the recently completed sale of the Alexandria Tire Company (Trenco) to the French firm Michelin for US$10 million. Michelin has pledged to invest US$40 million in the plant.

Other privatizations include:

- The sale of a 36 percent stake in Bisco Misr in January, which raised US$17.4 million.
- The sale of the National Bank of Egypt's shares in NSGB to Societe Generale last February. This transaction raised US$ 92.9 million.
- The sale of Suez Cement Company to Ciments Francais and a consortium of investors in March 2005: Ciments Francais, Italcementi Group sub-holding for international activities, along with a consortium of local and international investors has purchased a 33.4 percent stake in Suez Cement Company, Egypt's leading cement producer. This transaction will enable Ciments Francais to raise its shareholding in Suez Cement from 39.9% to more than 54%. The offer price, which includes a majority premium, has been set to LE 97 per share. The transaction amounts to approximately US$360 million. The Suez Cement shares will remain quoted on the Cairo and Alexandria Stock exchanges.
- The Ministry of Investment has already divested 17 of the 170 assets planned for sale during 2005, which is more than what was sold throughout the whole of 2004. These sales have to date generated over LE1 billion in foreign direct investments.

This approach should speed up the process of privatization and speed up the process of restructuring as there are more investment funds available in the private sector than in the government sector for corporate restructuring.

12. Annulment of Decree No. 506/2001 on Surrender Requirements

The Prime Minister issued Decree No. 2059/2004 rescinding Decree No. 506/2003 that required exporters to surrender 75 percent of their foreign exchange proceeds. This development reflects the stability of the foreign exchange market and will further enhance the liquidity of the market.

13. Insurance Sector

The Egyptian insurance sector is composed of 4 public sector companies (3 direct and 1 specialized reinsurance). The direct insurance companies are Misr Insurance, Al Chark Insurance and the National Insurance companies, while the specialized company is Egyptian Reinsurance. In addition, there are 16 private companies, and 1 insurance co-operative society, 614 private pension funds (operating mainly in life and retirement insurance sector), 3 Governmental Insurance Funds, and 5 insurance pools.

The private sector companies are: Suez Canal Insurance, Al Mohandes, Delta, Pharaonic (AIG), Arab Misr Insurance Group (AMIG), Pharaonic American Life (ALICO), Commercial International Life Insurance (CIL), the Egyptian Company for Export Guarantee (ECG), ACE CIIC, Allianz Egypt, Egypt Saudi Insurance Home, Allianz for Life Insurance-Egypt, Royal and Sun Alliance, NSGB Life, ACE Life and BUPA Egypt Insurance.

Oversight and related institutions include the Supreme Council of Insurance, the Egyptian Insurance Supervisory Authority (EISA), the Insurance Federation of Egypt, the Cargo Supervision & Surveying Office of Egypt, and the Institute of Insurance Studies.

13.1 Market Indicators: Comparing the last two quarters (30/9/2004 - 30/12/2004)

L.E. Billion	Sep-04	Dec- 04
Total direct premium	1.14	2.24
Total investment	15.96	16.06
Total assets	19.2	19.5
Shareholders equity	3.51	3.1
Policyholder's rights	11.99	12.5
Market share % of public sector	*65.4*	*70.2*
Market share% of private sector	*34*	*29.8*

13.2 Recent Developments

In a step towards privatization, procedures for the valuation of the four state-owned insurance companies by international investment banks are under development. In 2001, the World Bank completed an assessment of the Egyptian Insurance Supervisory Authority. The assessment included a review of the legal framework and legislation applying to the insurance sector. The review concluded that the Egyptian Insurance Supervisory Authority complies with the IAIS 17 core principles at the time for effective regulation and supervision. A new review is currently underway to re-assess the insurance supervisory system in light of the increase in the number of the core principles to 28.

The four state owned insurance companies have been rated by A. M. Best based on the financial strength of the companies, their operational performance, and market profile. The ratings are as follows:

- Misr Insurance Company (A-)
- Al Chark Insurance Company (A-)
- The National Insurance Company (NR-4)
- The Egyptian Reinsurance Company (B++)
- Al Mohandes Insurance Company, a private sector company, also solicited the services of A. M. Best and was assigned B++.

In February 2002 Ministerial Decree No. 15 was issued for combating money laundering and ensuring that institutions transacting in insurance and reinsurance in the Egyptian market take the necessary procedures to prohibit any unlawful use of money within Egypt. In February 2003, EISA issued "Rules for Combating Money Laundering in the Egyptian Insurance Market." In February 2004, Egypt was removed from FATF list of non-cooperative countries in the combating of money laundering.

The GOE is committed to developing and strengthening the supervisory role of EISA including promoting corporate governance with a view to ensure the existence of a strong insurance regulator. Towards this end, Ministerial Decree No.157 was issued in November 2003 to apply Corporate Governance principles in the Egyptian insurance market, through establishing an audit committee from the Board of Directors of public and private sector companies operating in the market. EISA is also receiving technical assistance from USAID and the Commercial Law Development Program (CLDP) of the U.S. Department of Commerce (USDOC) with a view to addressing regulatory and supervisory issues. The USIAD project "Reform of the Insurance Market" (RIM) was completed in 2000 and a new project "Modernizing Egyptian Insurance Supervision" (MEIS) is now being implemented. Under the CLDP, there is a public awareness campaign to enhance public awareness and interest in the insurance sector, as well as study tours and training programs for EISA staff to help them gain experience in different fields of insurance regulation, development and conducting campaigns

Concerning private pension funds, Law No. 54 / 1975 governing these funds is being amended, and is expected to be presented to Parliament next year. Amendments to the law aim at increasing the number of participants, encouraging long-term savings, and improving the asset management of the private pension funds.

13.3 Other Developments

- In 1995, the Insurance Supervision and Control Law No.10 / 1981 was revised and amended to enable foreign insurers to operate in the market through a 49 percent maximum share in joint ventures with Egyptian companies. Issued capital was increased as well as the solvency margins. In addition, the amendments included the deregulation for rates of all classes of insurance.
- In 1998, Law No. 10 / 1981 was amended by Insurance Law No. 156 of 1998 to eliminate foreign equity ceilings, thus allowing for full private sector ownership. The requirement for an Egyptian managing director on the board was removed in order to encourage the transfer of foreign managerial know-how.
- Decree No.157 concerning new insurance accounting standards that comply with international standards and ensure transparency was issued in May 1999.
- In August 2001 Ministerial Decree No. 599 was issued, amending Decree No. 45 / 1999 of the Executive Regulations. The new decree aimed at improving the procedures of claims settlement.
- Ministerial Decree No. 621 was issued by the end of year 2001 to oblige insurance companies to submit financial forms to EISA in an electronic form. The decree has been in force since January 2002.
- Ministerial Decree No. 890 concerning the Unified Model Standard of the Articles of Association of the state-owned insurance and reinsurance companies was issued in 2003.

13.4 Potential for Growth

The insurance market in Egypt has a significant growth potential for further development and efficiency gains. Total insurance premiums in Egypt represented only 1.1 percent of GDP in 2003/2004. In similar economies this percentage is between 4 to 5 percent. The Egyptian market thus offers considerable scope for development in terms of individual spending on insurance products, the industry's share in GDP, and the introduction of other new insurance products and incentives. In addition, a steady improvement in incomes as economic growth rates increase will help increase contractual savings including insurance premia.

To achieve this potential, the Government of Egypt is pledged to reform the insurance sector through legislation and organizational development. Elements of the Government’s efforts include:

- Presentation to Parliament of a new Private Health Insurance draft law.
- Encourage alliances between insurers and banks (bankassurance).
- Enhance EISA’s supervisory role and its institutional capacity.
- Monitor and regulate the performance of intermediaries and carry out comprehensive market conduct training.
- Introduce further legislative changes.

The Government is also in the process of creating an insurance information center that will increase transparency and credibility and hence, public confidence.

14. EGYPT ACCEPTS THE OBLIGATIONS OF ARTICLE VIII OF THE IMF'S ARTICLES OF AGREEMENT

Since 1991, Egypt has refrained from imposing restrictions on the making of payments and transfers for current international transactions. Effectively Egypt has been compliant with the obligations of Article VIII, although it had not formally accepted its obligations. On January 2, 2005, the Government of Egypt notified the IMF[6] that it has accepted the obligations of Article VIII[7], Sections 2, 3 and 4. By accepting the obligations of Article VIII, Egypt undertakes to continue not to impose restrictions on the making of payments and transfers for current international practices, and from engaging in any discriminatory currency arrangements or multiple currency practices without IMF approval. By accepting these obligations, Egypt gives confidence to the international community that it will pursue sound economic policies that preclude the need to use such restrictions, and signals that it will contribute to a multilateral payments system free of restrictions.

A total of 163 of the IMF 184 member countries have now accepted the obligations of Article VIII, Sections 2, 3 and 4.

15. THE WORLD BANK APPROVES A $20 MILLION LOAN TO SUPPORT EGYPT'S EARLY CHILDHOOD EDUCATION PROJECT

The World Bank's Board of Directors approved in February 2005 a $20 million loan to partially support the Government's Early Childhood Education Project that focuses particularly on disadvantaged children. The Project seeks to increase access to kindergartens in 18 governorates and will help the Government move towards the goal of expanding coverage of early childhood education from 13 percent today to 60 percent by 2010 .

The total cost of the project is US$108 million, which will also be financed by the Government of Egypt, the Canadian International Development Agency (CIDA), the World Food Program (WFP) and other international donors .

One component of the project will focus on enhancing quality, by supporting the development of curriculum and educational materials, teacher training, and provision of food.

16. OPIC PROVIDES US$300 MILLION IN INSURANCE TO APACHE TO HELP EGYPT SHIFT FROM OIL TO NATURAL GAS

The Overseas Private Investment Corporation (OPIC) made a commitment in January 2005 to provide US$300 million in political risk insurance to the U.S. company Apache that is helping Egypt shift the emphasis of its energy production from oil to more environmentally-friendly natural gas. OPIC’s board of directors had approved the project in April 2004 .

Apache Corporation will use the OPIC insurance to develop various oil and gas concessions in Egypt. Natural gas discoveries in the Western Desert have already played a significant role in helping Egypt to convert much of its thermal power generation capacity from oil to natural gas, and in providing the resources necessary to meet growing local energy needs as well as expanding Egypt’s hydrocarbon exports

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[6] Egypt joined the IMF on December 7, 1945. Its quota is SDR 943.7 million (about US$1.45)
[7] See IMF website: http://www.imf.org/external/pubs/ft/aa/aa08.htm

as large discoveries of gas emerge in the Western Desert and Nile Delta. The oil and gas sector accounts for 8 percent of GDP.

17. ANNUAL MEETING 2005 OF THE WORLD ECONOMIC FORUM IN DAVOS

Business, political and social leaders met in Davos, Switzerland for five days at the end of January 2005 to discuss Immediate action on the tough issues of poverty, climate change, education, equitable globalization and good global governance. Specifically, participants at the Annual Meeting called for the implementation of a series of concrete measures designed to yield immediate and long-lasting results, including the adoption of technology to reduce the emission of greenhouse gases, the creation of a fund to accelerate financial aid to the poorest nations and the removal of trade barriers that deprive developing countries of the dividends of global economic growth. Participants were urged in the closing session to exercise "self responsibility, global responsibility ... and responsibility to the next generation."

Early in the five-day Meeting, participants gathered in a town hall meeting to single out the six issues they consider most critical to the world today and to identify the key challenges related to each. At the top of their list, they placed poverty, followed by equitable globalization, climate change, education, the Middle East and global governance.

Among the recommendations made by participants was the implementation of a proposed international financing facility that would deliver aid to the neediest countries at a more rapid and predictable rate. To foster equitable globalization and make trade fairer, participants urged negotiators to complete the Doha Agenda of trade talks to enshrine principles of reciprocity, free trade and the liberalization of trade in services.

For any of these measures to work, however, the world's poor nations must be at the forefront of this agenda, participants agreed. Offering assistance to the developing world has to be done in a way that recognizes and preserves the dignity of the people. Rather than approach the poor as a problem, developed nations and companies need to view them as an opportunity, a source of new markets, labor and innovation.

An Egyptian delegation consisting of the Prime Minister, the Ministers of Finance, Petroleum, Trade, Investment and Information Technology participated in the 2005 Meeting.

18. ARTICLE IV CONSULTATIONS

On May 18, 2005, the Executive Board of the IMF concluded the 2005 Article IV Consultations[8] with Egypt. During these discussions IMF staff reviewed recent directions of economic policies in Egypt. Egypt has consented to publish the IMF Staff[9] report that reflects these discussions. Following the approval of the Staff Report by the Board of Directors, the IMF published Public Information Notice (PIN)[10] No. 05/72[11].

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[8] Article IV Discussions are held annually with IMF member countries.

[9] See http://www.imf.org/external/pubs/ft/scr/2005/cr05177.pdf

[10] *Public Information Notices (PINs)* are issued after Executive Board discussions of Article IV consultations with member countries.

[11] See http://www.imf.org/external/np/sec/pn/2005/pn0572.htm

Box. 2: Extracts from the IMF Executive Board Assessment of Egypt

Directors welcomed the clear change in the direction of economic policies in Egypt since the 2004 consultation. They commended the authorities on their comprehensive economic reform program and the impressive achievements to date. Directors welcomed the priority being attached to modernizing the public sector and to reducing government interference in market mechanisms. They welcomed the decisive measures taken in the areas of customs tariffs, taxes, and subsidies, the ambitious programs of privatization and financial sector reform, and the improvements in transparency. Directors considered that these policy achievements have increased market confidence. They also noted the strengthening of the externally-driven recovery, as well as the positive developments in the foreign exchange market and the recent good news on the inflation front.

Notwithstanding the substantial progress attained since mid-2004, Directors noted that the challenges ahead to build a dynamic, private sector-driven economy in Egypt remain considerable. … Directors encouraged the authorities to sustain the current pace of structural reform while pursuing fiscal consolidation and a prudent monetary policy. These policies would help bring about the robust responses of private investment and output growth that are needed to reduce unemployment and poverty. Directors were encouraged by the authorities' awareness of these challenges and their commitment to implement the reforms necessary to address them.

Directors congratulated the authorities on the successful unification of the exchange rate. In particular, they applauded the disappearance of the parallel market premium, which has removed a serious distortion from the economy, and the launching of the interbank market for foreign exchange. Directors also welcomed Egypt's acceptance of the obligations of Article VIII, Sections 2, 3 and 4. They noted that a market-determined, flexible exchange rate would be beneficial for foreign investment, increase the economy's resilience to shocks, and improve macroeconomic management. Directors welcomed the authorities' commitment to continue to let the exchange rate be determined by market forces and to tolerate short-term fluctuations in the rate.

Directors recognized that the Central Bank of Egypt (CBE) has continued work to strengthen the monetary policy framework over the past year. They encouraged the CBE to intensify these efforts, and to continue developing a cohesive and credible monetary policy framework that effectively anchors inflation expectations in the context of a flexible exchange rate, and that relies on a proactive interest rate policy.

19. The Stabilization Program

The IMF/Egypt Stabilization Program was implemented from 1991 to 1997. There is no longer a stabilization program in effect.

- Since 1991, Egypt has pursued a comprehensive economic reform program that has achieved macroeconomic stability and is now being followed by structured reforms that have served to:
    - Create an open, market oriented, decentralized economy.
    - Foster economic growth; promote foreign direct investment.
    - Encourage private sector investment and integrate Egypt into the global economy.
- Egypt's reform program has received significant international support from the two Bretton Woods Institutions and other donors.
    - At inception, the IMF provided an 18-month stand-by arrangement.

- A total of US$ 14.2 billion Paris Club debt reduction and rescheduling was instituted, of which US$6.2 was implemented in the third stage.
- A subsequent 3-year extended funding facility was provided by the IMF.
- An Economic Reform and Structural Adjustment Program (ERSAP) and a Structural Adjustment Monitoring Program (SAMP) were formed in cooperation with the World Bank, and were supported by international donors such as the EU, the African Development Bank and USAID.
- A new IMF Standby Agreement, agreed in 1996, was successfully completed in September 1998.
- As a result of the impressive achievements to date, a new program with the IMF will not be needed.

- Continued economic progress is ensured, based upon:
  - Egypt's sizeable and well-diversified economy.
  - Expanding international opportunities.
  - Modest external debt levels.
  - Significant build-up of international reserves.
  - Strong coverage of debt service requirements.
  - Political stability (domestically and regionally).
  - Sustainable GDP growth.
  - Potential for further economic growth as a result of continued structural reforms.

STATUS OF RECENT ECONOMIC LEGISLATION

	Law	Status
1.	Financial Leasing Law No. 95/1995, amended by Law No. 16/2001	Enacted.
2.	Central Depository Law No. 93/2000	Enacted.
3.	Mortgage Law No. 148/2001	Enacted.
4.	Money Laundering Law No. 80/2002	Enacted.
5.	Intellectual Property Rights Law No. 82/2002	Enacted.
6.	Special Economic Zones Law No. 83/2002	Enacted.
7.	Civil Association and Establishments Law No. 84/2002	Enacted.
8.	Export Promotion Law No. 155/2002	Enacted - Executive Regulations awaiting approval.
9.	Telecommunication Law (UTL) No. 10/2003	Enacted.
10.	Unified Labor Law No. 12/2003	Enacted.
11.	Central Bank, the Banking System and Monetary Law No. 88/2003	Enacted.

	Law	Status
12.	Law Number 15/2004 concerning Electronic Signature	Enacted.
13.	Small and Medium Enterprises Law No.141/2004	Enacted.
14.	Income Tax Law No. 91/2005	Enacted.
15.	Competition Law No. 3/2005	Enacted – Executive Regulations under preparation.
16.	Draft Unified Corporate Law	Pending discussion.
17.	Draft Capital Markets Law	Pending discussion.
18.	Presidential decree No. 231 of the year 2004 concerning organization of Ministry of Investment	Enacted.
19.	Presidential decree No. 300 of the year 2004 issuing the Customs Tariffs	Enacted.

Overview of Selected Recent Economic Legislation

Law No. 91 / 2005 Concerning the Income Tax

- Less than two months after the appointment of the new Cabinet, Minister of Finance Youssef Boutros-Ghali presented a new income tax law during the annual conference of the National Democratic Party, held in September 2004. The draft law was circulated and discussed by all stakeholders and then sent to Parliament for approval. The Parliament has passed the new law and the President has signed and issued it in the Official Gazette in June 2005.

- The new income tax law makes the Egyptian tax system more transparent for both national and foreign companies looking to invest in Egypt. It cuts personal and corporate income taxes, and unifies tax exemptions and legislations. It introduces a 50 percent reduction in personal and corporate taxes to a maximum rate of 20 percent. It has also restructured income tax brackets into three categories, with tax rates of 10, 15 and 20 percent. Existing tax exemptions for annual earnings of under LE 5,000 would double. Working spouses would benefit from the new law as each of them would be eligible for an exemption of LE 5,000 on wages. Civil servants would get a personal exemption of LE 4,000 annually.

- Additionally, the law grants a general amnesty for taxpayers in all cases before courts the subject of which is the disagreement between the taxpayer and the Tax Authority on the tax estimation, provided that the disagreed tax amount does not exceed LE 10,000. Moreover, the law provides for a settlement process in tax evasion cases or other offences upon request from the concerned person within one year of the entry into force of the law. These provisions are seen essential in order to encourage Egypt's informal economy to legalize its status.

- The law also provides for phasing out tax exemptions for newly established companies. Companies listed on the Stock Exchange would also lose the tax exempt status of their paid-in capital.

- In addition to rate reductions, the law provides for streamlining tax administration and merge all income tax legislations into one law. The law is intended to encourage the voluntary submission of tax returns by taxpayers, the timely payment of taxes, and greater compliance of citizens who previously evaded taxes whether because of high rates or cumbersome procedures. A key element of the law is the introduction of self-assessment for taxpayers. This places the burden of proof for tax evasion on Tax Authority which will now limit its inquiry to a sample of some 5 to 10 percent of all taxpayers. The elimination of what had been viewed as discretionary assessments aims at regaining the missing trust between taxpayers and the Tax Authority.

- The Ministry anticipates a significant improvement in the cost effectiveness of the Tax Authority and a reduction in costs to enterprises and individuals associated with the payment of taxes. The new system raises revenue from a limited number of tax rates and will therefore substantially reduce administration and compliance cost. Avoidance of numerous taxes that yield limited revenue will also facilitate tax assessment and avoid the impression of excessive taxation. The new law also introduces high deterrent penalties against tax fraud.

- The proposed rate reductions and administrative changes will, in the medium term, stimulate the economy. Higher profits for businesses will encourage faster economic growth, thus expanding the tax base and ultimately increasing tax revenues. This should partially make up for the shortfall in tax revenues, estimated at between LE 3.2-3.5 billion. GDP growth rates should increase by 2-2.5 percent giving rise to at least LE 2 billion in additional revenues.

- A broad tax base with limited exemptions enables revenue to be raised with relatively low rates. The erosion of the tax base through exemptions requires higher tax rates to make up for the loss in revenue. Higher rates only serve to increase the likelihood of tax evasion. Hence, expected improved tax compliance under the new reforms should also cover a large part of the loss in tax receipts.

- Proceeds from an ambitious privatization program that includes 172 state-owned companies, a public sector bank and the stake of the government in joint venture banks will also be used to finance the temporary increase in the budget deficit.

- Over the longer term the government will be building up the administrative capacity of the state to collect taxes. In addition, a plan was set, immediately after the issuance of the law, to create awareness of taxpayers in order to encourage them to take part in the reform. This plan depends to a large extent on press and media campaigns directed to all classes of society.