# Financial stability and growth

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**The CBE has worked over the last three years to bring inflation to stable and comfortable levels**

Egypt's economy has demonstrated strong economic growth, even during the financial crisis. In the fiscal year that ended in June, the economy grew at 4.7 per cent. Egypt's strong external position, its sound banking system, and the bold reforms implemented since 2002, have enabled Egypt to weather the impact of the global financial crises.

It is also among the 10 most-active reformers for the fourth year running, moving up to 106th place from 116 among 183 economies worldwide in the World Bank's Overall Ease of Doing Business ranking.

With the goal of maintaining price stability, the CBE has worked over the last three years to bring inflation to stable and comfortable levels that foster investment and economic growth. Inflation has also been affected by demand-side factors associated with sustained economic growth. Moreover, Egypt was hard hit by the global price increases of food, energy and other primary goods between 2007 and 2008. The inflation rate for the period was 11.7 per cent. In response, the CBE gradually raised interest rates: the overnight deposit and lending rates during June, August and September 2008 rose by 1.5 percentage points to reach 11.5 per cent and 13.5 per cent, respectively.

The global economic downturn led to moderating inflationary pressures in the Egyptian economy. The headline CPI annual inflation rate declined to 14.3 per cent and 13.5 per cent in January and February 2009 to record an accumulative drop of 10.1 percentage points over six months. In response, the CBE cut the overnight deposit and lending rate 6 times starting from February 2009 to September to reach 8.25 per cent and 9.75 per cent respectively. During December 2009, February and March 2010, the CBE left the overnight deposit and lending rate unchanged at 8.25 per cent and 9.75 per cent, respectively: the annual inflation rates declined to 12.8 per cent and 12.2 per cent, respectively during these two months.

The CBE Monetary Policy Unit (MPU) has launched a core inflation measure derived from headline inflation, that is used as a complementary indicator to distinguish the underlying trend of inflation, and also provides a means by which the monetary authority can separate the 'noise' and short-run fluctuations in the incoming data from the more persistent trend which provides 'signals' about current and future inflation. The annual core CPI inflation registered 7.39 per cent, 6.90 per cent and 7.04 per cent in January, February, and March 2010, respectively.

The Banking Sector Reform Programme was introduced as an integral part of the economic reform programme aiming at creating a sound and diversified financial sector, capable of contributing to Egypt's growth and providing access to financial services to a much broader segment of the Egyptian population. The programme was based on two phases: Phase I, during the period (2004-08) entailed four main pillars: (i) Privatisation and consolidation of the banking sector; (ii) addressing the non-performing loans issue; (iii) financial and managerial restructuring of state-owned banks; (iv) upgrading CBE banking supervision, restructuring and consolidation. It is worth mentioning that Phase I was one of the main reasons that the banking system has been able to withstand the financial turmoil.

The core objectives of Phase II (2009-11) are focusing on deepening the Egyptian banking sector, enhancing its efficiency, competitiveness, transparency, and risk management policies to ensure that it will effectively conduct its role in financial intermediation sustaining domestic economic growth and development, targets furnishing the following strategic components:

1. Supervise and monitor the launch of a complete operational and financial restructuring plan for the three state-owned specialised banks.
2. Follow up on the operational and institutional restructuring of state-owned banks to ensure sustainability of Phase I restructuring achievements and finalising the requirements necessary to improve their efficiency in financial intermediation and risk management.
3. Implement Basel II framework.
4. Adopt an initiative promoting the development and growth of banking activities/services catering especially for the SME sector. In December 2008, the CBE set in motion an initiative to enhance bank credit to small and medium-sized enterprises.
5. Review and enforce the implementation of corporate governance rules in the banking sector and the CBE.

**FX Inter-Bank System**

On 23rd December 2004, the CBE launched the Foreign Exchange Inter-bank System, whereby banks can source foreign exchange. It is worth mentioning that this system has completely eliminated the parallel market by sufficiently meeting all market needs and preventing any manipulation or speculation in the FX market. Attesting to its successful management of the foreign exchange market through the dollar interbank market, the CBE managed to provide adequate resources to meet the capital outflows in the wake of the global financial crisis. This action helped bolster dealers' confidence in the foreign exchange market and dispel their concerns about the Egyptian pound's exchange rate fluctuations.

**Establishment of a Credit Bureau**

The CBE has introduced greater coherence into monetary management. It set up the first world class private credit bureau in Egypt to provide market-based credit information that is critical for helping lenders make more informed decisions and spur economic growth in Egypt.

**External Profile**

With regards to Egypt's balance of payments, the negative effect of the financial crisis became clear in the 2nd quarter of the 2008-09 financial year, and spread over the whole fiscal year 2008-09 reflecting a current account deficit for the first time in eight years, amounting to US$4.4 bn (bn), compared with an average surplus of US$20 bn throughout the seven previous years. During fiscal year 2008-09, the Egyptian balance of payments ran an overall deficit of about US$3.4 bn, with gross international reserves falling by an equal amount.

During the first half of the 2009-10 financial year, the Egyptian balance of payments recovered from the repercussions of the global economic crisis, falling back to US$1.3 bn, against US$2.5 bn during the corresponding period a year earlier. Furthermore, the capital and financial account concluded net inflows of about US$3.3 bn higher than that registered a year earlier (US$2.0 bn). As such, the BOP ran an overall surplus of US$2.6 bn, against an overall deficit of US$546.8 million during the corresponding period of the previous year.

The main three foreign currency generators in Egypt's balance of payments are tourism, the Suez Canal and overseas' workers' remittances. They have all been affected by the financial crisis. Tourism revenues dropped in 2008-09 but improved in the first half of 2009-10, increasing by 4.7 per cent compared to the first half of 2008-09. The increase was witnessed in the second quarter of FY 2009-10 by around 13.0 per cent. Suez Canal revenues are resuming their upward trend, while the drop in overseas workers' remittances was most clear during the third and fourth quarters of 2008-09. Foreign Direct Investment in Egypt continues to grow steadily since the FY 2003-04, reaching its highest level in 2007-08 at US$ 13.2 bn, to drop to US$8.1 bn in 2008-09.

**External Debt**

Egypt's external debt has continued to fall since the 1990s, dropping from US$46 bn in 1990 to US$31 bn in 2009. At the end of June 2009, Egypt's outstanding external debt registered US$31.5 bn, down by US$2.4 bn from June 2008, amounting to 17 per cent of GDP, and has been relatively stable over the years. However, it went down from 136 per cent between 1992 and 1994 to 55.1 per cent for the financial year 2008-09 as a percentage of current account receipts. During 2008-09 most of Egypt's external debt indicators improved reflecting the strength of the external sector.

It is also noteworthy that almost all of external debt is medium and long-term. The public sector (official sector) is the major obligor, carrying US$29.7 bn or 94.2 per cent of Egypt's external debt (mostly bilaterally), much of it on concessional terms. The private sector owed US$1.8 bn, or 5.8 per cent. As a result, external debt service is generally below 11 per cent of current account receipts. (5.3 per cent in 2008-09). Net international reserves reached US$34.2 bn at the end of December 2009, covering 102.6 per cent of the total external debt, which reached US$33.3 bn at the end of December 2009, reflecting a secure ratio. F

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**Foreign Direct Investment in Egypt**