THE ECONOMIC REFORM PROGRAM

Tracking the Implications for
EGYPT'S PETROLEUM SECTOR

AUGUST 2018

OUR VISION

Egypt Oil & Gas is launching its Research & Analysis division. The new R&A division is aiming to provide petroleum industry stakeholders with different types of information covering the latest updates in the promising sector. The reports are based on industry facts and figures - from reputable, reliable and official sources only. Egypt Oil & Gas R&A will transform this raw data into valuable original research and analysis.

EGYPT OIL&GAS RESEARCH & ANALYSIS

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ABOUT THIS REPORT

This is the first report to be published by Egypt Oil & Gas R&A division. It investigates the impact of the IMF-backed economic reform program on the petroleum sector. It is the first report of its kind; bringing together and analyzing a wide range of data into one document. It features comparative analysis of IMF data and figures published by the Egyptian government, demonstrating the differing visions of Egypt's economic trajectory. By connecting these pieces, Egypt Oil & Gas R&A sheds light onto the changes witnessed by the sector over the past two years. This will enable investors and industry stakeholders to make more informed decisions.

This report was written by **Mahinaz El Baz** and **Matthew Hoare.**

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INTRODUCTION

After half a decade of instability, a stringent program of economic reforms - along with a strategy specifically targeted to develop and modernize Egypt's petroleum industry - was urgently needed to retain international confidence in both the Egyptian economy and its petroleum sector.

The landmark $12 billion loan agreement signed between the International Monetary Fund (IMF) and the Egyptian government on November 11, 2016 was conditioned on a set of economic reforms designed to revive the stagnating economy. Following the approval of the loan, the IMF said that the program would return financial stability and stimulate economic growth across the economy.

The program essentially aims to return government debt to sustainable levels, improve Egypt's foreign-exchange market, raise the competitiveness of its investment climate, reduce the inflation rate, and control the balance of payments (BOP) and budget deficit. All those factors combined, in addition to the decreasing arrears to international oil companies (IOCs), are expected to increase foreign direct investment (FDI) inflows, specifically into exploration and production (E&P) activities.

Now, 20 months on, Egypt Oil & Gas examines the impact of the reform program on the petroleum sector.

THE IMF LOAN AGREEMENT

THE IMF LOAN AGREEMENT

Prior to the agreement, the Egyptian government adopted several fiscal and monetary policy reforms; this was, as the IMF notes, a demonstration of commitment to the broader reform agenda stipulated in the November 2016 agreement. In March 2016, eight months before the full liberalization of the exchange rate, the Central Bank of Egypt (CBE) held an exceptional auction, selling dollars at a rate of EGP 8.85 instead of EGP 7.73 - a 14.5% devaluation of the currency. The government also pressed ahead with cutting the fuel and electricity subsidies budget by almost 3% of Gross Domestic Product (GDP), lowered income taxes and proposed implementing a value-added tax (VAT) to replace the general sales tax.

The economic program itself comprises a raft of monetary and fiscal policy reforms, as well as measures directed specifically at the energy sector.

MONETARY POLICY

The liberalization of the exchange rate system was a key demand of the IMF prior to signing the agreement. Accordingly, on November 3, 2016 the CBE unpegged the pound from the US dollar and allowed it to float on the market – resulting in a sharp devaluation of the currency. The CBE also raised interest rates by 300 basis points to 14.75%, and held deposit auctions to reduce excess liquidity.

Since these exchange rate reforms, the CBE followed a policy prescription that attempts to contain the inflationary effects of the devaluation. This includes maintaining interest rates at their current levels and restricting the flow of credit to banks, and government-backed organizations and institutions.

FISCAL POLICY

The program mandates a series of austerity measures designed to bring government debt down to sustainable levels of around 78% of GDP by fiscal year (FY) 2020/21. The government committed to raising VAT from 13% to 14% in FY 2016/17 and abolishing the indexation of public sector bonuses and allowances in order to increase revenues and lower expenditure respectively. The document also mentions the implementation of public employment reforms, but does not go into details about what policy changes this would entail.

Energy subsidies represent the greatest obstacle to restoring stability to government finances. At their peak in FY 2013/14, energy subsidies consumed as much as EGP 139.5 billion (of which EGP 126.2 billion was spend on fuel subsidies). This amounted to a staggering 6.6% of GDP. In response, the government committed to the complete removal of electricity subsidies by FY 2020/21 while it promised to trim the fuel subsidy budget to EGP 25 billion in the same year. The Sisi government's policy to reduce subsidies represents a notable departure from past governments, which have been reluctant to take meaningful action on this politically-sensitive issue. The IMF's last loan to Egypt – negotiated with Mubarak and Prime Minister Atef Sedky back in 1991 – resulted in only limited subsidy cuts, with the government unwilling to meet the World Bank's demands of complete removal by 1995.

The agreement heralds the Egyptian government's commitment to the reform agenda for the energy sector. While the IMF's initial press release is fairly light on sector-specific information, it does highlight plans to address the unsustainability of the Egyptian General Petroleum Company's (EGPC) finances. Included in this strategy are measures to reduce the state company's debts, improve operational transparency, and introduce efficiency savings.

THE LOAN: REVIEWS AND TRANCHES

The loan agreement, made with the IMF's Extended Fund Facility (EFF), carries a three-year term, meaning that the final tranche will be disbursed in 2019. As of July 2018, the IMF has undertaken three separate reviews of Egypt's economic progress. The first was completed July 13, 2017, the second later that year on December 20, and the third at the end of June 2018.

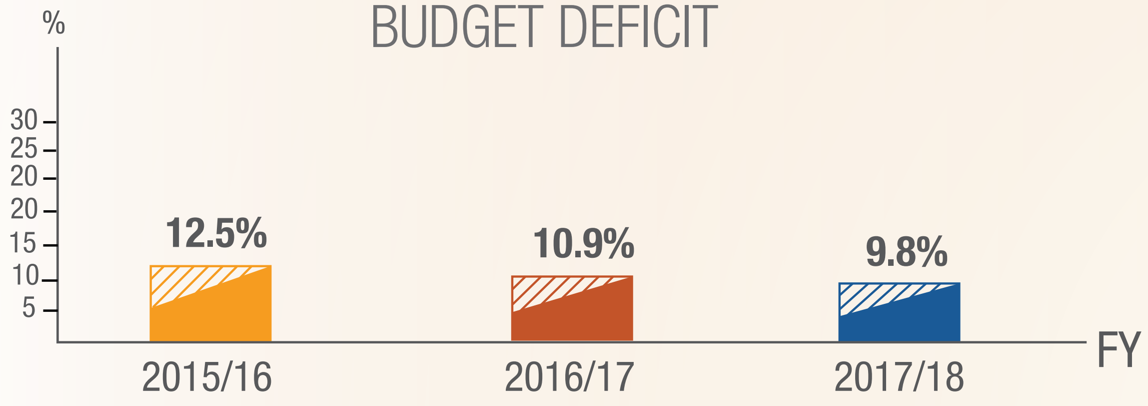
The IMF has been satisfied that the government is sticking to the terms of the agreement and has released a tranche following the completion of each review. The fund released $1.25 billion in July 2017, $2.03 billion in December 2017, and $2.02 billion in July 2018, as well as the initial $2.75 billion disbursed after the agreement was signed. This means that around $8 billion has so far been transferred to the CBE, with another $4 billion to be released by the end of 2019.

TACKLING
THE BUDGET DEFICIT

TACKLING THE BUDGET DEFICIT

Right after implementing the reform program, Egypt's budget deficit for FY 2016/17 fell from 12.5% to 10.9%, the lowest level in five years, according to the Ministry of Planning, Monitoring and Administrative Reform (MPMAR). While the IMF estimated the cash balance to stand at -9.7% of GDP in FY 2016/17, it actually recorded -10.7%, the IMF revealed in their third review. In addition, the IMF predicted an overall balance of -10% of GDP in the same fiscal year, which recorded -10.7%.

BUDGET DEFICIT



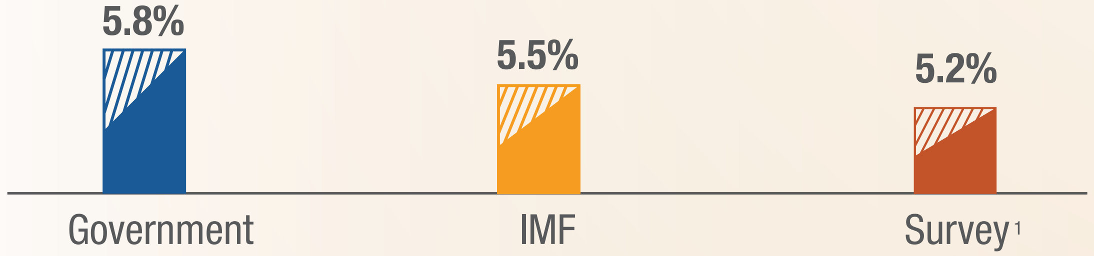
Source: Ministry of Planning, Monitoring and Administrative Reform (MPMAR), Ministry of Finance

IMF OVERALL BALANCE PROJECTIONS: 2016 VS. 2018 In Percent of GDP

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2012/22	2022/23
IMF NOV. 2016	-12.1	-10	-8.3	-5.9	-4.3	-3.9	-	-
IMF JULY 2018	-12.5	-10.9	-9.7	-8.1	-6.1	-4.8	-4.2	-4.2

Source: IMF

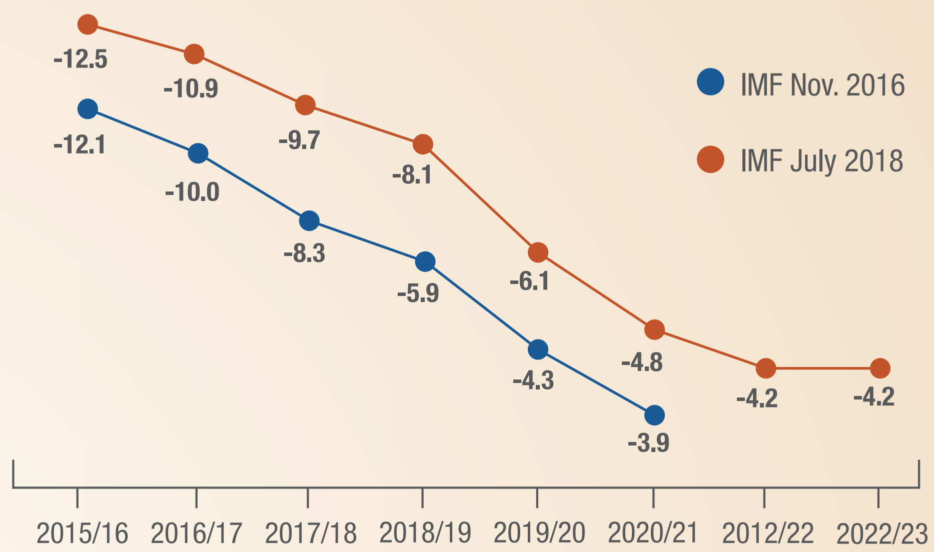
GDP PROJECTIONS (FY 2018/19)



Source: Ministry of Finance, IMF, Reuters

[1] Based on a survey of 13 economists conducted by Reuters.

IMF OVERALL BALANCE PROJECTIONS: 2016 VS. 2018 (AS A PERCENTAGE OF GDP)



Source: IMF

At the end of July, Minister of Finance Mohamed Maait revealed that the budget deficit in FY 2017/18 fell by more than a percentage point to 9.8%, down from 10.9% in the previous fiscal year and slightly above the 9.1% targeted in the 2017/18 pre-budget report. This narrowly missed the IMF's latest budget deficit projections of 9.7%, made during its third review of the economic program that finished earlier in July.

In early July, the Ministry of Finance announced that Egypt had a primary budget surplus for the first time in 15 years. Maait stated that Egypt achieved a 0.2% primary budget surplus, worth EGP 4 million ($223 million) in FY 2017/18. It is worth mentioning that primary budget figures do not factor in interest payments on government debt.

The cabinet submitted the new state budget for FY 2018/19 to the House of Representatives in April. The budget targets spending of EGP 1.4 trillion and revenue of around EGP 989 billion in the current fiscal year. By achieving these targets, the government aims to reduce the budget deficit to 8.4% of GDP, achieve a primary surplus of 2% of GDP, and reduce public debt to 91-92 % of GDP. In addition, the government anticipates the economy to grow by 5.8% of GDP in FY 2017/18.

From its side, the IMF expects Egyptian finances to improve in the years ahead. In its third review published in July 2017, it predicts the government to successfully achieve a 2% of GDP primary budget surplus in FY 2018/19, and for this to continue all the way through to FY 2022/23. It further forecasts Egypt to achieve a net cash balance of -8.0 of GDP in FY 2018/19, rising to -5.8% in FY 2019/20 and -4.5% in 2020/21. The fund projects the government to achieve an overall balance of -8.1% of GDP in FY 2018/19, -6.1% in FY 2019/20 and -4.8% in FY 2020/21.

Prior to signing the agreement, the IMF stressed that reducing fiscal deficits considerably and thereby placing public debt on a clearly declining path is an important objective of the reform program. To this end, the government plans to reduce the budget deficit by cutting public debt to around 75-80% by FY 2021/22, the Ministry of Finance has said. To reach these targets, the state has to achieve a sustainable 2% of GDP primary budget surplus by FY 2020/21.

In the short term, the draft budget for FY 2018/19 is based on the assumption that oil prices will settle at around $67 per barrel. The Ministry of Finance explained in its pre-budget report that for every dollar increase in oil prices, the government will have to pay an extra EGP 4 billion annually in

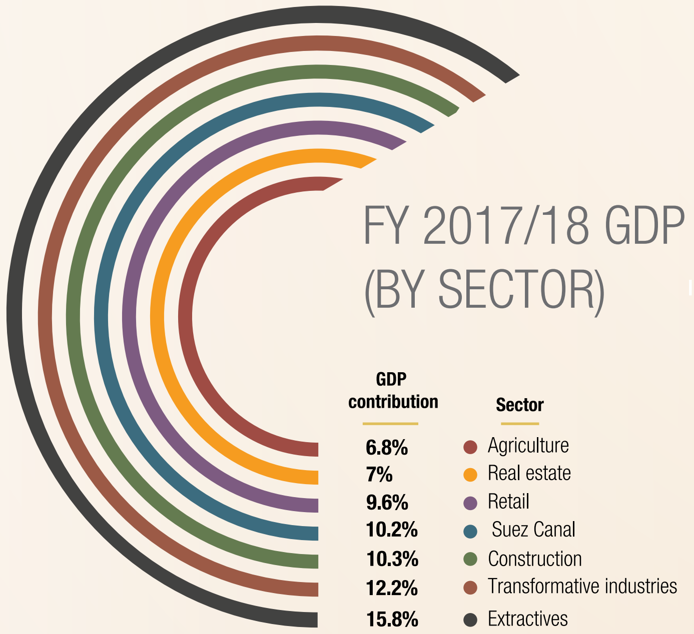
FY 2018/19 BUDGET

Source: Ministry of Finance

expenditures, thus heavily impacting the budget deficit targets. Moreover, this increase in expenses would limit the money available to the government to finance capital and social expenses in light of the increases in international prices, eating up the health and education allocations.

As a result, Egypt's cabinet approved in early June the request of the finance and petroleum ministries to contract with some international insurance banks against the risks of increasing oil prices. At the end of July, the cabinet announced that the finance and petroleum ministers were preparing to begin contracting with international financial institutions. It is so far unclear which institutions will provide the government with the insurance, or when the contracts will likely be finalized. It is worth noting that the oil quantities and appropriate pricing mechanisms will be agreed upon by a working group from both ministries. Furthermore, the working group is expected to develop a framework for a future vision to hedge against the risks caused by fluctuating oil prices and settle the target price of insurance based on international forecasts and studies.

Putting these precautions in place will help to avoid what happened in FY 2017/18 when the Ministry of Finance had to seek the House of Representative's approval to allocate an extra EGP 70.3 billion from the budget due to the unexpected rise in oil prices.



Source: State Information Service

REDUCING EXPENDITURES

In the years before the signing of the IMF agreement, subsidies – along with social benefits - were the biggest ticket item in the budget, exceeding even wages and interest payments. In order to continue with the budget deficit reduction plan, the government decided to move forward with reducing energy subsidies.

In FY 2014/15, the government launched an energy subsidies reform program by reducing subsidies and increasing fuel prices in the budget. The government has since committed to periodically increasing the pre-tax cost-recovery ratio on most fuel products in order to achieve 100% at the end of FY 2018/19 and to eliminate electricity subsidies by FY 2020/21, according to the IMF.

In order to successfully reach their budget deficit targets, the government announced a reduction in energy subsidies one day after floating the Egyptian Pound in November 2016. A second reduction occurred in June 2017. It is worth mentioning that Egypt was the sixth cheapest country all over the world to fuel a car in 2017, according to Global Petrol Prices.

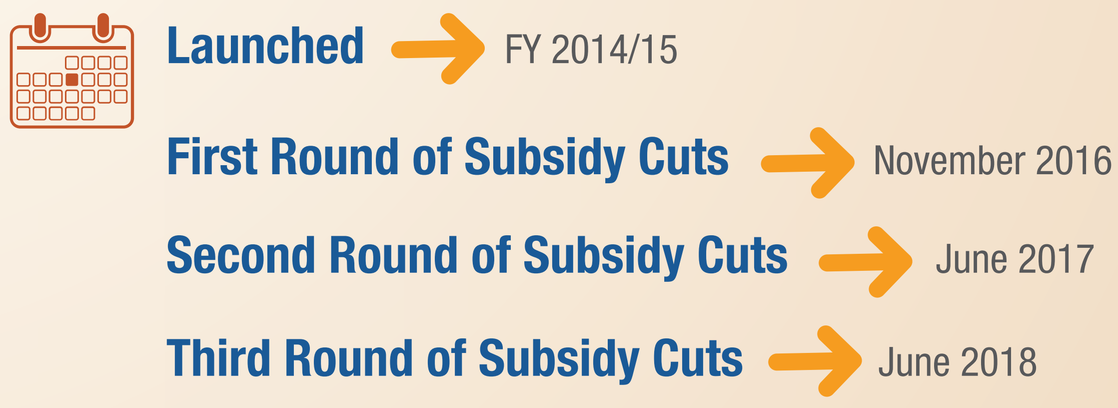
Prior to the budget approval for the FY 2017/18, the State Information Service said that the government had earlier cut fuel subsidies in a move that will save around EGP 35 billion compared to FY 2016/17. The government has followed through on its plan for a fourth round of electricity subsidy cuts, lowering its expenditures on electricity subsidies to EGP 30 billion.

In June 2018, the government announced the third round of fuel subsidy cuts since the currency floatation. This came a few days after reducing electricity subsidies and raising prices by an average of 26% from July 2017.

One month later, Egypt's Prime Minister Mostafa Madbouly announced that the government would be increasing the prices of natural gas for household and commercial users from the beginning of August. Prices have risen by EGP 0.075 per cubic meter for each consumption band: up to 30 cubic meters (up to EGP 0.175), 30-60 cubic meters (up to EGP 0.250), and more than 60 cubic meters (up to EGP 0.300).

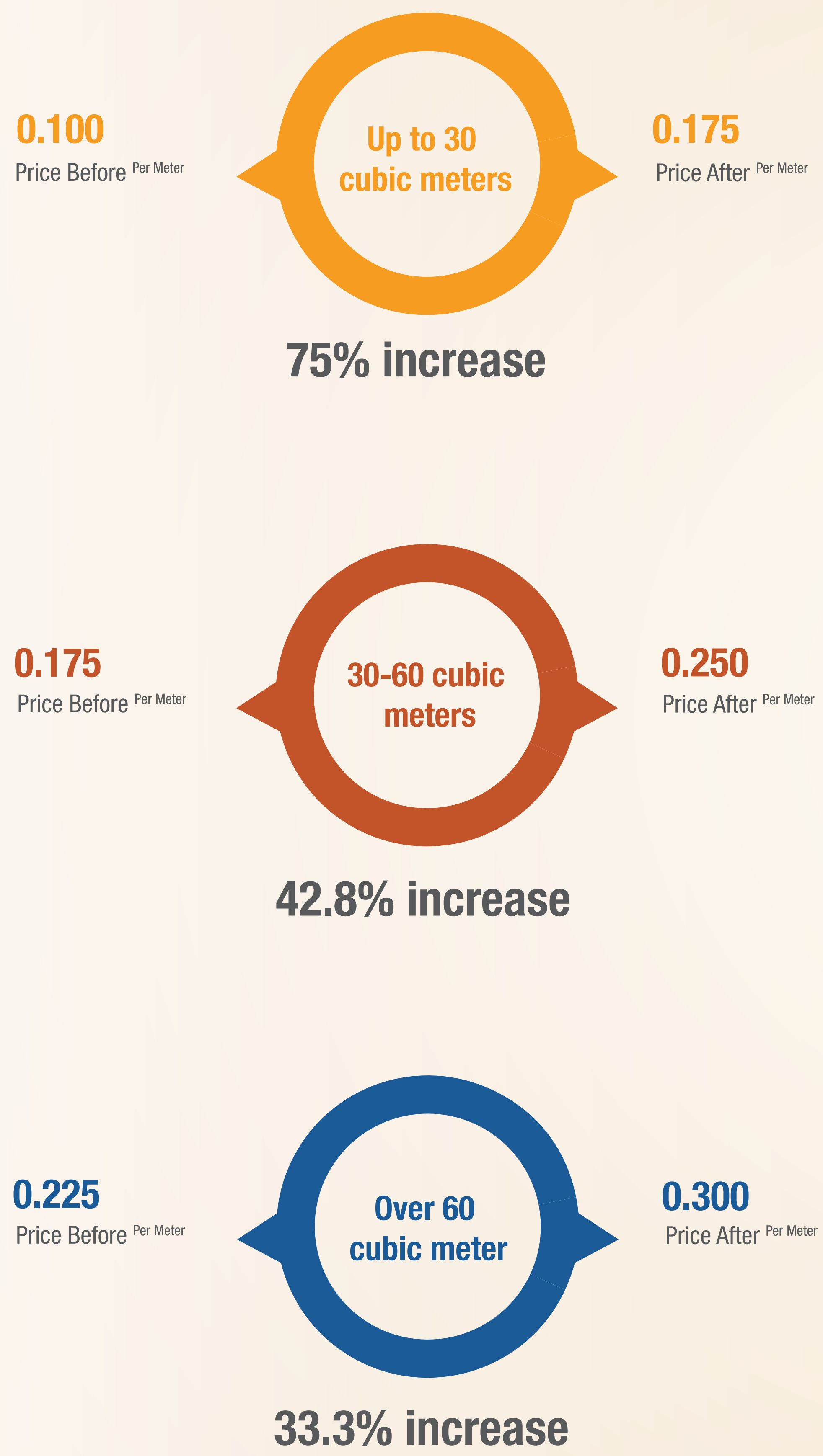
The budget of FY 2018/19 has allocated EGP 1.4 trillion of spending. Within it, fuel subsidies have been cut by around 21% compared to the previous fiscal year, bringing fuel subsidies expenditure down to around EGP 89 billion. Electricity subsidies will witness a tougher cut of around 45%.

FUEL SUBSIDIES REFORM



Source: Ministry of Petroleum and Mineral Resources, Ministry of Finance

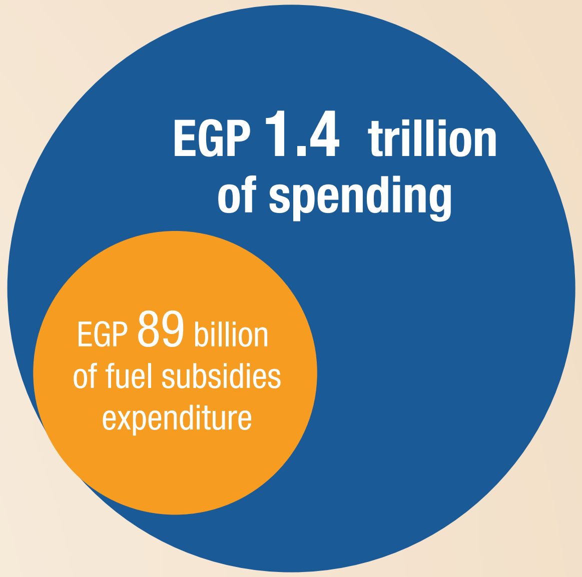
NATURAL GAS SUBSIDY CUTS (EGP) 2018



Source:The Egyptian Cabinet

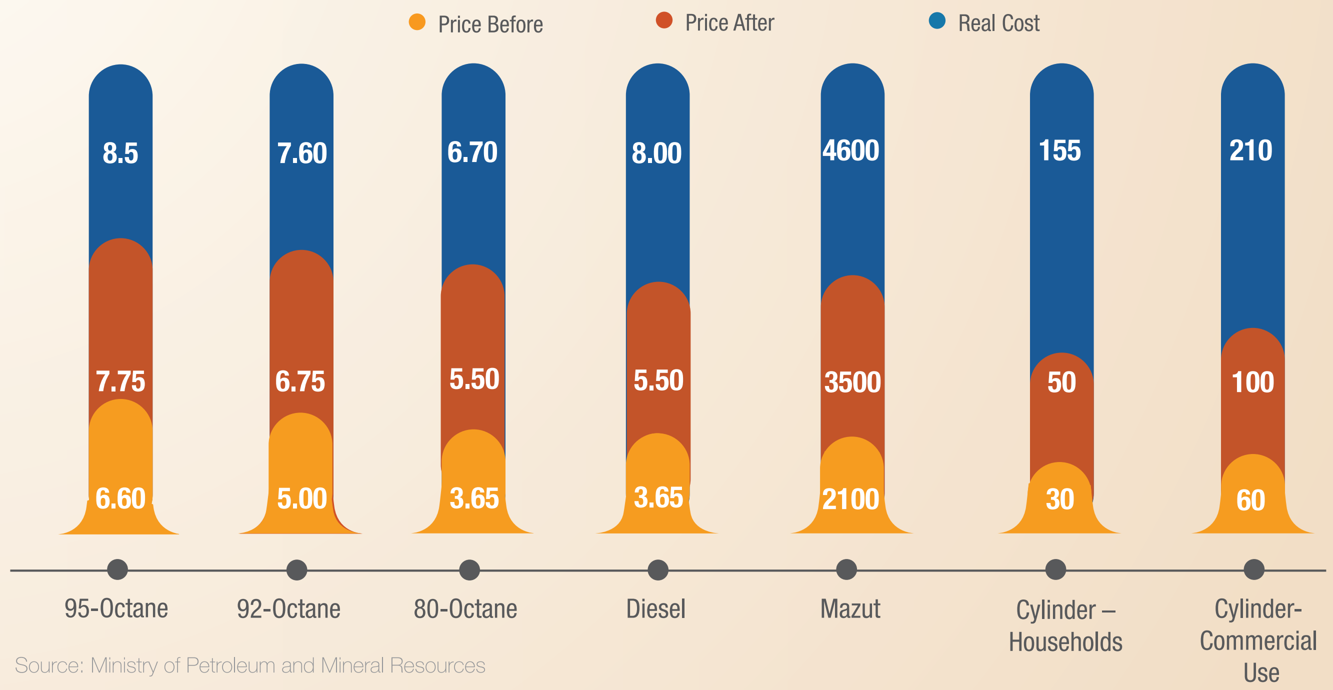
In February, the prime minister announced that an automatic fuel price indexation mechanism would be applied to most fuel products. The new mechanism was approved in June; however, it will be implemented by end-December 2018. The policy aims to adjust fuel prices according to many factors, including changes in global oil prices, the exchange rate, and the share of imported fuel in domestic consumption. In addition, it is designed to maintain the cost-recovery ratios for fuel products, safeguard the budget from unexpected changes in the exchange rate and global oil prices, and help ensure that available fiscal resources support the most vulnerable and not the wealthy, the IMF said in the third review of Egypt's economic program.

FY 2018/19 BUDGET



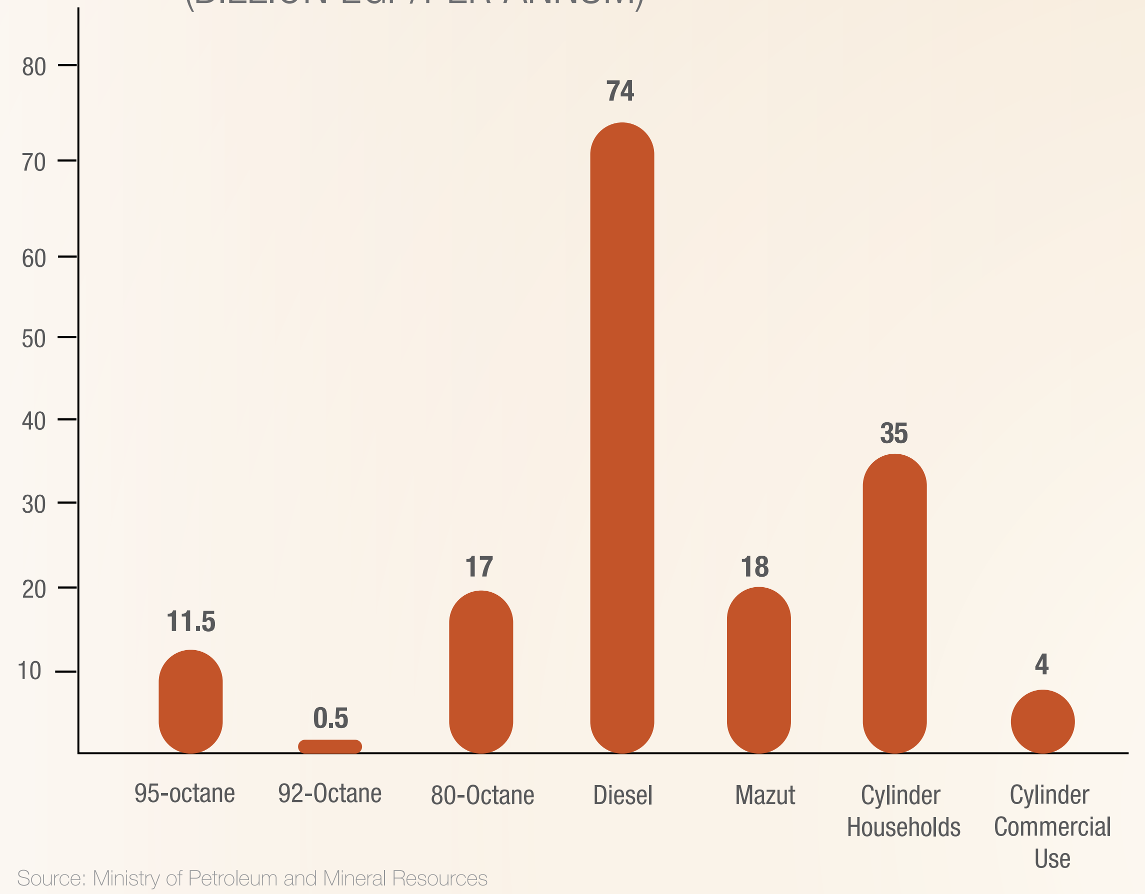
Source: Ministry of Finance

FUEL SUBSIDY CUTS (EGP)



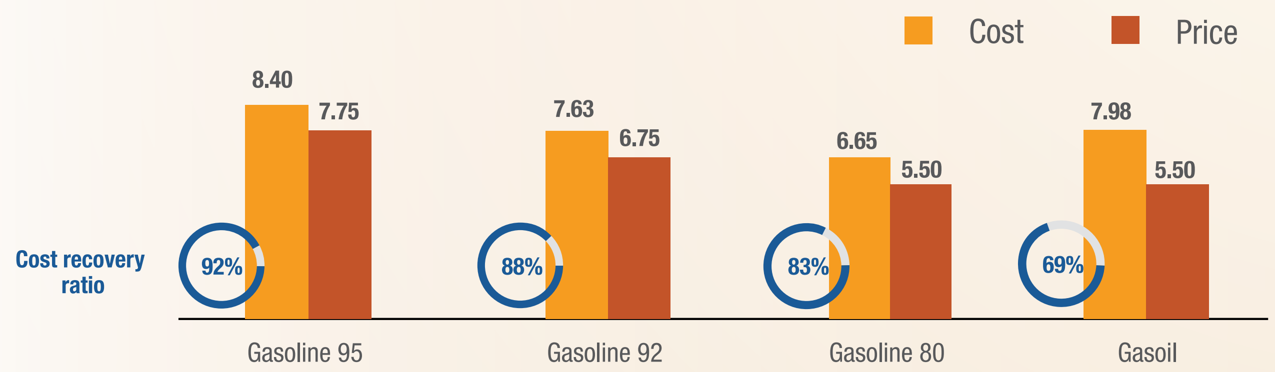
Source: Ministry of Petroleum and Mineral Resources

THE COST OF FUEL SUBSIDIES (BILLION EGP/PER ANNUM)



Source: Ministry of Petroleum and Mineral Resources

FUEL SUBSIDIES COST RECOVERY RATIO



Source: Ministry of Petroleum and Mineral Resources

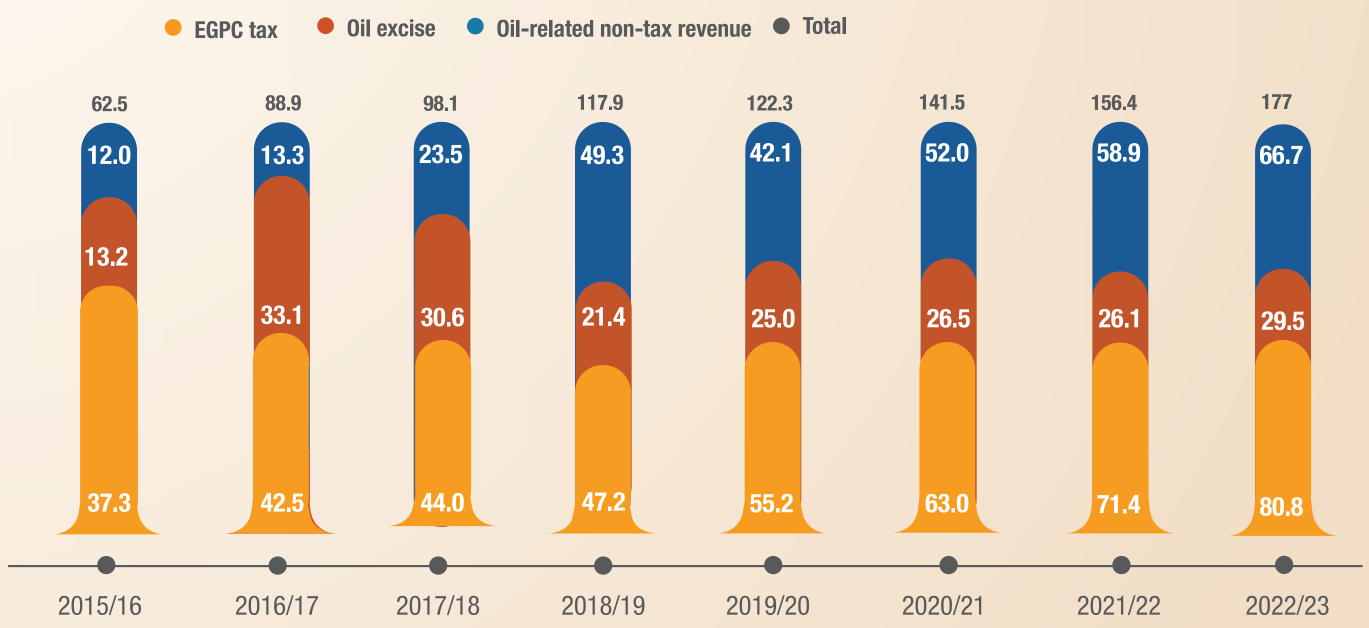
MAXIMIZING REVENUES

Along with energy subsidy cuts, the government's fiscal reform program includes increasing revenues through launching new taxes to reduce the country's ballooning budget deficit. Thus, Egypt implemented the VAT, a new sales tax that aims to improve the efficiency of tax collections, and broaden the tax base. Furthermore, VAT helps reduce the tax burden on job-creating manufacturers and helps improve Egypt's global profile as a competitive place to do business.

Replacing the 10% sales tax, VAT was first introduced in Egypt at a rate of 13% in October 2016. In January 2017, the state announced that it will bring forward to July 1, 2017 a 1% VAT rise to 14%. Daily News Egypt reported that the original plan had been to raise VAT on October 1, 2017. However, faced with a large deficit, the government decided to bring the tax rise forward in a bid to increase revenue for the fiscal year. The IMF expects that a 14% VAT rate will generate an average of 1.1 - 1.3% of GDP in additional revenues between FY 2016/17 and FY 2018/19. The fund projects VAT receipts to more than triple from EGP 179.5 billion in FY 2016/17 to EGP 613.1 billion in 2022/23.

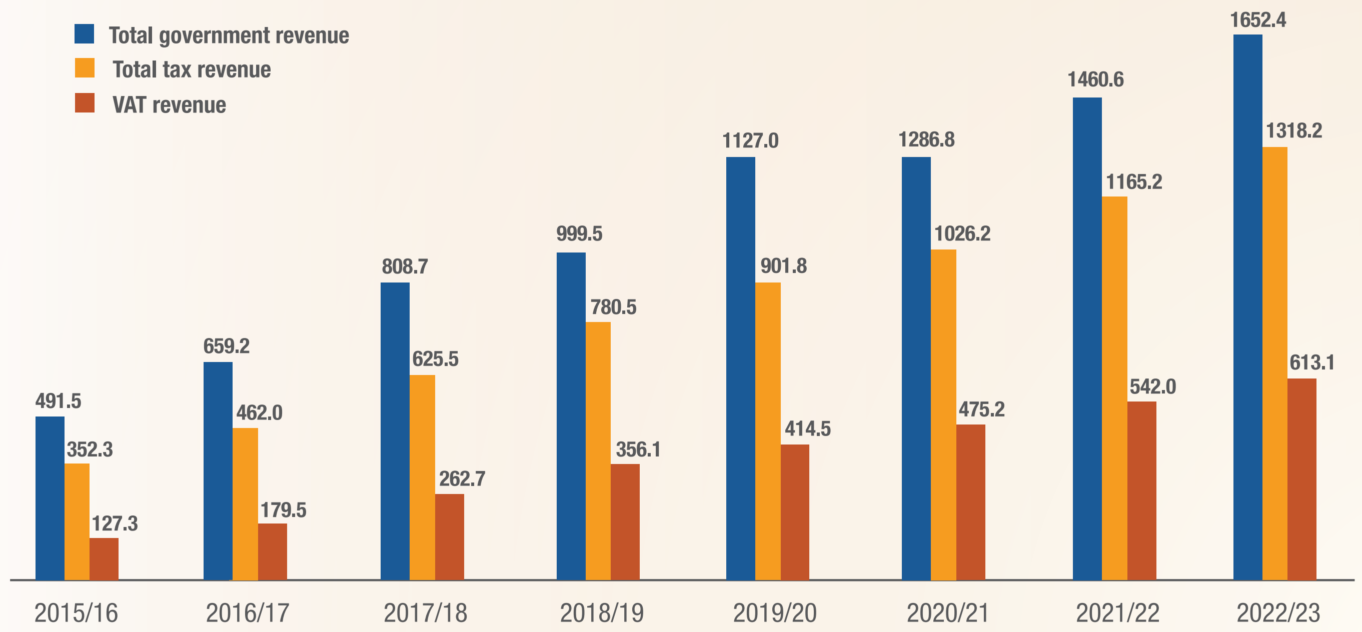
The short-run implications of tax reform have been evidenced in FY 2017/18. Overall tax revenues increased by 62% year-on-year (YOY) to EGP 249 billion in the first half of FY 2017/18, according to Ahram Online. VAT receipts were recorded at EGP 121 billion - an 83% YOY increase. This means that VAT accounted for almost half of the government's tax revenue between July and December 2016. It is worth noting that total revenues expected from the FY 2018/19 budget are around EGP 989 billion ($55 billion), EGP 817 billion of which would be spent on debts and interest. The IMF projected in their third economic review in July 2018 that the government will take EGP 780.5 billion in tax revenues in FY 2018/19, of which VAT will account for almost half of tax receipts at EGP 356.1 billion. The IMF forecasts tax revenue to increase substantially over the next four years, reaching EGP 1.318 trillion EGP.

GOVERNMENT REVENUE FROM OIL SECTOR (IN BILLION/EGP)



Source: IMF

GOVERNMENT REVENUE (IN BILLION/EGP)



Source: IMF

The Egyptian Tax Authority (ETA) is planning to increase tax revenues by retrospectively applying VAT to ride-sharing companies, such as Uber and Careem, for the past two years. The authority expects to collect up to EGP 6 billion in tax revenues from charging VAT on these two companies alone, according to Mubasher. Moreover, the ETA is actively looking into imposing VAT on online ad buys and e-commerce transactions; a move that would subject the online sale of goods and services to the tax on both domestic players and global giants such as Google and Facebook, Al Bawaba Business reported. The government aims to bring in EGP 7-9 billion from settling tax disputes in the current fiscal year, according to the ETA. However, the potential for online VAT is still under discussion as part of the finance ministry's plan to revamp the tax filing system for corporations in FY 2019/20. Thus, the authority plans to speak with players in the industry to discuss the best mechanism with which to impose VAT on both ad buys and e-commerce sales.

MONETARY
POLICY

MONETARY POLICY

EXCHANGE RATE LIBERALIZATION

On November 3, 2016, the CBE took the radical decision to abolish Egypt's fixed exchange rate system. Now, instead of the central bank determining the exchange rate, the value of the Egyptian pound would be subject to the market dynamics of interbank currency trading. The pound fell sharply against the US dollar from EGP 8.77 per dollar to EGP 14.635 per dollar on the day of the devaluation, before falling further to EGP 17.417 the following week. The IMF loan – upon which the currency floatation was conditioned – was finalized the following week.

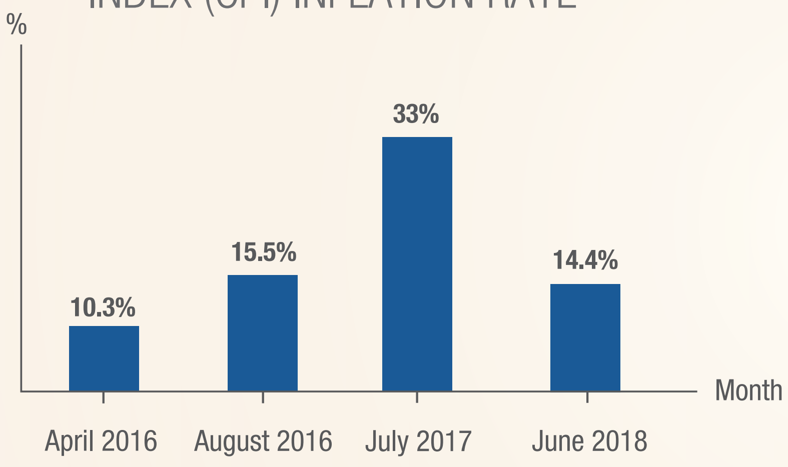
One of the CBE's key policy objectives of devaluing the currency was to combat the emergence of a black market that arose as dollars became scarcer, in the post-revolution environment. On November 3, 2016 dollar prices on the official market jumped above the black market for the first time, before falling back over the following week. Since the floatation, the difference between the official and black market rates has narrowed. In July 2018, dollars on the black market were $0.0079 more expensive than on the official market. This is a sharp contrast from the beginning of 2016 when the black market dollar rate was around $0.088 more expensive than the official dollar.

INFLATION

Since the CBE made its initial tentative adjustment to the exchange rate in March 2016, the rate of inflation has fluctuated wildly. Following the initial currency devaluation, the headline consumer prices index (CPI) rate of inflation – which includes more volatile commodities such as food and fuel – jumped from 9% in March to 10.3% in April. Headline inflation continued to rise steadily through the summer of 2016, peaking at 15.5% in August.

The floatation of the pound in November sent headline CPI surging to 19% - up from 13.5% in October – before climbing to 30% by the following February. After peaking at 33% in July 2017, inflation steadily declined to a pre-floatation low of 11.5%. Following government cuts to energy subsidies in the FY 2018/19 budget, headline CPI jumped by almost 300 basis points to 14.4% in June 2018 – the first increase in 11 months. The CBE said after June's MPC meeting that it expects inflation to fall to single digits by the end of 2018 after the effects of the subsidy cuts dissipate.

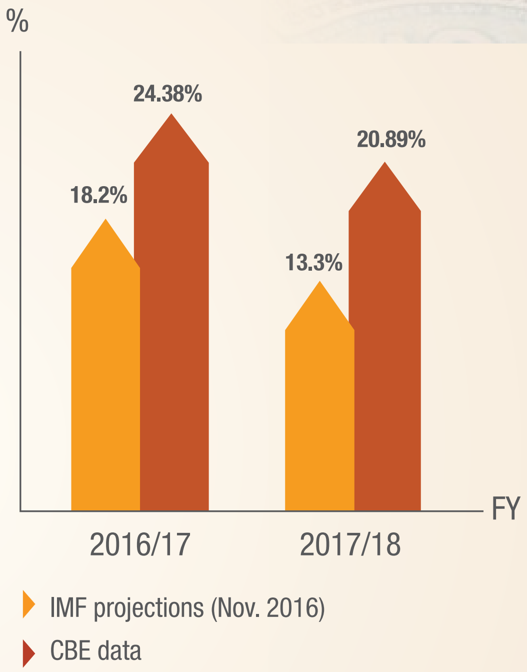
THE HEADLINE CONSUMER PRICES INDEX (CPI) INFLATION RATE



Source: CBE

When examining the CBE's core inflation data, it is evident that the IMF heavily underestimated the effects of the currency devaluation and subsidy cuts on the core CPI rate. While the fund was projecting average inflation rates of 18.2% in FY 2016/17 and 13.3% in 2017/18, CBE figures show that core CPI rose instead by 24.4% and 20.9% respectively. While these forecasts were inaccurate, the IMF's prediction that core inflation would fall to single digit figures by FY 2018/19 may still be realized. Core CPI continued to decrease in July 2018 (to 8.5%) - despite the latest round of energy subsidy cuts – and may continue to decline over the coming months.

ANNUAL CPI INFLATION VS. 2016 IMF PROJECTIONS

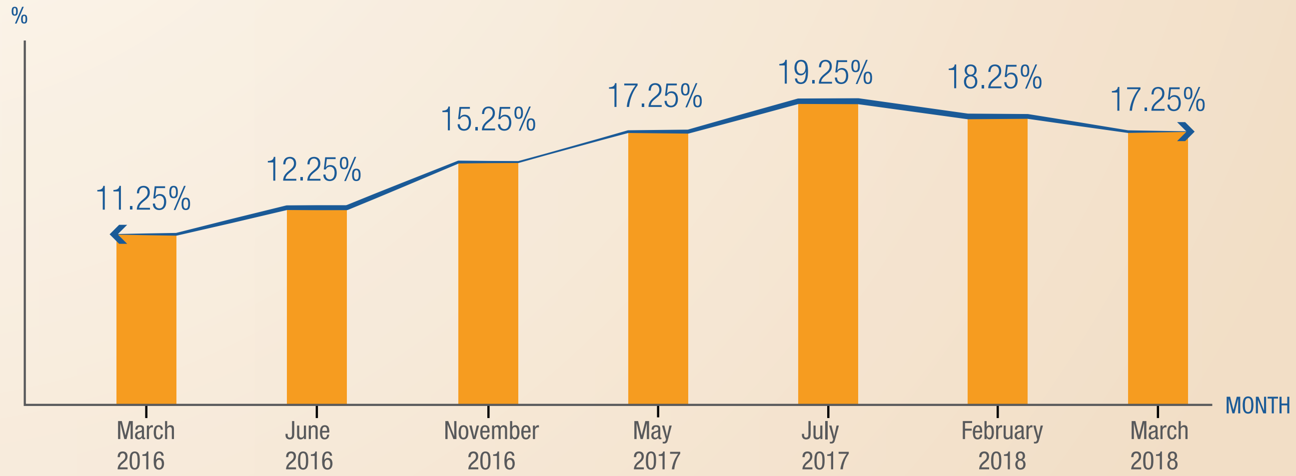


Source: CBE, IMF

INTEREST RATES

Since the partial floatation of the pound in March 2016, the CBE has followed a tight monetary policy, continuously raising interest rates in an effort to contain the inflationary effects of devaluation. The Monetary Policy Committee (MPC) raised the discount rate by 150 basis points to 11.25% in March 2016; 100 basis points in June 2016; 300 basis points in November 2016; 200 basis points in May 2017; and a further 200 basis points in July 2017 to reach 19.25%. Since inflation started on its downward trajectory in July 2017, the CBE has slightly reduced the discount rate to its current level of 17.25%.

DISCOUNT RATE



Source: CBE

The CBE's monetary tightening succeeded in containing the effects of devaluation – albeit only after inflation reached levels not seen since the 1980s. As per the loan agreement, declining inflation rates will be met with looser credit conditions. This means that should core inflation continue to decline over the medium term, we will likely see further reductions to interest rates and a gradual improvement in borrowing conditions. The IMF noted in its third review that the CBE should carefully monitor the inflationary effects of the latest of the round of subsidy cuts.

FOREIGN RESERVES

As a result of sealing the $12 billion deal between the CBE and the IMF, foreign reserves increased by 60%, reaching $31.03 billion in June 2017, according to official figures. In general, international reserves in Egypt have averaged around $22.7 billion from 2003 until 2017, reaching an all-time high of $37 billion in December 2017 and a record low of $13.4 billion in March 2013, according to the CBE.

In the 20 months since the floatation of the pound, increased foreign currency inflows have helped Egypt's foreign reserves to reach record highs. Reserves have almost doubled from $24.26 billion in December 2016 to $44.25 billion in June 2018, helped by a weaker currency and the first four loan disbursements. Government bond sales have also bolstered reserves - most notably in February 2018 when they jumped by $4.3 billion following a successful $4 billion Eurobond auction.

The latest IMF projections forecast foreign reserves to reach $44.8 billion by the end of the current fiscal year, before climbing to $45.3 billion in FY 2020/21 and $47.5 billion in FY 2021/22.

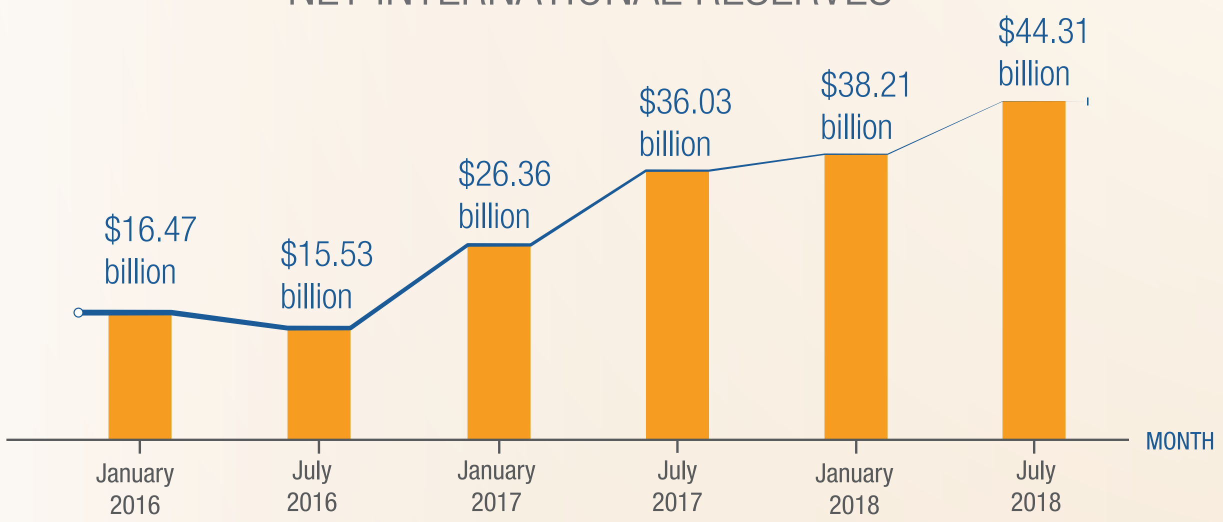
DOMESTIC AND EXTERNAL DEBT

While both domestic and external debts have experienced rapid increases this decade, data suggests that the pace of debt accumulation appears to have slowed since the government embarked on its economic reform program.

Data for gross domestic debt shows that debt reached EGP 3.414 trillion (83.8% of GDP) between July and December 2017, compared to EGP 3.053 trillion during the same period in 2016, according to the CBE.

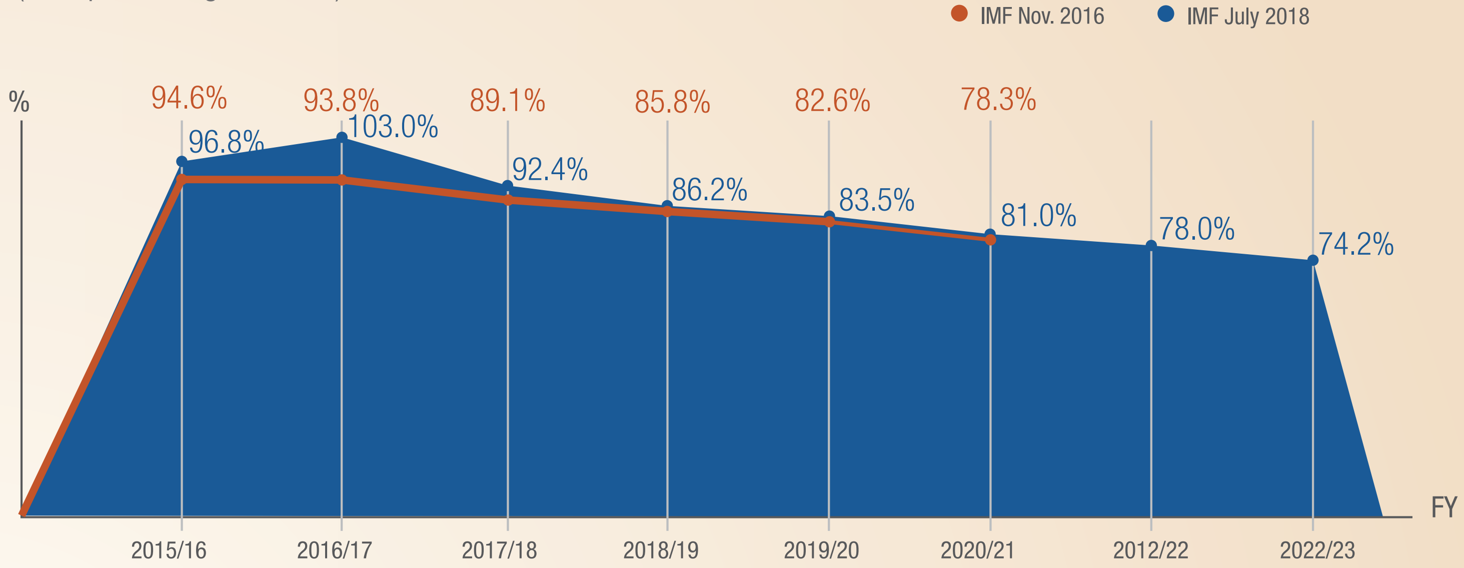
External debt data – available until Q2 2017/18 - demonstrates a similar trend. Debts rose from $67.3 million to $82.88 million (a $15.5 million increase) during the IMF period (Q2 2016/17 – Q2 2017/18). In comparison, debts increased by $19.5 million during the year before the IMF agreement (Q2 2015/16 – Q2 2016/17).

NET INTERNATIONAL RESERVES



Source: CBE

IMF GROSS GOVERNMENT DEBT PROJECTIONS: 2016 VS. 2018
(as a percentage of GDP)



Source: IMF

Under the IMF program, government debt as a percentage of GDP continued to increase in 2017. According to the fund's latest figures, gross government debt/GDP reached 103.3% in 2017, increasing from 96.8% in 2016. Current IMF forecasts see gross debt/GDP falling back to 91.2% in 2018 before decreasing to as much as 68.1% in 2023.

Egypt's credit rating has largely remained the same since the start of the economic reform program. The three largest credit rating agencies – Standard & Poor's (S&P), Fitch and Moody's – have not made major changes to their rating of Egyptian government debt. S&P has been the only agency to make changes to Egypt's credit profile since the start of the IMF program, upgrading Egyptian debt from B- to B in May 2018. S&P said that increasing gas production, rising exports, and a more competitive currency were helping to narrow the country's current account deficit and strengthen government finances. Fitch and Moody's have maintained their respective B and B3 ratings. In January 2018 Fitch raised their outlook from Stable to Positive, but said that Egypt's large government debt would remain the key obstacle to improving the country's credit profile.

In the debt markets, Egyptian government bonds have experienced considerable volatility since the partial floatation of the pound in March 2016. The largest shifts were seen in 3-month bonds, which surged from 10.988% in February 2016 to a peak of 20.757% in July 2017. However, longer-term bonds also saw considerable increases, with 10 and 5-year treasuries reaching peaks of 18.58% and 18.560% respectively in May 2017, while 1-year treasuries rose to 20.601% in July 2017.

Egypt's growing foreign reserves and stabilizing public finances contributed to a dramatic fall in long-term yields during the second half of 2017: 10-year bonds fell from their 18.58% peak to 15.45% in the five months between May and September. Similarly, 5-years fell 300 basis points to 15.50% in the same time period. Yields on short-term bonds also fell substantially, with 3-month treasuries falling almost 3% between July and September, while 6-month bonds fell by 240 basis points in the same period.

Yields have begun to creep back up since the beginning of 2018, amid a torrid six months for emerging markets. A strengthening dollar, US interest rate hikes, the rising price of oil and increasing tensions have raised fears about a slowdown in foreign investment in the Egyptian economy, and encouraged a sell-off in government bonds. Accordingly, 10-year bonds have moved from 14.75% in January to a new peak of 17.55% in July, and 5-years rose from 14.87% to 17.775% in the same time period. Short-term bond yields have experienced similar increases, with 6-months rising from 17.35% to 19.55% between April and June, and 3-months increasing 17.45% to 19.6%.

ARREARS TO IOCS

The exchange rate adjustment, in addition to the increasing foreign reserves, has helped in freeing up resources to pay for part of the accumulated arrears to IOCs, which stood at $2.2 billion at the end of January 2018 down from $3.5 billion in end-2016, according to the World Bank.

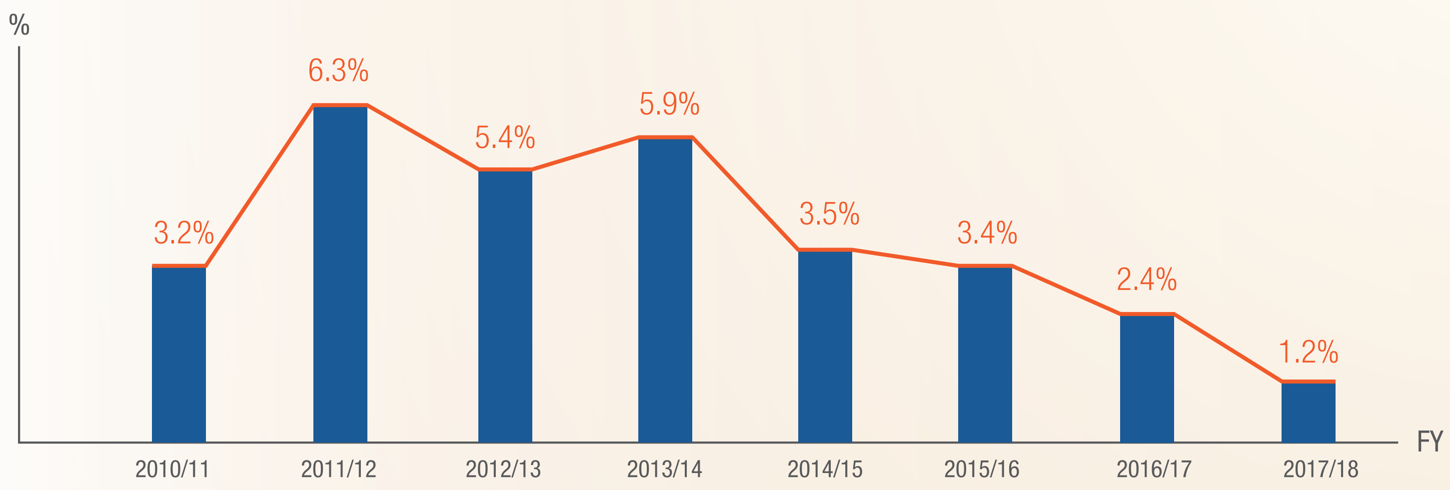
The arrears owed to IOCs have now fallen to $1.2 billion, beating 2010's record low of $1.35 billion, according to the Ministry of Petroleum and Mineral Resources' press release. Moreover, Egypt's national oil companies (NOCs) will pay all debts owed to international partners before the end of 2019, as Egypt's Minister of Petroleum and Mineral Resources, Tarek El Molla, has mentioned on many occasions.

In FY 2011/12, Egypt faced the highest foreign debt to IOCs, reaching $6.3 billion, according to official figures. One year later, Egypt's then-interim government was trying to handle the daunting task of restoring the petroleum sector. The government's debt to IOCs was successfully decreased to $5.4 billion by the end of the year, yet burdened the country's budget and negatively affected investors' confidence in the sector.

As soon as he took over power, President Abdel Fattah El Sisi has pledged in several occasions to mitigate those debts, and that the government is "committed" to paying NOCs' arrears.

As a result, the Ministry of Petroleum and Mineral Resources was successfully able to cut the receivables total almost in half to $3.4 billion in FY 2015/16, according to official figures. This has been accompanied by well-received moves to speed up decision-making over block and concession awards, as well as a new revised model contract.

ARREARS TO IOCS (IN BILLION/$)



Source: Ministry of Petroleum and Mineral Resources

TRADE AND INVESTMENT

TRADE AND INVESTMENT

BALANCE OF PAYMENTS

Egypt's international transactions are dependent on three main sources of revenue: tourism, the Suez Canal, and hydrocarbon exports. The three sources have not changed over the past decade, which makes the economy increasingly vulnerable to external factors.

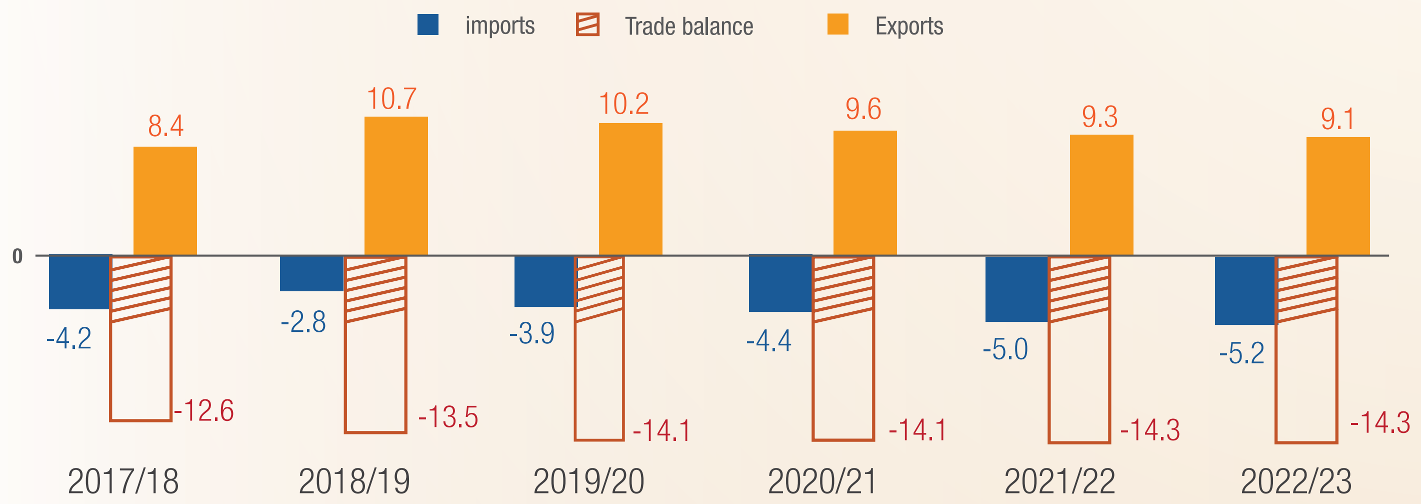
In the light of the static structure of Egypt's BOP, the government had to take steps toward diversifying and strengthening revenue sources. The current economic reform program is mainly aiming to reduce the BOP's deficit and create more internal sources of revenue. Yet, the reform has had negative effects in the short-run. Faced with higher import costs after floating the exchange rate in November 2016, importers had to choose between maintaining their margins or their market share. One determiner of this choice can be the scale of any depreciation.

A modest change would be easier to absorb in terms of costs, and the first partial depreciation in March 2016, of around 13%, did not result in a significant rise in inflation. However, after the second depreciation due to November's floatation, on top of the increase in prices for imported factors of production, most private corporates in the formal sector raised wages by 10-20%, making an increase in selling prices necessary, a report by BNP Paribas highlighted.

On the other hand, the positive effects of the reform manifested in FY 2016/17 as Egypt's international transactions ran an overall BOP surplus of $13.7 billion. Of this, $12.2 billion was realized between November and June following the CBE's decision to float the currency. This is a large improvement when compared to the overall BOP deficit of $2.8 billion in the previous fiscal year. Positive BOP data continued into the following fiscal year as well, as the government revealed an overall BOP surplus of $11 billion between July and March in FY 2017/18.

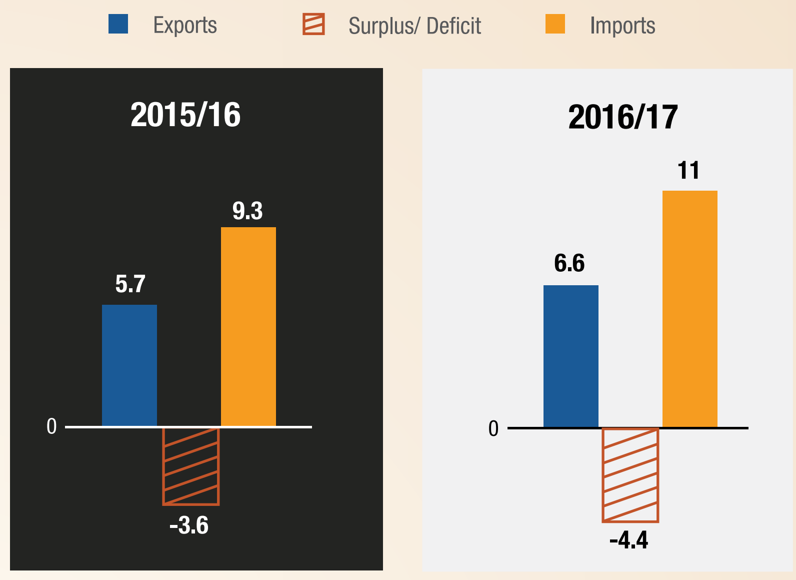
The current account continued to improve, with a sharp contraction of 57.5% ($7.2 billion) in its deficit, posting $5.3 billion against $12.5 billion in the same period a year earlier. This improvement was an outcome of the increase in both services balance surplus by 138.2% and net current transfers by 23.2%, and the retreat in trade deficit by 1.3%, according to the CBE.

PETROLEUM BALANCE OF TRADE (IN BILLION/$)



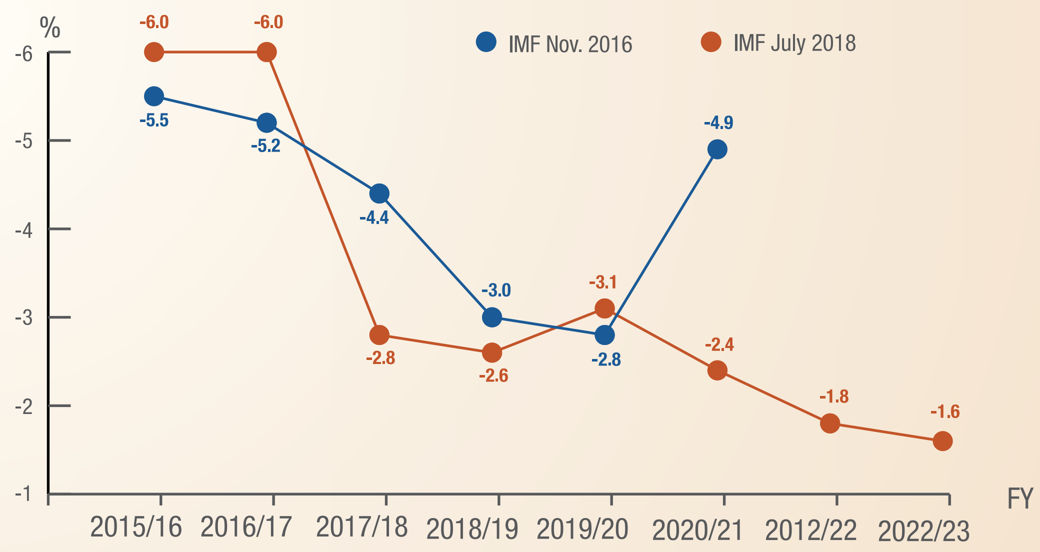
Source: IMF

PETROLEUM BALANCE OF TRADE (IN BILLION/$)



Source: Ministry of Petroleum and Mineral Resources, MPMAR, CBE

IMF CURRENT ACCOUNT PROJECTIONS:
2016 VS. 2018 (AS A PERCENTAGE OF GDP)



Source: IMF

It is worth noting that in FY 2014/15, Egypt had to halt liquefied natural gas (LNG) exports and became a net natural gas importer, with a hydrocarbon external deficit of $3.6 billion compared with a surplus of $5.1 billion in FY 2009/10. During that period, the current account deficit was largely driven more by the negative hydrocarbon balance than by the decline in tourism, according to the CBE's statistics.

In the mid-term, the IMF expects Egypt's overall balance to reach an overall surplus of $1.1 billion in 2020/21. It further expects the current account deficit to be $8.9 billion and the trade deficit at $45.3 billion.

FOREIGN DIRECT INVESTMENT

In 2015, Egypt's Ministry of Investment and International Cooperation began drafting a new investment law before even launching the economic reforms. On June 1, 2017 Egypt approved the long-awaited Investment Law No. 72 of 2017. The new law replaces the former No. 8 of 1997, previously amended in March 2015, according to a 2017 report by Alex Bank entitled "Egypt's News Investment Law". The new law reflects the efforts made by the Egyptian government and legislative authorities to avoid any misreading of local and foreign investors' needs. It is designed partly to make things easier for investors and businesses to obtain free or subsidized land, and protects contracts against challenges from third parties, according to a study by the American Chamber of Commerce in Egypt.

Furthermore, foreign investors have returned to the Egyptian debt market in FY 2016/17, buying around $13 billion as of the end of June compared to $1 billion the year before, as hikes in interest rates boosted appetite in the country's domestic debt, according to a presidency statement. As an overall result of the economic reform, investments in FY 2016/17 jumped 27.5% from a year earlier, according to the Ministry of Finance's report.

FDI in the petroleum sector increased by $1.3 billion to $8.1 billion in FY 2016/17, up 19% from the $6.8 billion invested in FY 2015/16, according to the Ministry of Petroleum and Mineral Resources. In FY 2016/17, Egypt's oil and gas sector received around EGP 90.1 billion of investments, increasing by 9.1% on the previous fiscal year. It is worth noting that 73% of these investments were injected into natural gas exploration activities, while crude oil amounted to 10.2% of total inward investments, and other extractions represented 16.8%, according to MPMAR.

Affirming the economic importance of the oil and gas sector in Egypt, MPMAR figures highlight that from FY 2010/11 until FY 2015/16, petroleum investments represented more than 20% of total investments injected into the national economy.

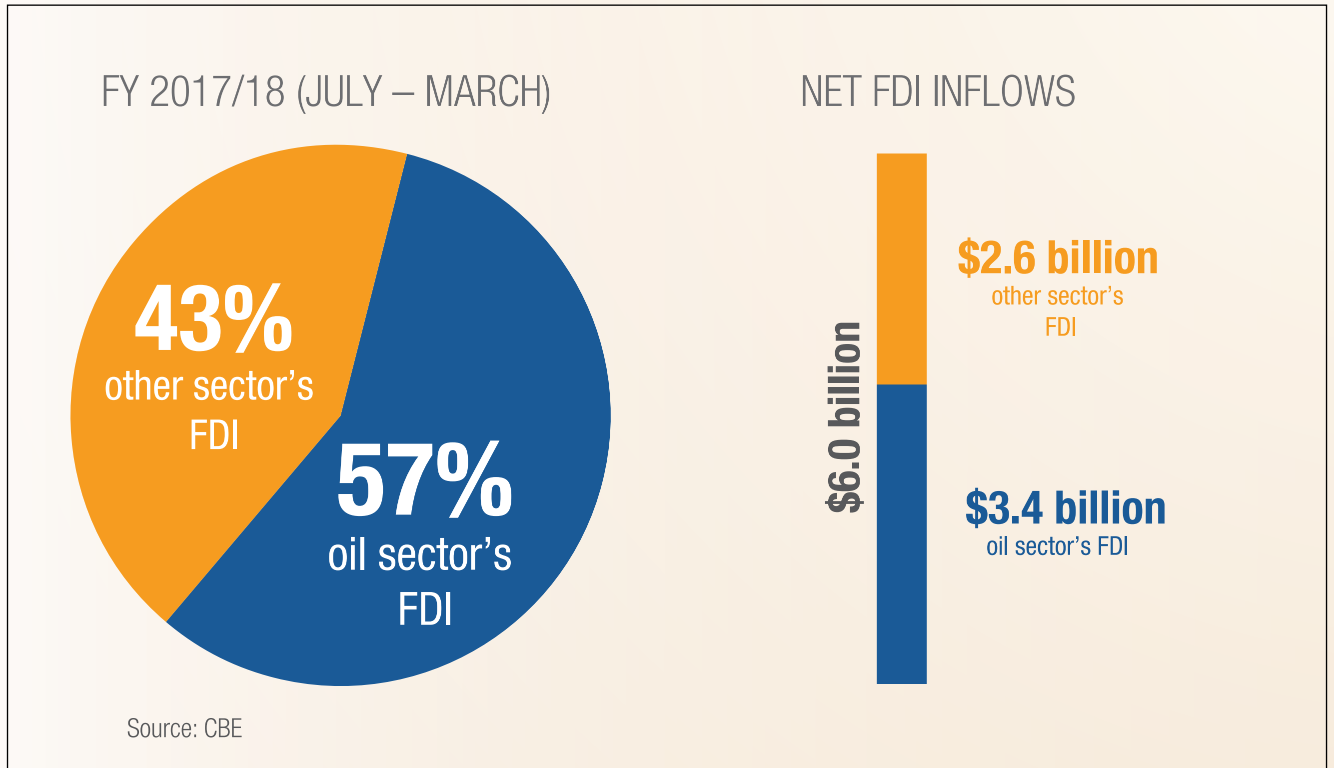
The latest available data show that total FDI inflows in Egypt recorded around $10.2 billion, while total outflows reached $4.2 billion between July and March of FY 2017/18. Accordingly, net FDI in Egypt amounted to $6.0 billion of inflows, mainly due to the net investment of $3.4 billion in the oil sector, according to the CBE.

Having an optimistic outlook for Egypt's net FDI, the IMF expects Egypt to receive a net FDI of $12.6 billion by the end of FY 2020/21, representing around 3.5% of GDP.

The above figures affirm that the authorities are determined to continue with the reforms, and that there is great progress in addressing various issues that IOCs are facing within the Egyptian market today. This will hopefully drive additional investments and further increase their confidence in the Egyptian economy.

With the current international challenges facing the country, the government will not risk facing another sharp decline in investment, like what happened after the events of 2011 or after the severe decrease in international oil prices in 2014. For instance, total investments in the natural gas sector decreased by more than 50%, from EGP 54.3 billion in FY 2011/12 to around EGP 25.5 billion in FY 2013/14, according to MPMAR.

The international challenges currently facing Egypt include the decline in the FDI pumped into the emerging markets and the developing countries due to the increasing interest rates in the US. In addition, a brewing American-Chinese trade war, the fluctuating international oil prices, and the American-Iranian tensions are indirectly affecting petroleum FDI into Egypt.



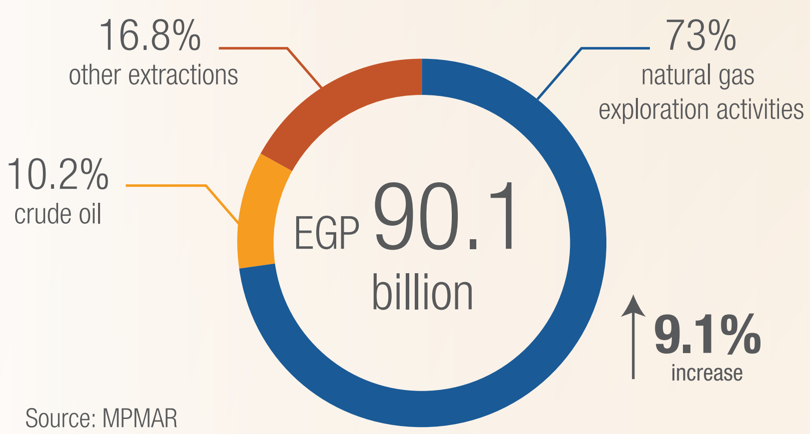
Source: CBE

In conclusion, the falling FDI into Egypt's petroleum sector is not only due to the state of political unrest and domestic economic issues, but international factors as well - especially the decline of global oil prices.

Nonetheless, during the past three years, Egypt has signed more than 82 new upstream exploration and production agreements with a minimum commitment of $15.4 billion in investments, according to an official press release.

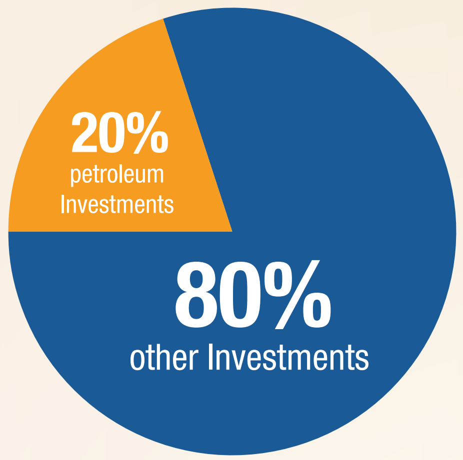
Egypt's hydrocarbon industry is well positioned to benefit from current economic reforms in the light of the growth of the country's natural gas production, which could help drive the Egyptian economy in the future. Moreover, the increase in foreign reserves is supporting investors' confidence, as it improves exchange market stability and therefore reduces exchange risk associated with capital investment decisions.

OIL AND GAS INVESTMENTS: FY 2016/17



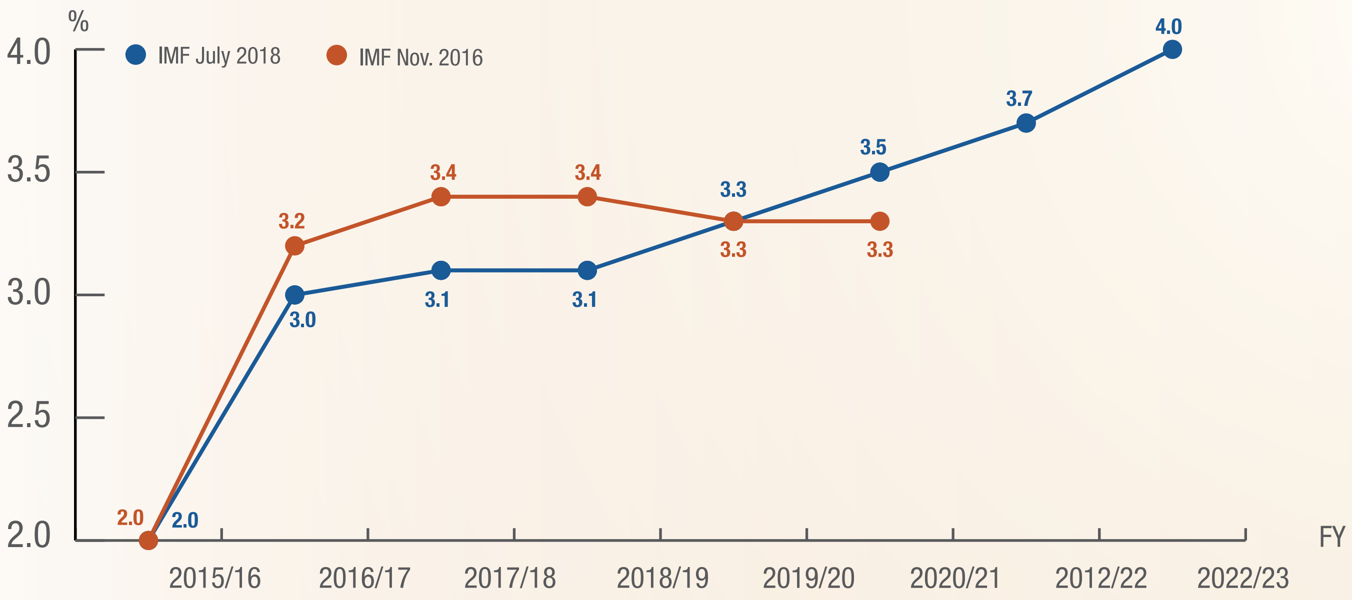
Source: MPMAR

FY 2010/11 – FY 2015/16



Source: MPMAR

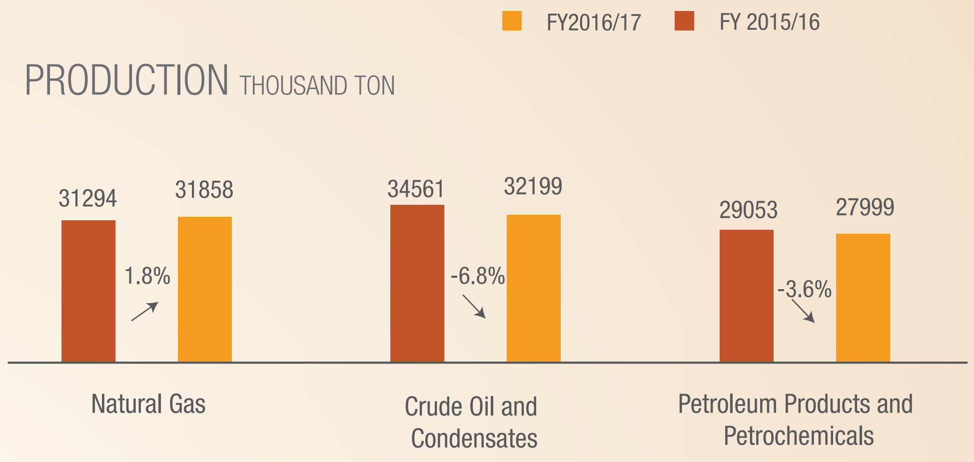
IMF NET FDI PROJECTIONS: 2016 VS. 2018 (AS A PERCENTAGE OF GDP)



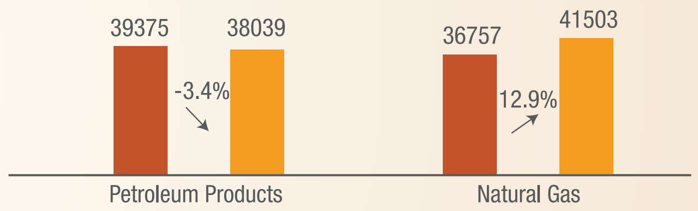
Source: IMF

PETROLEUM SECTOR'S MAIN ACTIVITIES: FY 2015/16 - FY 2016/17

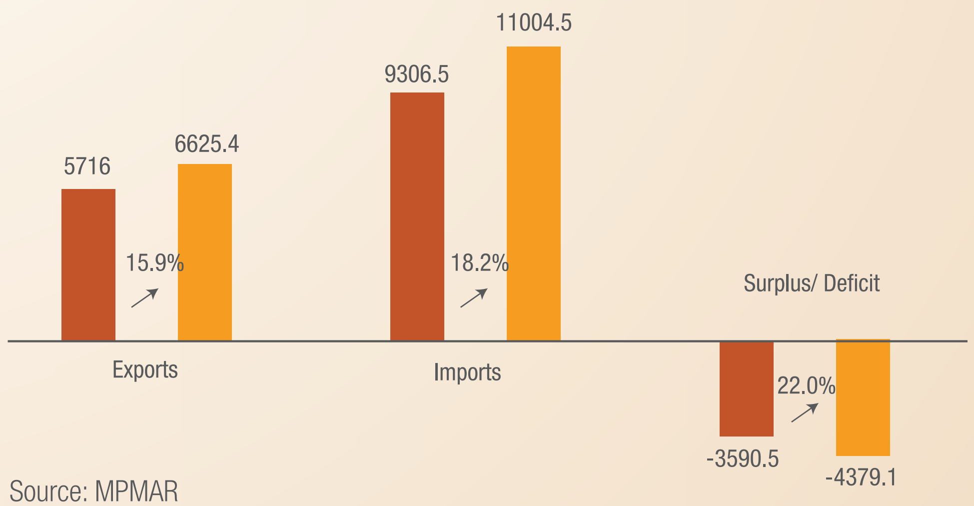
PRODUCTION THOUSAND TON



CONSUMPTION THOUSAND TON



PETROLEUM TRADE BALANCE MILLION $



Source: MPMAR

CONCLUSION

CONCLUSION

Over the past 20 months, Egypt has made significant progress implementing the program of reforms agreed with the IMF in November 2016. Key monetary and fiscal policy changes have started to deliver positive results both in the petroleum sector and the wider economy. Foreign investment in the country's oil and gas industries has notably increased, while the government's dedication to paying off all arrears accumulated by state-owned companies is enhancing the state's reputation as a reliable partner for IOCs.

In terms of the broader economy, the reforms are translating into positive economic data, with annual GDP growth projected to hit 6% in 2020/21, foreign reserves rising to record highs, and inflation heading towards single-digit figures.

There, however, remains more to do. Over the coming years the government will continue to work towards narrowing the budget deficit, bringing public debt levels under control and reducing overall government expenditure. A critical part of this will be ensuring that the government achieves its target for fuel subsidies, which are scheduled to be eliminated completely by the end of FY 2018/19. Alongside the reduction of the state subsidy bill, rising tax receipts driven by efforts to increase private sector financial inclusion will have positive changes on Egypt's budget deficit.

The government is yet to announce dates for the long-awaited initial public offering (IPO) program of state-owned companies – a policy that will also help to shore up state finances. While a list of 23 companies was released earlier in 2018, there have been no official statements regarding company valuation or IPO dates.

Overall, the future looks bright for Egypt's petroleum sector. With increasing production rates, rising revenues and a spate of new exploration and production activities underway, the government's commitment to the economic reform program is paying dividends for both the sector and the wider Egyptian economy.

APPENDIX

ECONOMIC INDICATOR/ FISCAL YEAR	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Balance of Payments	**IN BILLIONS US$**									
Current account	-2.4	-12.2	-19.8	-15.3	-6.9	-8.1	-10.8	-8.9	-7.1	-6.6
Balance on goods and services	-25.4	-28	-32.2	-30.5	-25.3	-25.5	-29.5	-29	-28.6	-29.8
Exports of goods and services	43.6	43.9	34.8	37.6	45.8	53.1	57.9	62.5	67.9	74.4
Imports of goods and services	-69	-71.9	-66.9	-68	-71.1	-78.5	-87.4	-91.5	-96.4	-104.2
Capital and financial account	4.9	17.6	21.2	14.4	12.5	5.4	8.4	10	9.8	10.3
FDI (net)	3.8	6.1	6.8	7.7	7.8	9.5	11.3	12.6	14.3	16.9
Overall balance	1.8	6.1	-2.8	-2.1	5.8	-2.7	-2.3	1.1	2.7	3.7
External debt [1]	46.1	47.2	55.8	79.9	86.9	91.5	87.5	87.5	87.1	82.9
External debt service	2.9	2.9	5	7.3	12	14.7	17	10.6	9.1	10.7
Budget Data	**IN BILLIONS EGP**									
Total government revenue	436.3	465.3	491.5	659.2	808.7	999.5	1127	1286.8	1460.6	162.4
Tax revenue	260.3	306	352.3	462	625.5	780.5	901.8	1026.2	1165.2	1318.2
Non-tax revenue	100.6	133.8	135.6	179.5	182	217.8	224	259.4	294.1	332.7
Total government expenditure	701.5	733.3	817.6	1031.9	1229.7	1430.4	1493.2	1611.4	1778	2013.8
Wages and other remunerations	178.6	198.5	213.7	225.5	240	266.1	306.1	352.5	399.6	452
Purchases of goods and services	27.2	31.3	35.7	42.5	48.1	60.1	66.7	71.9	79.1	89.4
Interest payments	173.1	193	243.4	316.6	433.5	542.7	506.9	490.8	503.4	571.8
Subsidies, grants, social benefits	228.6	198.6	201	276.7	331	337.3	342.1	390.7	455.5	515.3
Energy subsidies	139.5	97.5	81.1	142.6	150.9	115.1	52.8	26.8	29.5	33.3
Fuel subsidies	126.2	73.9	51	115	120.9	99.1	40.4	26.8	29.5	33.3
Investment	52.9	61.7	69.3	109.1	111.4	148.5	178	199	221.6	250.7
Cash balance	-265.2	-268	-326.1	-372.8	-421	-430.9	-366.3	-324.7	-317.4	-361.4
Primary balance	-102.8	-86.3	-95.9	-63	9.1	108	123.4	144.9	162	183.2
Overall balance [2]	-275.9	-279.3	-339.3	-379.6	-430.4	-434.7	-383.5	-345.9	-341.4	-388.6

[1] Includes multilateral and bilateral public sector borrowing, private borrowing and prospective financing (in 2011/12).
[2] IMF staff definition
Source: IMF

ECONOMIC INDICATOR/ FISCAL YEAR	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
National Accounts	**ANNUAL CHANGE (%)**									
Real GDP at market price	2.2	4.2	4.3	4.2	5.2	5.5	5.9	6	6	6
Domestic demand	4	4	5.5	5	3.9	4.8	4.9	5.1	5.3	5.3
Domestic consumption	4.4	3.3	4.6	4	3.2	3.2	3.4	3.7	3.8	3.6
Investment	1.7	8.6	11	11.3	8.2	13.6	12.1	11.3	11.4	11.8
Gross fixed capital formation	1.4	9.8	19.6	7.7	11.8	13.6	12.1	11.3	11.4	11.8

[1] Includes multilateral and bilateral public sector borrowing, private borrowing and prospective financing (in 2011/12).
[2] IMF staff definition
Source: IMF

ECONOMIC INDICATOR/ FISCAL YEAR	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Balance of Payments	**IN % OF NOMINAL GDP**									
Current account	-0.8	-3.7	-6	-6	-2.8	-2.6	-3.1	-2.4	-1.8	-1.6
Balance on goods and services	-8.4	-8.5	-9.7	-11.9	-10.1	-8.3	-8.5	-8	-7.4	-7
Exports of goods and services	14.4	13.3	10.5	14.7	18.3	17.4	16.8	17.2	17.6	17.6
Imports of goods and services	-22.9	-21.8	-20.1	-26.5	-28.4	-25.3	-25.3	-25.1	-25	-24.7
Capital and financial account	1.6	5.3	6.4	5.6	5	1.8	2.4	2.7	2.5	2.4
FDI (net)	1.3	1.9	2	3	3.1	3.1	3.3	3.3	3.7	4
Overall balance	0.6	1.8	-0.8	-0.8	2.3	-0.9	-0.7	0.3	0.7	0.9
External debt [1]	15.3	14.3	18.3	41.3	34.5	29.9	26.4	25	23.3	19.7
External debt service	0.1	0.1	1.5	2.8	4.8	4.8	4.9	2.9	2.4	2.5
Budget Data	**IN % OF NOMINAL GDP**									
Total government revenue	20.8	19.1	18.1	19	18.2	18.6	18	18	18	18
Tax revenue	12.4	12.6	13	13.3	14.1	14.5	14.4	14.3	14.4	14.4
Non-tax revenue	4.8	5.5	5	5.2	4.1	4.1	3.6	3.6	3.6	3.6

[1] Includes multilateral and bilateral public sector borrowing, private borrowing and prospective financing (in 2011/12).
[2] IMF staff definition
Source: IMF

ECONOMIC INDICATOR/ FISCAL YEAR	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Total government expenditure	33.4	30.2	30.2	29.7	27.7	26.7	23.8	22.5	21.9	21.9
Wages and other remunerations	8.5	8.2	7.9	6.5	5.4	5	4.9	4.9	4.9	4.9
Purchases of goods and services	1.3	1.3	1.3	1.2	1.1	1.1	1.1	1	1	1
Interest payments	8.2	7.9	9	9.1	9.8	10.1	8.1	6.9	6.2	6.2
Subsidies, grants, social benefits	10.9	8.2	7.4	8	7.5	6.3	5.5	5.5	5.6	5.6
Energy subsidies	6.6	4	3	4.1	3.4	2.1	0.8	0.4	0.4	0.4
Fuel subsidies	6	3	1.9	3.3	2.7	1.8	0.6	0.4	0.4	0.4
Investment	2.5	2.5	2.6	3.1	2.5	2.8	2.8	2.8	2.7	2.7
Cash balance	-12.6	-11	-12	-10.7	-9.5	-8	-5.8	-4.5	-3.9	-3.9
Primary balance	-4.9	-3.6	-3.5	-1.8	0.2	2	2	2	2	2
Overall balance [2]	-13.1	-11.5	-12.5	-10.9	-9.7	-8.1	-6.1	-4.8	-4.2	-4.2
National Accounts	**IN % OF NOMINAL GDP**									
Real GDP at market price	100	100	100	100	100	100	100	100	100	100
Domestic demand	108.5	108.4	109.6	112.2	109.4	107.7	107.9	107.3	106.7	106.4
Domestic consumption	94.7	94.1	94.5	96.9	94.1	91.2	90.5	89	87.4	86
Investment	13.8	14.4	15	15.3	15.3	16.4	17.4	18.3	19.3	20.4
Gross fixed capital formation	12.6	13.7	14.5	14.8	15.3	16.4	17.4	18.3	19.3	20.4

[1] Includes multilateral and bilateral public sector borrowing, private borrowing and prospective financing (in 2011/12).
[2] IMF staff definition
Source: IMF

OFFICIAL VS. PARALLEL EXCHANGE RATES (USD)

DATE	BUY			SELL		
	OFFICIAL	PARALLEL		OFFICIAL	PARALLEL	
9/7/18	17.8313	17.8392	-0.0079	17.9557	17.9392	0.0165
8/7/18	17.8223	17.8353	-0.013	17.952	17.9349	0.0171
5/7/18	17.8174	17.8343	-0.0169	17.9511	17.9343	0.0168
4/7/18	17.813	17.8324	-0.0194	17.9443	17.9324	0.0119
8/11/16	17.417	17.5837	-0.1667	17.8427	17.9723	-0.1296
7/11/16	16.4111	16.3929	0.0182	17.2632	17.2329	0.0303
6/11/16	15.6643	15.7297	-0.0654	16.2222	16.3159	-0.0937
3/11/16	14.635	13.5277	1.1073	14.655	14.2757	0.3793
2/11/16	8.77	8.8583	-0.0883	8.79	8.88	-0.09
14/3/16	8.84	8.9252	-0.0852	8.86	8.9494	-0.0894
13/3/16	7.7201	7.8083	-0.0882	7.7401	7.8301	-0.09
5/1/16	7.7201	7.808	-0.0879	7.7401	7.8301	-0.09
4/1/16	7.7201	7.8083	-0.0882	7.7401	7.8301	-0.09

Source: CBE

EGYPT IN GLOBAL RANKING INDICATORS

INDICATOR	SCORE	GLOBAL RANKING (2017)	GLOBAL RANKING (2016)	YEARLY CHANGE
Global Competitiveness Index (WEF)	3.9	100/137	115/138	15
Ease of Doing Business Index (WB)	N/A	128/190	122/190	-6
Global Innovation Index	27.16	105/127	107/128	2
Human Capital Index (WEF)	55.9	97/130	86/130	-11
Sustainable Development Goals (UN)	64.9	87/157	66/149	-21
Global Energy Architecture Index (WEF)	0.55	90/127	83/126	-7

Source: UN, World Bank, WEF, Cornell University

HEADLINE VS. CORE INFLATION (OCTOBER 2016 – JUNE 2018)

MONTH	HEADLINE CPI	CORE CPI
July -18	13.5%	8.5 %
Jun-18	14.38%	10.90%
May-18	11.45%	11.09%
Apr-18	13.12%	11.62%
Mar-18	13.32%	11.59%
Feb-18	14.40%	11.88%
Jan-18	17.07%	14.35%
Dec-17	21.90%	19.86%
Nov-17	25.98%	25.54%
Oct-17	30.82%	30.53%
Sep-17	31.59%	33.26%
Aug-17	31.92%	34.86%
Jul-17	32.95%	35.26%
Jun-17	29.76%	31.95%
May-17	29.71%	30.57%
Apr-17	31.46%	32.06%
Mar-17	30.91%	32.25%
Feb-17	30.25%	33.10%
Jan-17	28.14%	30.86%
Dec-16	23.27%	25.86%
Nov-16	19.43%	20.73%
Oct-16	13.56%	15.72%

Source: CBE, CAPMAS

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