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May 2, 1988

To: Members of the Executive Board

From: The Acting Secretary

Subject: Arab Republic of Egypt - Staff Report for the 1987 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1987 Article IV consultation with the Arab Republic of Egypt, which will be brought to the agenda for discussion on a date to be announced.

Mr. Chabrier (ext. 4519) or Mr. Jakubiak (ext. 7109) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

ARAB REPUBLIC OF EGYPT

Staff Report for the 1987 Article IV Consultation

Prepared by the Staff Representatives for the 1987 Consultation with the Arab Republic of Egypt

Approved by A. S. Shaalan and J. T. Boorman

May 2, 1988

I. Introduction

Article IV consultation discussions with the Arab Republic of Egypt were held during the period September 1987-April 1988. 1/ The earlier discussions coincided with those for the first review of performance under the 18-month stand-by arrangement approved by the Executive Board on May 15, 1987 (EBS/87/93) in an amount of SDR 250 million (54 percent of quota, or 36 percent on an annual basis).

Egypt made the first drawing of SDR 116 million following Board approval of the arrangement. The arrangement became inoperative from end-June 1987 owing to the nonobservance of performance criteria relating to the accumulation of new external debt arrears, the contracting of short- and medium-term external debt, and the intensification of exchange restrictions. The first program review, which was

1/ The discussions were initiated in Cairo during the period September 2-17, 1987, continued in Washington during the Annual Meeting in September and October, in Cairo during the periods of October 24-November 12, 1987, January 24-February 5, March 12-16, and April 5-6, 1988, and in Washington during the April 1988 Interim Committee meetings. In Cairo, the Egyptian representatives were led by the Prime Minister on most occasions, and included the Deputy Prime Minister and Minister of Planning, the Deputy Prime Minister and Foreign Minister, the Ministers of Economy and Foreign Trade, Finance, International Cooperation, and Cabinet Affairs, and the Governor of the Central Bank. Mr. M. Finaish, Executive Director, and Mr. M. Chatah, Advisor, participated in the October-November discussions. Staff members who took part in one or more missions were Messrs. P. Chabrier (Head), H. Jakubiak, S. Kawar, A. Tahari, P. Joyce (all of MED), C. Sisson (FAD), and L. Duran-Downing (ETR), and Ms. A. Jul (ETR). The missions were assisted by Mr. O. Gronlie, the Fund's resident representative in Egypt. Mr. A. S. Shaalan took part in the concluding policy meetings of most of the missions to Cairo and in the discussions in Washington. Mr. H. Bachmann (World Bank) participated in the September discussions. Mission secretaries were Ms. B. Monsma (ETR) and Mrs. P. Dhillon (MED).

envisaged to have been concluded by end-November 1987, was not completed because understandings could not be reached on policy actions in the areas of the exchange system, interest rates, energy prices, and agricultural procurement prices, and on corrective steps relating to the 1987/88 budget (fiscal year beginning July 1) and to departures in exchange rate management from agreed commitments. A review of performance under the stand-by arrangement is presented in Appendix III; the evaluation of performance has been impeded by shortfalls in the provision of information from commitments laid out in the technical memorandum of understanding. 1/

Egypt continues to avail itself of the transitional arrangements of Article XIV. The Fund and World Bank staffs have collaborated and have reached broadly similar assessments on the need for and content of adjustment policies. Relations with the Fund and the World Bank are summarized in Appendices IV and V, respectively.

II. Background

In the early 1980s, Egypt's economy registered high growth rates, owing largely to buoyant foreign exchange receipts stemming from oil exports, worker remittances, and foreign assistance. However, foreign aid had to be supplemented by large-scale commercial borrowings, leading to a rapid buildup of external debt. During the period, a key objective of policies remained the enhancement of living standards. In this regard, the authorities have been relatively successful, as income per capita and social benefits are generally better than in most developing countries (Appendix VII). However, the realization of these social objectives has placed substantial burdens on the budget and created significant structural maladjustments.

The main structural weaknesses of the economy include: widespread price/cost distortions, attributable in large part to extensive price controls and subsidies; negative real interest rates; a weakly structured budget, characterized in particular by a highly inelastic and narrowly drawn revenue base; a balance of payments suffering from a limited non-oil export base, a sizable imbalance between total export receipts and import payments, heavy dependence on worker remittances, and a mounting debt service burden; and complex exchange and inefficient trade systems.

Over the 1983/84-1985/86 period, the economic and financial problems confronting the economy and the inherent structural weakness of the balance of payments were brought into sharper relief by the declines in world oil prices. The lack of comprehensiveness of the policy response was reflected in continued excess aggregate demand and strong pressures on prices and the balance of payments (Table 1).

1/ The limited quality and availability of Egyptian statistical data impair economic analysis and the monitoring of economic developments (Appendix VI gives further details).

Table 1. Egypt: Selected Economic and Financial Indicators, 1983/84-1987/88

	Actuals 1983/84	Actuals 1984/85	Actuals 1985/86	1986/87 Mar. 1987 Program Proj.	1986/87 Prov. Actuals	1987/88 Mar. 1987 Program Proj.	1987/88 Staff Proj.
				(Annual rates of change)			
National income and prices							
GDP (at constant factor cost)	8.0	7.4	4.8	-2.0	-1.6 1/	2.0	-1.0
Nonoil GDP (at constant factor cost)	6.8	5.4	5.3	...	-2.4 1/	5.0	-1.5
Crude petroleum production	13.4	11.8	-2.5	-2.0	3.1	5.0	2.3
Non-oil GDP deflator	5.0 1/	9.8 1/	8.9 1/	...	30.0 1/	24.0	23.0
Consumer prices (period average)	18.0	14.6	15.9	30.0	25.2	20.0	25.0
Money and credit							
Private sector liquidity	22.7	22.4	25.6	8.9	16.0	8.9	...
Net domestic assets	23.7	22.3	21.1	17.3	20.4	20.3	...
Public sector	(22.3)	(18.1)	(14.8)	(21.0)	(18.7)	(17.7)	(...)
Central and local government	[16.6]	[14.9]	[19.2]	[17.5]	[16.1]	[14.4]	[...]
Private sector	(24.4)	(23.1)	(28.3)	(11.8)	(18.8)	(19.6)	(...)
Government budget							
Total revenue	6.4	9.1	13.1	-3.3	-3.0	13.2	11.7
Tax revenue	(3.1)	(10.4)	(10.1)	(11.3)	(4.9)	(40.3)	(25.8)
Total expenditure 2/	15.9	10.0	13.8	-7.9	-5.1	6.1	14.2
				(In percent of GDP)			
Government budget							
Total revenue	37.2	34.8	35.5	28.1	28.2	26.2	26.2
Tax revenue	(19.2)	(18.2)	(18.1)	(16.5)	(15.5)	(17.9)	(16.2)
Total expenditure 2/	60.3	56.8	58.3 3/	43.9	45.3	39.5	43.0
Overall deficit	23.1	22.0	22.8 3/	15.8	17.1	13.3	16.8
Net external financing	(3.8)	(4.7)	(5.0)	(1.5)	(3.3)	(0.3)	(2.5)
Domestic bank financing 2/	(10.0)	(8.5)	(7.9)	(8.0)	(8.2)	(6.3)	(8.2)
Domestic nonbank financing 4/	(6.0)	(6.4)	(7.3)	(6.4)	(6.4)	(6.6)	(6.1)
				(In percent of private sector liquidity) 5/			
Government budget 2/							
Overall deficit	53.2	47.3	46.0	33.8	36.5	30.4	38.1
Domestic bank financing	(23.3)	(18.3)	(16.0)	(17.0)	(17.5)	(14.6)	(18.6)
Domestic nonbank financing 4/	(13.8)	(13.8)	(14.7)	(13.6)	(13.6)	(15.1)	(13.8)
				(In billions of U.S. dollars)			
Balance of payments							
Oil exports	2.6	2.5	2.0	1.0	1.2	1.4	1.3
Non-oil exports	1.4	1.3	1.2	1.3	1.4	1.4	1.5
Imports	-10.3	-10.5	-9.5	-9.0	-7.8	-9.8	-8.4
Worker remittances	3.9	3.5	3.0	2.6	2.8	2.3	2.9
Current account (excluding official transfers)	-2.3	-3.5	-4.0	-4.9	-2.9	-5.3	-3.1
Official transfers	0.8	1.1	1.2	1.0	1.0	1.2	1.0
Overall balance	-0.5	-0.9	-0.8	-3.2	-2.9	-3.3	-3.1
Central Bank gross reserves (end-period) 6/	0.7	1.0	1.0	1.4	1.4	1.7	1.5
(In weeks of following year's imports, c.i.f.)	3.5	5.2	6.9	6.0	9.0	7.6	8.9
				(In percent of GDP)			
Current account deficit							
Including official transfers	6.4	10.1	13.7	17.4	8.7	17.4	9.4
Excluding official transfers	9.8	14.8	20.4	22.3	13.2	22.5	13.5
				(In percent of current account receipts)			
External debt outstanding	277	320	380	...	421	...	407
Debt service							
Before rescheduling	33	37	48	59	58	58	54
After rescheduling	33	37	48	26	26	19	16
Free market exchange rate (LE per U.S. dollar)							
(end-period) 7/	1.239	1.474	1.906	...	2.268	...	2.326 8/
(period average)	1.189	1.359	1.766	...	2.004	...	2.281 8/
Central bank pool rate (end-period) 9/	0.704	0.704	0.704	...	0.704	...	0.704 8/
				(In percent)			
Change in real effective exchange rate (Period average)							
Overall	15.1	15.9	-7.3	...	3.0	...	-2.6 8/
Free market	13.8	7.0	-23.8	...	-7.4	...	-11.6 8/
Terms of trade (aggregate)	2.5	2.3	-7.9	...	-22.1	...	-0.3
Interest rate on three-month deposits (end of period)	8.5	8.5	8.5	...	8.5	...	8.5 8/

Sources: Data provided by the Egyptian authorities; and staff estimates.

1/ Staff estimates. The non-oil GDP deflator utilizes data provided by the Central Bank.

2/ Includes assumptions of General Authority for Supply Commodities (GASC) deficits by the Government and net bank credit to GASC.

3/ Expenditure and the overall deficit exclude assumptions by the Government of debts of nonfinancial public enterprises. The deficit on a cash basis would be equivalent to 24.5 percent of GDP.

4/ Includes special insurance and pension funds and savings certificates. Excludes the statistical discrepancy between monetary and fiscal data on bank borrowing by the Government.

5/ Ratios are with respect to the Egyptian pound component of private sector liquidity.

6/ Excludes gold.

7/ Average rate for last month of period.

8/ As of March 1988. Change in real effective exchange rate is calculated on the basis of 12-month average exchange rates.

9/ The rate in the central bank pool at which transactions are effected, except for bilateral payments accounts, certain aid receipts, the servicing of suppliers' credits, and certain other transactions.

The latter pressures were characterized by current deficits (excluding official transfers), which rose on average to the equivalent of 15 percent of GDP; accruals of external debt service arrears amounting to US$3.3 billion over the period; and external debt service obligations equivalent to nearly 50 percent of current receipts in 1985/86. Under these circumstances, there was a sharp depreciation of the Egyptian pound in the outside-banks (free) market, which would have been even more severe if import restrictions had not been intensified. Real economic growth slowed.

During their consideration of the 1986 Article IV consultation reports, the Executive Directors stressed the importance for Egypt of embarking on a comprehensive adjustment program of demand management and structural reform, to be pursued with vigor and urgency, in order to contain inflation, restore external viability, and encourage sustainable growth in the medium term.

1. Developments in 1986/87

In 1986/87, the Egyptian authorities introduced a more forward looking set of economic policies. In the real sector, a number of administered prices were adjusted, while liberalization measures were introduced in agriculture, including elimination of the official monopolies on trade except for three major crops--cotton, sugar, and one half of the rice crop. Although the exchange system remained fragmented, an increasing number of foreign transactions by public entities were allowed to be carried out at, or close to, market-related rates. In the trade area, a comprehensive tariff reform was introduced in August 1986, which rationalized the tariff structure, reduced exemptions, and introduced a more appropriate exchange rate for customs valuation purposes; however, the reform was followed by increased restrictiveness of the import system.

In the financial area, the overall fiscal deficit/GDP ratio was reduced to about 17 percent (from 23 percent in the previous year) largely through a general compression of expenditures, including investment outlays. 1/ Moreover, subsidy costs declined, reflecting mainly falling international commodity prices, although prices of certain commodities were also increased for amounts supplied above the basic ration. On the revenue side, notwithstanding the tariff reform, budget receipts declined, mostly on account of the sharp fall in world petroleum prices, a sizable decline in imports, the above-noted structural weaknesses, and the emergence of recessionary conditions in the economy. The growth of private sector credit slowed markedly, reflecting in part the impact of restrictive credit measures introduced in April 1986; nevertheless, total net domestic assets continued to rise at a 20 percent annual rate.

1/ The calculation of the deficit excludes external grants, which are included in net external financing.

The continued high rate of overall credit expansion sustained excess domestic demand and intensified inflationary and balance of payments pressures. The CPI rose by about 25 percent, with part of the increase due to official price increases, while the overall balance of payments deficit widened to nearly US$3 billion. This weakening resulted from a turnaround in net capital movements--from an inflow of US$2.0 billion to an outflow of US$1.0 billion--on account of higher servicing of military debt; a sharp fall in suppliers' credits due partly to reduced cover by official agencies in creditor countries essentially in response to the accrual of external payments arrears; a large increase in petroleum export credits; and a substantial decline in unidentified private capital inflows, attributable in part to reduced confidence in the economy, as well as to a sharply lower effective yield differential in favor of foreign currency denominated assets. These developments were accompanied in the current account by a 40 percent decline in petroleum receipts, resulting from the low level of international oil prices. Under these circumstances, imports were compressed by nearly 20 percent, and the current account deficit fell to under US$3 billion (excluding US$1 billion of official transfers). The financing for the overall deficit and a buildup of net international reserves is expected to have been provided through an estimated US$3.1 billion of reschedulable external debt obligations (see below) and the accrual of US$0.5 billion of new arrears. Debt service obligations, equivalent to 58 percent of current receipts, were lowered to 26 percent on an actual basis through the debt relief; at end-June 1987, outstanding external debt was estimated at US$40 billion.

For 1986/87, official data indicate that real non-oil growth continued at about 5 percent. The staff assessment, based on fiscal, balance of payments, investment, and other developments, is that in real terms the non-oil economy probably contracted.

2. The economic reform program for 1987/88

The economic reform program, that was supported by the stand-by arrangement, was primarily directed at increasing the medium-term rate of real economic growth and reducing the pressures on the balance of payments and prices. These objectives were to be achieved through increased production of tradable goods and a more efficient utilization of resources, allowing a greater role to the private sector and market forces. In quantitative terms, the main macroeconomic objectives for 1987/88 were a real overall growth rate of 2 percent, a reduction in the basic inflation to 20 percent, a containing of the current account deficit of the balance of payments to about US$5 billion (excluding official transfers), and an increase in net international reserves. 1/ The larger current account deficit reflected essentially a programmed recovery of imports in order to sustain a higher growth rate.

1/ As a result of the exchange reform, the balance of payments presentation for 1987/88 is not strictly comparable with that for previous years.

The policy measures to be adopted under the program addressed both the aggregate demand and supply problems in the economy. However, the authorities stressed that the pace of reform needed to be gradual for social and political reasons. On the demand side, the overall fiscal deficit was to be reduced to 13 percent of GDP, with further steady annual retrenchments in the deficit to 4 percent by 1991/92. Since the increase in public sector bank borrowing implied by the budget was still large, the burden for the tightening of financial conditions had to fall to a large extent on the private sector.

On the supply side, a central program element was a simplification of the exchange system through establishment of a new bank foreign exchange market. 1/ Over the program period, transactions would be progressively transferred from the existing commercial bank pool to the new bank market, in which the exchange rate would be set by a chamber of banks on the basis of supply and demand as well as other relevant indicators. A premise of the economic program was that the outside-banks market would be left free to operate in order to ensure the competitiveness of the rate in the new bank market. Interest rates had been increased by 1-2 percentage points in May 1987, and agreement on a schedule to bring them to internationally competitive, positive real levels by June 1988 was to be reached during the first program review. The Government also undertook to eliminate all external arrears by June 1988 and not to incur any new external arrears during the arrangement.

In other supply-side areas, the authorities increased average petroleum product prices by 66 percent and electricity tariffs by 29 percent in May 1987, and committed themselves to further periodic increases, on the basis of a schedule to be agreed with the World Bank as part of the first review, in order to bring them to international levels by 1991/92. In agriculture, reform efforts were to be continued by making annual adjustments in official procurement prices, pricing inputs realistically, and further liberalization of agricultural trade. Further price liberalization in public sector industry was to be achieved, during a phasing-in period ending in mid-1988, so that most industrial sector prices would be determined on a competitive or, in cases of insufficient competition, economic efficiency basis.

On the occasion of the Executive Board's consideration of Egypt's request for the stand-by arrangement, the Managing Director noted that, under the authorities' proposed reform program, balance of payments viability would not be reached over the medium term unless additional policy changes were introduced and exceptional debt relief and international assistance were provided. Therefore, before presenting the request for Executive Board consideration, the Managing Director obtained a commitment from the authorities entailing a reinforcement of policies during the program period in the areas of the exchange rate, interest rates, and pricing. Assurances were also obtained from Egypt's major creditors and donors about their financial assistance, entailing a

1/ For a description of the exchange system, see Appendix IV.

rescheduling of current official debt obligations and outstanding arrears, under which creditors would make their best efforts to provide highly favorable conditions, and, assuming Egypt were to proceed vigorously in the pursuit of the required policies, a best effort to provide assistance, as appropriate, in order to help close any remaining financing gap in the balance of payments.

Shortly after approval of the arrangement, the Paris Club agreed to a rescheduling of Egypt's public and publicly guaranteed medium- and long-term external debt. The rescheduling encompassed 100 percent of the principal and interest payments falling due from January 1987 to June 1988, as well as 100 percent of arrears of principal and interest outstanding at end-1986, on loans contracted prior to October 31, 1986. These external obligations were to be rescheduled over 10 years, including a five-year grace period, on the basis of bilateral agreements, to be completed by October 1987, implementing the Agreed Minute.

III. Report on Discussions

The consultation and stand-by review discussions focused on economic developments, policies and prospects for 1987/88, as well as on the medium-term outlook for the economy and the policies which would be needed to move the overall external position toward long-run viability, while ensuring a resumption of economic growth and lower inflation.

1. Economic developments, policies, and prospects for 1987/88

The initial reaction of domestic and foreign markets to the introduction of the reform program was favorable, and Egypt's economy has experienced a number of positive developments in 1987/88, including a strengthened growth of non-oil export earnings early in the year, a substantial expansion of tourist receipts, and higher oil exports. Additionally, as indicated below, progress was made toward implementing some of the structural reforms envisaged under the program, and a cautious credit stance toward the private sector has been maintained.

These positive factors have, however, been accompanied by other less favorable developments. There have been important slippages in policy implementation, in particular with regard to the budget, the exchange and trade system, the pricing of key commodities, and interest rates. In addition, adverse external developments have complicated and weakened overall economic management. For instance, Egypt had to contend with the renewed weakening of world petroleum prices as well as a much lower than anticipated level of gross capital inflows. New money, which was anticipated at US$0.7 billion to close the external financing gap, did not materialize, while there was also a US$0.3 billion shortfall in suppliers' credits. Moreover, unanticipated payments of US$0.4 billion had to be made to two Paris Club creditors.

The Egyptian representatives indicated that the failure of donors and creditors to provide the level of external financing anticipated under the program had been an intense disappointment to the Government. This financing shortfall had resulted in lower imports and economic activity levels than envisaged, and these factors had led to a weaker budget performance as well as the incurrence of new external payments arrears. The Government was of the view that it had complied with its commitments under the program, and was committed to continue its economic reform efforts since these would benefit the country. The staff acknowledged that capital inflows and rescheduling coverage had been less than anticipated. However, some of the external financing shortfalls could be ascribed to perceptions in foreign markets regarding domestic policy weakness, which had affected in particular trade credits and private capital inflows, as well as to the inability to conclude agreements for certain types of financing; in the particular case of the World Bank, none of the envisaged three sectoral loans, totaling US$0.7 billion, has been signed to date. In the view of the staff, the reduced amount of external financing increased the adjustment burden on the authorities, but made these efforts even more necessary.

a. Fiscal policies

In the approved program, the overall 1987/88 fiscal deficit was to be contained to at most LE 7.1 billion or 13 percent of GDP (Table 2). The envisaged revenue-generating measures included increasing the consumption duty on cigarettes; expanding the coverage of consumption duties and converting some specific duties to an ad valorem basis; introducing license fees on self-employed professionals and independent businesses (Patente); and further increases in energy prices in the course of the fiscal year. Also, expenditures were to be contained through limiting the increase in the wage bill to 10 percent and the growth of other recurrent outlays to less than the inflation rate, as well as through refocusing the public investment program toward the completion of projects. During the negotiation of the program, the authorities indicated that, if the wage bill were raised by more than 10 percent, offsetting measures would be taken.

The 1987/88 budget, as approved in July, evidenced a number of departures from the above commitments: the major revenue steps actually taken were an increase in the consumption tax on cigarettes and a doubling of stamp taxes, some of which were later reduced; moreover, the increase in the government wage bill was 25 percent and directly offsetting revenue measures were not taken. In addition, the official estimate for gross external financing was increased by nearly LE 1 billion above the level envisaged in the stand-by program, but the sources of this new financing were not identified.

Table 2. Egypt: Summary of Fiscal Developments, 1983/84-1987/88

	1983/84	1984/85	1985/86	Prov. Actuals 1986/87	March 1987 Program Proj. 1987/88	Staff Proj. 1987/88
	(In billions of Egyptian pounds)					
Revenue	10.4	11.3	12.8	12.4	14.0	13.9
Central Government	8.2	8.7	9.7	9.7	12.6	11.6
Tax	(5.4)	(5.9)	(6.5)	(6.8)	(9.6)	(8.6)
Nontax	(2.8)	(2.7)	(3.2)	(2.8)	(3.0)	(3.0)
Investment self-financing	1.6	2.0	2.3	1.9	0.7	1.4
Other	0.6	0.6	0.7	0.9	0.8	0.9
Expenditure	16.8	18.5	21.0 1/	19.9	21.2	22.8
Current, of which:	10.8	11.9	13.0	13.2	15.2	16.2
Wages and salaries	(2.6)	(3.2)	(3.4)	(3.7)	(4.1)	(4.6)
Subsidies 2/	(2.9)	(2.7)	(2.8)	(2.3)	(2.7)	(3.0)
Interest	(1.1)	(1.3)	(1.5)	(1.8)	(2.9)	(2.8)
Net capital transfers	0.5	--	-0.2	0.1	0.3	0.3
Investment expenditure	5.5	6.5	8.3	6.6	5.6	6.3
Overall deficit	6.4	7.2	8.2 1/	7.5	7.1	8.9
External financing (net)	1.1	1.5	1.8	1.4	0.2	...
Domestic bank 3/	2.8	2.8	2.9	3.6	3.4	...
Domestic nonbank	1.7	2.1	2.6	2.8	3.5	...
Other (includes discrepancy)	0.9	0.8	0.9 1/	-0.3	--	...
Memorandum item:						
GDP at current market prices	27.9	32.5	36.0	44.1	53.6	53.0
	(As percent of GDP)					
Total revenue	37.2	34.8	35.5	28.2	26.2	26.2
Central government tax	19.2	18.2	18.1	15.5	17.9	16.2
Central government nontax	10.1	8.4	8.9	6.4	5.5	5.6
Total expenditure	60.3	56.8	58.3	45.3	39.5	43.0
Current	38.6	36.6	36.0	30.0	28.4	30.6
Investment and net capital transfers	21.7	20.2	22.3	15.3	11.1	12.4
Overall deficit	23.1	22.0	22.8	17.1	13.3	16.8
External financing	3.8	4.7	5.0	3.3	0.3	...
Domestic bank 3/	10.1	8.5	7.9	8.2	6.3	...
Domestic nonbank	6.0	6.4	7.3	6.4	6.6	...
	(As percent of opening stock of Egyptian pound component of domestic liquidity)					
Overall deficit	53.2	47.3	46.0	36.5	30.4	38.1
Domestic bank 3/	23.3	18.3	16.0	17.5	14.6	...
Domestic nonbank	13.8	13.8	14.7	13.6	15.1	...
	(Change in percent)					
GDP	12.4	16.6	10.8	22.2	21.7	20.3
Revenue	6.4	9.1	13.1	-3.0	13.2	11.7
Central government tax	3.1	10.4	10.1	4.9	40.3	25.8
Expenditure	15.9	10.0	13.8	-5.1	6.1	14.2
Current	22.7	10.5	9.0	1.9	15.2	22.6
Investment and net capital transfers	5.5	8.9	22.4	-16.4	-11.8	-2.4

Sources: Ministry of Finance; Central Bank of Egypt; and staff estimates.

1/ Expenditure, the overall deficit, and other financing exclude LE 0.6 billion of debts of nonfinancial public enterprises assumed by the Government, in order that this special transaction not distort the presentation of the underlying trends.
2/ Includes assumptions of General Authority for Supply and Commodities (GASC) deficits by the Government and net bank credit to GASC.
3/ Includes net bank credit to GASC.

During the discussions, the staff expressed the view that, if the above slippages from the planned revenue measures were not corrected early in the year, the overall deficit would likely approximate LE 9 billion or 17 percent of GDP. At an early stage, the Egyptian representatives indicated that they would contain outlays for subsidies through changes in distribution arrangements, and stated their intention to take some of the originally envisaged revenue measures in early 1988 if five- or six-month actual budgetary data showed that the budget was off track. Subsequently, when none of the above measures had been taken and the first quarter fiscal data suggested that budgetary performance was moving off track, generating intensified pressures on prices and the exchange market, the representatives informed the staff that several tax changes were ready to be presented for parliamentary approval. These included a broadening of consumption taxes, the introduction of the license fees, as well as increases in charges for certain government services. While welcoming these intentions, the staff indicated that their implementation would need to be accelerated in order to realize a meaningful augmentation of revenues in 1987/88. Even then, given their limited scope and the inherent collection difficulties confronting some of these measures (e.g., the Patente), their introduction would not be sufficient to put the budget back on track and supplementary quick-yielding measures (in particular a large energy price adjustment) with a large revenue potential would also be needed.

As no supplementary budgetary measures had been implemented by mid-April, the staff continued to estimate that the overall deficit was likely to be LE 9 billion (17 percent of GDP). Tax receipts are forecast to be LE 1 billion lower than programmed (although 26 percent higher than in the previous year), 1/ while current outlays are anticipated to be LE 1 billion larger owing to the above-mentioned wage increase and greater than projected subsidization, which is presently forecast to account for 22 percent of current expenditure. On these bases and the assumption that the authorities' higher net external financing forecast is realized and is fully used for budget support, domestic bank borrowing for the budget would, ceteris paribus, be 30 percent higher than originally expected. However, preliminary revenue data for the first 8 months of the fiscal year and expenditure data for the first half suggest that the above staff estimates of the overall deficit and domestic bank financing may be exceeded in the absence of corrective steps.

1/ The staff estimates that of the LE 2 billion deviation from the programmed budget deficit about LE 0.4 billion could be attributed to reduced imports.

b. Monetary and credit policies

Interest rates were increased by 1-2 percentage points in May 1987. The representatives stated that this adjustment had been significant. The interest rate issue was socially sensitive, and a further increase in interest rates would adversely affect economic growth and could lead to widespread bankruptcies. The staff noted that the banking system's interest rates remained substantially negative in real terms, 1/ discouraging domestic savings and capital inflows, and thereby putting pressures on the balance of payments, while encouraging inefficient resource use and investment decisions as well as dollarization of the economy. Moreover, the low bank interest rates contrasted unfavorably with the reported high yields offered by the Islamic investment companies, which had attracted sizable Egyptian pound deposits. These institutions, which had grown in number, were not being supervised by the Central Bank. The representatives indicated that the Government was preparing a law to regulate the operations of these companies, under which they would be prohibited from carrying out banking operations and treated as investment companies that could issue shares and bonds.

As regards credit performance under the program, the June ceilings on net domestic assets and public sector credit and the target for net international reserves were observed; 2/ however, it is not clear that the September ceilings and target were observed owing to a number of data problems that are still being investigated (see Appendix III). As the first review was not completed, no subsequent credit ceilings were set. Monetary data for the first six months of 1987/88 indicate that net domestic assets rose by only 1 percent (Appendix I, Table 6). For the most part, this lower than expected outturn appears to reflect a stagnation in private sector credit and a substantial contractionary impact from the change in net unclassified liabilities. However, credit to the Government rose by 8 percent and was equivalent to nearly 54 percent of its allocation for the year. In explaining these developments, the Egyptian representatives commented that they had been maintaining a tight credit stance for the private sector. Banks had been given quarterly ceilings on an individual basis and penalties were being imposed for exceeding the ceilings. For the period after December 1987, a moderate relaxation of the credit stance had been introduced by the Central Bank.

The official monetary data suggest that over the first six months of 1987/88 net international reserves of the banking system rose by LE 3.3 billion; of this amount, LE 1.3 billion represented valuation adjustments associated with the depreciation of the banks' accounting

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1/ Over the period of the discussions, the interest rate on three-month deposits was 8.5 percent, while inflation is estimated to be on the order of 25 percent for 1987/88 and the rate of appreciation of the U.S. dollar against the pound was 17.7 percent for 1987 (see below).

2/ See Appendix III, Table 9.

exchange rates. The staff observed that the remaining increase in net reserves equivalent to some LE 2 billion (or US$1.5 billion) appeared to be inconsistent with the pressures on the balance of payments and the buildup of external payment arrears. The Egyptian representatives responded that the net reserves increase was mainly attributable to the higher import deposits requirement put in place with the opening of the new bank market; the bulk of these deposits had been made in foreign exchange. The staff commented that such an import deposit effect could occur only to the extent that the deposits had been made using foreign exchange from the outside-banks market. To the extent that the import deposits were made utilizing residents' foreign currency deposits held with the domestic banking system, an associated increase in net international reserves would suggest that accounting misclassifications had occurred. The representatives undertook to examine these issues further, and a technical assistance mission from the Fund is to visit Cairo soon to review monetary statistics and suggest improvements.

Two important issues confront the banking sector, namely the extent of nonperforming loans and the foreign currency exposure of banks. The representatives observed that at present the problem of nonperforming loans was not as acute as previously. Since June 1987, the banks had been instructed to provision or to write off loans as soon as cases were taken to court, and there had recently been no significant increase in nonperforming loans on balance sheets. As regards the commercial banks' net foreign currency liabilities (US$0.9 billion at end-June 1987), the staff mentioned that this situation posed prudential difficulties for banks, as a depreciation of the exchange rate resulted in foreign exchange losses proportional to that exposure. The Egyptian representatives indicated that in 1987 banks had been required to begin making provisions for foreign exchange losses. Losses that had accrued before May 1987 had almost been covered by January 1988, but provisioning would have to continue to cover subsequent losses; in addition, the bank's accounting exchange rate was expected to depreciate further.

c. Production, pricing, and development policies

The staff noted that a number of encouraging structural reforms and pricing measures had been introduced in 1986/87. As a result, agricultural production and exports had expanded and the financial performance of a number of public sector industries had improved. However, structural reform was a continuous process, and additional corrective measures should be undertaken this year as provided in the program. This would entail, inter alia, real price increases for energy and in the agricultural and industrial sectors.

The representatives stated that significant price increases had been introduced in 1986/87 and so far in 1987/88 in the industrial sector, and this pace could not be sustained further into 1987/88. In this context, it was not likely that energy prices would be raised in 1987/88, since the economy still had to adjust to the May 1987 increases in petroleum product prices and electricity tariffs. 1/ Moreover, cotton prices had been raised by 26 percent in January 1988, 2/ and with the elimination of forced procurement for most crops, farmers had generally been receiving the free domestic market price. However, the authorities did not intend to abolish controls over the pricing of, and delivery requirements for, the three remaining crops for the foreseeable future. For cotton, controls were necessary because of the crop's importance to the domestic textile industry and the pricing of popular cloth, while sugar and rice were regarded as strategic crops in the food distribution system.

In March 1987, the World Bank staff reviewed the Second Five-Year Plan (1987-92) and was broadly satisfied with the size and composition of its investment program. Total investment is projected to remain at about 20 percent of GDP over the five-year period, with an increasing share to be assumed by the private sector. The authorities are allocating a larger share of investment to the commodity producing sectors, with priority being given to the completion of ongoing projects and the rehabilitation of existing capacity. The Government is also assigning high priority to developing new energy resources and is pursuing an active natural gas development program. Reflecting this policy, the processing and signing of new oil and gas exploration agreements, containing better exploration incentives, have been expedited.

General economic activity as well as investment appear to remain depressed in 1987/88, in particular in manufacturing. On the basis of various indicators, the staff estimates that real GDP is likely to stagnate or possibly to show a further decline of 1-2 percent. In addition, the reduced flow of the Nile river over recent years, if continued, could adversely impact hydroelectricity production and possibly also agriculture. Given low import availability and maintenance of excess demand, inflation appears to be accelerating, with most observers estimating the increase in the general price level to be on the order of 25 percent or more; however, the official CPI showed on average an increase of 14 percent over the first 8 months of 1987/88. 3/

d. External sector policies

The new bank foreign exchange market began operations on May 11, 1987, when some 40 percent of transactions previously carried through the commercial bank pool were transferred to the new bank market, along with certain transactions previously effected in the outside-banks

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1/ Egyptian petroleum product prices are now on average about 30 percent of ex-refinery prices in southern Europe.

2/ The World Bank had recommended a 48 percent increase.

3/ While prices of a number of public sector products have been increased, the prices of most essentials have not been raised since May 1987. This would indicate that the basic rate of inflation is much higher than the increase in the official price index.

market. All other transactions (apart from those reserved to the central bank pool) continued to be financed through either the commercial bank pool, own exchange accounts, or the outside-banks market. A further large shift of transactions was implemented in November, and all remaining transactions in the commercial bank pool were moved in mid-March 1988, thereby closing this market about four months ahead of schedule. No understanding was reached during the program review on a schedule for unification of the central bank pool with the new market.

The staff commended the authorities for the introduction of the new bank market and for accelerating the pace of unification, but noted that since its opening, strains had steadily intensified in the new bank market, as evidenced by a widening gap between the demand for and supply of foreign exchange, a buildup of pending public and private sector applications for import letters of credit, and large increases in letters of credit opened monthly from own resource accounts. 1/ These strains reflected growing demand pressures emanating from the weakening fiscal position, the authorities' managing of the exchange rate in the new market, and lack of an efficient interbank market due to the low margins set by the authorities in the context of a nonmarket-determined exchange rate, which have discouraged banks with surplus foreign exchange from selling to deficit banks. Although at the opening of the market, the exchange rate had been set in line with the rates in the outside-banks market at LE 2.165 per U.S. dollar, subsequently the rate has evidenced only a moderate depreciation (to about LE 2.25 = US$1 in mid-April 1988), even though pressures on the balance of payments had intensified and inflation differentials with competitor countries had widened. 2/ There was therefore a need for a new approach to the formulation of exchange rate policy, to be supported by more restrictive financial policies and by more adequate margins to facilitate an efficient interbank market. A key objective of exchange rate policy should be to enhance external competitiveness for the tradable goods sectors, an objective not being achieved at present.

In response to the staff's observation, the representatives replied that in their view the exchange rate level in the new market was broadly appropriate, as it was less than 5 percent more appreciated than in the outside-banks market. They added that the competitiveness of the tradable goods sectors depended not only on exchange rate policy, but also on the removal of production rigidities and trade barriers--including protectionism abroad. Moreover, a more rapid depreciation of the rate would translate into larger price increases which would generate further public protest. The staff noted that the parallel

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1/ At the opening of the market, in order to prevent multiple applications for foreign exchange, importers were required to place prior import deposits totaling 100 percent.

2/ Between May 1987 and March 1988, the real effective exchange rate for the Egyptian pound in the new bank market would have appreciated by 15 percent, assuming an annual domestic inflation of 25 percent.

market appeared to be limited in size and the depreciation in that market had been contained by the intensification of import restrictions. The representatives confirmed that the banks had recently begun to take a cautious approach to opening import letters of credit. In particular, public sector banks, each responsible for certain sectors of the economy, ensured that all import letter of credit applications represented a genuine demand for imports rather than imports for stocking and speculative purposes.

The staff noted that the initial exclusion of private sector external debt service payments from the new market in conjunction with the closing in late May 1987 of the outside-banks market, through which private sector debt service payments had been previously effected, had resulted in the buildup of reportedly large private sector external payment arrears after May 1987. 1/ This development in turn had adversely affected Egypt's capacity to finance trade. The Egyptian representatives stated that the action to close the outside-banks market had simply regularized the exchange market situation, as the outside-banks market had always been illegal. They further pointed out that private sector debt servicing initially could be effected through the use of foreign exchange from free accounts, and that in their view this indicated that a large proportion of the private debt arrears had resulted from commercial risk rather than from regulatory impediments affecting access to foreign exchange. Nevertheless, they stated that since February 1988 the banks had been permitted to sell, for the servicing of unguaranteed private sector external debt and domestic bank debt denominated in foreign currency, up to 10 percent of their available foreign exchange each month, with priority given to debt service relating to imports.

Balance of payments developments to date in 1987/88 indicate an improved performance by oil and non-oil exports, sharply higher tourist receipts, but also continued weakness in imports and capital inflows. The higher oil sector receipts reflect in part more timely implementation of market-based oil export pricing policies. Staff projections for the year as a whole (Table 3) envisage a moderate widening of the current account deficit to US$3.1 billion (nearly 14 percent of GDP) from its 1986/87 level, essentially due to an anticipated slight recovery in imports and higher interest payments. On the capital account, net outflows are projected to be on the order of US$0.9 billion, reflecting in large part the fact that export credit agencies have remained effectively off cover for Egypt, a lower availability of banking facilities, reduced drawings on project and commodity loans, and lesser private capital inflows than initially envisaged.

1/ Private sector debts were not covered by the Paris Club rescheduling, but in the Agreed Minute the Egyptian authorities undertook "not to impose any restrictions ..... which would prevent private debtors in Egypt from paying promptly their obligations overdue or falling due."

Table 3. Egypt: Balance of Payments Summary, 1982/83-1987/88

	1982/83	1983/84	1984/85	1985/86	Prov. Actuals 1986/87	March 1987 Program Proj. 1987/88	Staff Proj. 1987/88
	(In billions of U.S. dollars)						
Trade balance	-5.5	-6.3	-6.6	-6.3	-5.2	-7.0	-5.6
Exports	(3.6)	(4.0)	(3.9)	(3.2)	(2.6)	(2.8)	(2.8)
Petroleum	[2.5]	[2.6]	[2.6]	[2.0]	[1.2]	[1.4]	[1.3]
Other	[1.1]	[1.4]	[1.3]	[1.2]	[1.4]	[1.4]	[1.5]
Imports, c.i.f.	(-9.1)	(-10.3)	(-10.5)	(-9.5)	(-7.8)	(-9.8)	(-8.4)
Services (net)	0.5	0.1	-0.3	-0.7	-0.6	-0.5	-0.4
Receipts, of which:	(4.0)	(4.0)	(4.0)	(3.7)	(4.2)	(4.7)	(4.9)
Tourism 1/	[0.3]	[0.3]	[0.4]	[0.3]	[0.4]	[1.1]	[1.1]
Suez Canal dues	[1.0]	[1.0]	[0.9]	[1.0]	[1.1]	[1.3]	[1.2]
Investment income	[1.0]	[1.1]	[1.0]	[0.9]	[0.8]	[0.8]	[1.0]
Payments, of which:	(-3.5)	(-3.9)	(-4.3)	(-4.4)	(-4.8)	(-5.2)	(-5.3)
Interest	[-1.8]	[-2.0]	[-2.5]	[-2.3]	[-2.7]	[-2.9]	[-3.1]
Worker remittances 1/	3.2	3.9	3.5	3.0	2.8	2.3	2.9
Official transfers	0.8	0.8	1.1	1.2	1.0	1.2	1.0
Cash grants	(--)	(--)	(0.2)	(0.5)	(0.3)	(0.2)	(0.3)
Commodity grants	(0.8)	(0.8)	(0.9)	(0.8)	(0.6)	(1.0)	(0.7)
Current account	-1.0	-1.5	-2.4	-2.8	-2.0	-4.1	-2.2
Excluding official transfers	-1.8	-2.3	-3.5	-4.0	-2.9	-5.3	-3.1
Capital account	1.5	1.0	1.4	2.0	-1.0	0.8	-0.9
Direct investment	0.2	0.1	0.2	0.2	0.2	0.3	0.2
Project and commodity loans (net)	0.4	0.2	0.3	--	-0.2	0.2	-0.3
Drawings	(0.9)	(0.7)	(0.8)	(0.8)	(0.6)	(1.1)	(0.6)
Amortization	(-0.5)	(-0.5)	(-0.5)	(-0.7)	(-0.8)	(-0.9)	(-0.9)
Suppliers and buyers (net)	-0.1	-0.5	--	-0.2	-0.7	-0.7	-1.0
Drawings	(0.9)	(0.8)	(0.9)	(1.2)	(0.6)	(0.7)	(0.4)
Amortization	(-0.9)	(-1.3)	(-0.9)	(-1.4)	(-1.3)	(-1.4)	(-1.4)
Other official capital (net)	--	-0.3	-0.4	--	-1.2	-0.5	-0.7
Of which: other debt amortization	(-0.2)	(-0.2)	(-0.4)	(-0.5)	(-0.9)	(-0.5)	(-0.6)
Other private capital (includes errors and omissions) 2/	0.9	1.4	1.3	1.9	0.9	1.5	0.9
Overall balance	0.5	-0.5	-0.9	-0.8	-2.9	-3.3	-3.1
Net international reserves (increase -)	-0.9	-0.1	-0.4	-0.4	-0.6	-0.4	-0.4
Financing gap	0.4	0.6	1.4	1.3	3.5	3.8	3.5
Accruals (+)/payments (-) of arrears	0.4	0.6	1.4	1.3	0.5	-0.7	-1.5 3/
Arrears	(0.4)	(0.6)	(1.4)	(1.3)	(--)	(-0.7)	(-1.0) 4/
Moratorium interest in arrears	(--)	(--)	(--)	(--)	(0.2)	(--)	(-0.2)
Delayed payments (private sector)	(...)	(...)	(...)	(...)	(0.3)	(--)	(-0.3)
Reschedulable maturities	--	--	--	--	3.1	3.8	4.1
New money	--	--	--	--	--	0.7	--
Residual gap	--	--	--	--	--	--	(0.9) 5/
Memorandum items:							
Central Bank gross reserves (end-period) (excluding gold)	0.7	0.7	1.0	1.0	1.4	1.7	1.5
(In weeks of following year's imports)	(3.4)	(3.5)	(5.2)	(6.9)	(9.0)	(7.6)	(8.9)
Current account deficit (as percent of GDP) 6/							
Including official transfers	4.4	6.4	10.1	13.7	8.7	17.4	9.4
Excluding official transfers	8.0	9.8	14.8	19.6	13.2	22.5	13.6
	(In percent)						
Growth rates:							
Petroleum exports	...	4.0	--	-23.1	-39.8	48.5	4.7
Other exports	...	27.3	-7.1	-7.7	13.5	9.8	10.9
Imports, c.i.f.	...	13.2	1.9	-9.4	-18.5	9.3	8.0
Worker remittances	...	21.9	-10.3	-15.0	-4.3	-13.0	1.9

Sources: Central Bank of Egypt, Ministry of Economy, and staff estimates.

1/ The program projections and the staff estimates for 1987/88 utilize a revised estimation methodology reflecting the exchange system reform measures introduced in May 1987.
2/ Mainly private sector foreign exchange inflows.
3/ Projected payments required to clear all outstanding nonreschedulable arrears.
4/ Includes US$0.4 billion of payments, made to two creditor countries, that were not anticipated at the time of the Paris Club rescheduling.
5/ New money of US$0.9 billion would be required to finance the repayment of all outstanding nonreschedulable arrears. However, no new money is now expected to become available in 1987/88. This figure represents the extent to which, in the absence of new money, the arrears repayment target of US$1.5 billion cannot be met.
6/ Local currency GDP was converted at the outside-banks exchange rate.

As a result, the overall external deficit is expected to remain near US$3 billion and, with allowance for some increase in reserves, to entail a financing gap of US$3.5 billion.

While debt rescheduling, if fully realized, could provide US$4.1 billion of resources, Egypt also would need to make payments equivalent to US$1.5 billion to clear all outstanding external arrears by June 1988 (Table 4). Meeting this goal, however, would require new money inflows of US$0.9 billion. To date no new resources of this nature have been received, and none are expected to materialize over the balance of 1987/88. Consequently, it is expected that nearly US$1 billion of Egypt's external debt service arrears is likely to remain unsettled.

As of early April 1988, bilateral agreements had been signed with nine Paris Club members, and while discussions had been held with eight other members, agreements had not been reached mainly owing to issues about terms of rescheduling and in some cases procedural or technical difficulties. Moreover, discussions had not yet started with one Paris Club creditor and most non-Paris Club countries. The authorities of Egypt and the Islamic Republic of Iran have exchanged a number of communications with the objective of initiating discussions on establishing more orderly arrangements regarding Egyptian debt obligations to that country. The mission urged the authorities to speedily conclude all bilateral agreements with creditors.

2. Prospects and policies for 1988/89 and the medium term

Beginning with the January/February discussions, the authorities and the staff, while continuing to review the possibilities for adopting measures to contain the deterioration in the budget and the balance of payments over the remaining months of 1987/88, also initiated discussions on the policy elements for a new and reinforced economic program to be implemented at the time of the 1988/89 budget.

a. Medium-term balance of payments outlook

For the purpose of the discussions, the staff prepared a base scenario which assumed that a strong adjustment stance would be adopted with the 1988/89 budget and sustained well into the medium term. The assumptions are described in Appendix II. The main objective would be to limit the external current account deficit to a level that, under reasonable expectations, could be financed by autonomous capital inflows, debt relief, and other exceptional financing from Egypt's creditors and aid donors. Given external resource constraints, only a moderate resumption of real economic growth could be achieved.

Table 4. Egypt: External Debt and Debt Service, 1982/83-1987/88 1/

	1982/83	1983/84	1984/85	1985/86	1986/87	Staff Proj. 1987/88
	(In billions of U.S. dollars)					
External debt outstanding (end of period)	...	33.1	36.4	37.7	40.4	43.1
Medium- and long-term	...	27.4	30.8	32.6	35.9	38.7
Public sector 1/	(22.2)	(25.7)	(29.0)	(29.9)	(33.2)	(35.9)
Private sector 2/	(...)	(1.7)	(1.8)	(2.8)	(2.8)	(2.8)
Short-term 3/	5.3	5.7	5.6	5.1	4.5	4.4
External debt service obligations after rescheduling						
Medium- and long-term	2.7	3.4	3.5	4.4	2.2	1.3
Principal 4/	(1.6)	(2.0)	(1.8)	(2.6)	(1.3)	(0.3)
Interest	(1.1)	(1.4)	(1.7)	(1.8)	(0.9)	(1.0)
Short-term	0.5	0.5	0.6	0.4	0.3	0.4
Total debt service	3.2	4.0	4.1	4.8	2.5	1.7
Principal	1.6	2.1	1.8	2.6	1.3	0.3
Interest	1.6	1.9	2.3	2.2	1.2	1.4
Rescheduling 5/	--	--	--	--	3.1	4.1
Principal	--	--	--	--	1.7	2.6
Interest	--	--	--	--	1.4	1.5
Accruals (+)/payments (-) of arrears	0.4	0.6	1.4	1.3	0.5	-1.5 6/
Principal	(...)	(0.4)	(0.6)	(0.7)	(...)	(...)
Interest	(...)	(0.2)	(0.8)	(0.5)	(...)	(...)
	(In percent)					
External debt outstanding (end of period)						
As percent of current receipts 7/	...	277	320	380	421	407
As percent of exports of goods and services	...	414	461	539	594	560
As percent of GDP	...	141	152	185	184	188
External debt service ratio before rescheduling						
As percent of current receipts 7/	30	33	37	48	58	54
As percent of exports of goods and services	43	50	52	69	82	75
External debt service ratio after rescheduling						
As percent of current receipts 7/	30	33	37	48	26	16
As percent of exports of goods and services	43	50	52	69	37	22
	(In billions of U.S. dollars)					
Interest on residents' foreign currency deposits 2/	0.6	0.6	0.6	0.5	0.4	0.4
Servicing of total foreign currency obligations after rescheduling	3.8	4.5	4.8	5.3	2.9	2.1
As percent of current receipts 7/	35	38	42	53	30	20
As percent of exports of goods and services	51	56	60	76	43	27

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

1/ Public and publicly guaranteed disbursed debt. Includes principal and interest in arrears, as well as interest on interest in arrears, and IMF Trust Fund.
2/ Staff estimates.
3/ Short-term foreign liabilities of the banking system.
4/ On public and publicly guaranteed debt only. Data are not available for private sector debt service.
5/ The rescheduling agreed by the Paris Club in May 1987. The estimates incorporate all official creditors, including those outside the Paris Club.
6/ Projected repayments required to clear all outstanding nonreschedulable arrears. Includes US$0.4 billion of payments, made to two creditors countries, that were not anticipated at the time of the Paris Club rescheduling.
7/ Excludes official transfers.

The key policy elements of the strategy, which have been agreed with the World Bank staff, would be substantial reductions in the fiscal deficit along the path of the original reform program--which envisaged an overall deficit of 11 percent of GDP in 1988/89--in support of wide-ranging structural measures such as full unification of exchange markets with maintenance of a realistic exchange rate, achievement of market-based pricing through the liberalization of economic activities, and early achievement and maintenance of competitive real positive interest rates.

Under this policy scenario, the staff estimates that the external current account deficit (excluding official transfers) could be limited to US$3.2 billion annually on average over the period 1988/89-1991/92 (Table 5). A more rapid improvement in the deficit cannot realistically be expected in view of Egypt's substantial debt service obligations and the weak structure of the current account. On the capital account, there would still be net outflows until 1990/91 in part reflecting the steady increase in amortization payments obligations and the time lag before improved confidence is reflected in higher suppliers' credits and aid flows. Under these circumstances, there would be a gradual reduction in Egypt's annual external financing gap from US$3.5 billion in 1987/88 to about US$2 billion in 1991/92. To cover these financing gaps, Egypt would annually require sizable, although declining, new debt relief as well as moderate new money inflows in some years. However, in late 1991/92, the grace periods of the prior Paris Club and other reschedulings would begin to expire. Consequently beginning in 1992/93, the capital account would start to evidence large and rapidly growing net outflows, and as a result the external financing gaps would begin to rise sharply despite continuing declines in the current account deficits. This scenario, which assumes conventional financing terms, points to the reality that, even if Egypt sustains a strong adjustment program well into the medium term, debt service obligations are of such a magnitude that the external position cannot become viable without greatly increased concessionality in external financing and/or sharply stepped up foreign aid levels on concessional terms.

b. Policy issues

The Egyptian representatives expressed the view that the adjustment envisaged in the staff scenario was too rapid, and its impact would jeopardize economic growth and social stability. The pace of reform had to be geared to likely public reaction, and public tolerance had now been stretched to the danger point. They stressed that the Government was committed to economic reform, but that the adjustment effort would have to extend over a large number of years in areas such as the pass-through of full unification of the exchange system to the prices of essential commodities, as well as energy pricing and interest rates.

Table 5. Egypt: Medium-Term Projections of the Balance of Payments

	Actual	Projections							
	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95
				(In billions of U.S. dollars)					
Trade balance	-5.2	-5.6	-6.2	-6.5	-6.6	-6.7	-6.9	-7.0	-7.2
Exports	(2.6)	(2.8)	(2.9)	(3.2)	(3.7)	(4.2)	(4.8)	(5.4)	(6.1)
Imports (c.i.f.)	(-7.8)	(-8.4)	(-9.1)	(-9.7)	(-10.3)	(-11.0)	(-11.7)	(-12.4)	(-13.3)
Services (net)	-0.6	-0.4	-0.2	-0.2	--	0.1	0.3	0.4	0.5
Of which: interest payments	(-2.7)	(-3.1)	(-3.4)	(-3.6)	(-3.7)	(-3.8)	(-3.9)	(-4.0)	(-4.1)
Worker remittances	2.8	2.9	3.1	3.3	3.5	3.7	3.9	4.2	4.4
Official transfers	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Current account	-1.9	-2.2	-2.3	-2.4	-2.1	-1.9	-1.6	-1.5	-1.3
Excluding official transfers	-2.9	-3.1	-3.3	-3.4	-3.1	-2.9	-2.6	-2.5	-2.3
Capital account	-1.0	-0.9	-0.4	-0.3	-0.1	0.2	-1.0	-1.6	-1.9
Direct investment	0.2	0.2	0.2	0.3	0.3	0.4	0.5	0.6	0.7
Project and commodity loans (net)	-0.2	-0.3	-0.1	--	0.1	-0.6	-0.9	-0.8	-0.8
Drawings	(0.6)	(0.6)	(0.7)	(0.7)	(0.7)	(0.8)	(0.8)	(0.9)	(0.9)
Amortization	(-0.8)	(-0.9)	(-0.7)	(-0.7)	(-0.7)	(-1.3)	(-1.7)	(-1.7)	(-1.7)
Suppliers and buyers (net)	-0.7	-1.0	-1.0	-1.0	-1.0	0.1	-0.4	-0.4	-0.4
Drawings	(0.6)	(0.4)	(0.4)	(0.5)	(0.6)	(0.7)	(0.8)	(1.0)	(1.1)
Amortization	(-1.3)	(-1.4)	(-1.4)	(-1.5)	(-1.6)	(-0.6)	(-1.3)	(-1.4)	(-1.5)
Other official capital (net)	-1.2	-0.7	-0.5	-0.5	-0.5	-0.7	-1.2	-1.9	-2.5
Other private capital (includes errors and omissions) 1/	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0
Overall balance	-2.9	-3.1	-2.8	-2.7	-2.3	-1.7	-2.6	-3.0	-3.3
Net international reserves (increase-)	-0.6	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Financing gap	3.6	3.5	3.2	3.1	2.7	2.1	3.0	3.4	3.7
Accruals (+)/payments (-) of arrears	0.5	-1.5 2/	-0.9	--	--	--	--	--	--
Reschedulable maturities 3/	3.1	4.1	3.7	3.5	3.3	2.0	1.8	1.7	1.5
New money 4/	--	--	0.3	-0.5	-0.7	0.1	1.2	1.7	2.1
Residual gap	--	0.9 5/	--	--	--	--	--	--	--
Memorandum items:									
				(Growth rate in percent)					
Exports	-19.8	8.0	2.7	12.4	14.9	14.4	13.4	13.0	11.8
Imports	-18.6	8.0	8.1	7.0	6.4	6.2	6.4	6.5	6.6
Terms of trade	-22.1	-0.3	-3.3	-2.6	-1.2	-0.8	-0.8	-0.9	-0.9
Tourism	17.1	... 6/	7.6	7.6	7.6	7.6	7.6	7.6	7.6
Worker remittances	-4.3	... 6/	6.5	6.5	6.5	6.0	6.0	5.5	5.5
				(In percent of GDP)					
Current account deficit									
Including transfers	8.7	9.4	8.6	8.2	6.9	5.7	4.7	3.9	3.3
Excluding transfers	13.2	13.6	12.3	11.6	10.2	8.7	7.5	6.5	5.8
				(In percent of current receipts) 7/					
Debt service									
Before debt relief	57.8	54.4	50.9	48.9	45.9	42.9	49.1	51.4	52.5
After debt relief	26.0	15.7	18.2	24.0	26.1	28.9	37.4	41.6	44.3
External debt outstanding	419.4	406.8	398.4	381.6	359.2	336.1	315.5	299.6	287.0
				(In weeks of following year's imports)					
Central Bank gross reserves	9	9	9	10	10	10	11	11	...

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

1/ For 1986/87, mainly private sector foreign exchange inflows. For the projection years, includes private sector foreign exchange inflows and amortization payments relating to debt reschedulings and new money to cover the financing gap.

2/ Projected payments required to clear all outstanding nonreschedulable arrears. Includes US$0.4 billion of payments, made to two creditors countries, that were not anticipated at the time of the Paris Club rescheduling.

3/ Assumes maintenance of October 31, 1986 as cut off date and no rescheduling of previously rescheduled maturities.

4/ Represents the amounts exceeding (+) or less than (-) the rescheduling of 100 percent of reschedulable maturities required to close the financing gap. The new money requirements could be met either by fresh credits or by rescheduling of previously rescheduled debt.

5/ New money of US$0.9 billion would be required to finance the repayment of all outstanding nonreschedulable arrears. However, no new money is now expected to become available in 1987/88. This figure represents the extent to which in the absence of new money, the arrears repayments target of US$1.5 billion cannot be met.

6/ Cannot be calculated due to a revised estimation methodology.

7/ Excluding official transfers.

Moreover, it would not be possible to adhere to the budget deficit reduction path included in the original reform program. Any steps implemented without accompanying measures aimed at mitigating the negative impact of adjustment on the poorer segments of the population could undermine any reform. They stressed that real incomes in Egypt were low and had fallen in recent years. The representatives hoped that the international community would be forthcoming in its assistance in order to sustain Egypt's own adjustment effort.

The staff indicated that, while realizing the political and social constraints faced by the authorities, the present economic situation required adoption of a strong comprehensive program. Delaying adjustment might very well be more costly subsequently in economic and social terms as it could necessitate even stronger and less socially acceptable actions. A forceful approach was needed to avoid these consequences and would help reverse the present trends in the economy, rebuild confidence domestically and abroad, and encourage autonomous capital inflows.

(1) Budgetary policy

The staff assessment is that a critical element in the adjustment effort should be to place the budget deficit back onto the downward medium-term path envisaged at the inception of the current stand-by arrangement. This objective requires adoption of quick-yielding revenue measures supplemented by structural reform actions to permanently broaden the tax base and improve its elasticity. Fund technical assistance on taxation has recently elaborated on this strategy. Among the most promising steps to raise revenue quickly for the 1988/89 budget, the staff recommended increasing the domestic prices of energy products, cigarettes, and a number of services; improvements in consumption taxation through broadening the base and scope as well as converting existing specific rates to an ad valorem basis; introducing the Patente; and increasing the minimum tariff rate to 5 percent for all items, except a very limited number of essential commodities. Regarding structural reforms, the staff urged speedy introduction of a general sales tax, the rationalization of the generous tax incentives currently offered to enterprises, reductions of tax exemptions, a rigorous stemming of import leakages from the duty-free zones, and reform of the income tax with a view to instituting a global tax.

On the expenditure side, the staff noted that, while important steps were already being implemented, such as delaying the automatic appointment to the public sector of new university graduates by several years, there was a need for far-reaching steps to achieve savings in public spending, ranging from the moderation in wage policy to a restructuring of public enterprises and a substantive revamping of the open-ended subsidy system. The staff emphasized that consumer subsidies, which had been contained recently in part because of low international prices for most food items, should be restricted to only genuinely basic commodities, and that the Government should consider introduction of a selective means test to restrict access to the truly needy as well as the integration of subsidy and wage policy. At the same time, subsidies to public economic enterprises and entities should be sharply curtailed by allowing full pricing autonomy to virtually all public companies.

The Egyptian representatives indicated that the authorities recognized the need for a tighter fiscal policy. Their target reduction in the overall deficit was on the order of 2 percent of GDP a year from the 1987/88 outcome. They were reviewing a number of options on the revenue side, but observed that any medium-term improvement in revenue would depend in large measure on the pace of economic growth. The introduction of a general sales tax needed further study, and in this connection, they requested further technical assistance from the Fund as well as in the areas of income taxes. On the expenditure side, the authorities had been successful in restraining nonwage current spending and investment outlays, and intended to continue such expenditure restraint in 1988/89, in particular by shifting some public sector investment to the private sector. As for subsidies, a number of measures had been taken in the past to limit these outlays, but subsidies on essential commodities remained a sensitive social issue and the Government did not intend to increase the ration prices of the five basic commodities (wheat, wheat flour, sugar, tea, and edible oil) for the next several years.

(2) Credit and interest rate policies

The staff noted that substantial reductions in the fiscal deficit would make it possible to provide increased credit to the private sector, while limiting the expansion of aggregate credit and domestic liquidity to levels consistent with the balance of payments and price objectives. Within a cautious credit policy, appropriate sectoral distribution of credit, giving priority to the productive sectors, was also important. The staff also emphasized that a meaningful economic adjustment program could not be devised without early realization of internationally competitive, positive real interest rates, as well as correction of the interest rate structure in order to reverse the positive spread of some deposit rates over loan rates and to allow the loan rate structure to reflect lending risk considerations. The representatives responded that they intended to continue pursuing restrained credit policies toward the private sector, and were diverting new nongovernment credit away from trade toward productive investments. They were not, however, prepared to increase interest rates by more than one to two percentage points in the immediate future.

(3) Production and pricing policies

The staff observed that durable real growth of the non-oil economy in an environment of domestic financial stability would depend also on liberalization of the economy to facilitate the operation of market forces. In this regard, it would be important to remove price controls affecting the private sector and permit substantial pricing autonomy to public sector enterprises and entities. The general principle to be followed should be to allow domestic producer prices to adjust to their international price equivalents converted at an appropriate unified exchange rate. In this regard, the staff noted that, while presently most nonmajor agricultural products were free from price controls and if exported were transacted at the new bank market exchange rate, this policy did not apply to cotton, sugar, and half the rice crop.

The Egyptian representatives responded that considerable progress had already been made in freeing prices and easing controls. They also noted that in the public industrial sector more flexible pricing policies would need to be accompanied by an adequate investment strategy, oriented toward quick-yielding projects and an improvement in overall performance, although it was realized that annual investment resources in coming years would be constrained by the availability of budget funding. Some public enterprises were unprofitable and would need rehabilitation investment along with improved management to increase their productivity and lower their production costs. Revised pricing policies alone would not be sufficient to re-establish the profitability of these enterprises. While welcoming the measures already taken, the staff commented that, with regard to correcting cost/price distortions, it had in mind a much broader and formalized approach to pricing flexibility. To assist in formulating such an approach, the staff proposed that the authorities reach early agreement with the staffs of the World Bank and the Fund on the overall scope and schedule for implementation of a price liberalization effort.

With regard to the particular case of energy, the staff observed that the previously noted pricing principle was of considerable importance for efficient investment decision making, mobilization of budgetary resources, and increasing petroleum exports through restraining domestic consumption. Energy prices were very low relative to world prices, and the price of gasoline had fallen by 40 percent in real terms since its last increase in August 1986. Consequently, over the medium-term domestic energy prices should be increased annually on the basis of a reasonable schedule to reach international equivalence. The staff encouraged quick agreement with the World Bank on such a schedule. The representatives responded that their commitment in the stand-by arrangement to bring energy prices to world equivalence by 1991/92 was too tight, and that a six-year adjustment period was more appropriate, with no adjustment before July 1989. However, in the context of a World Bank energy sector loan, the authorities would be prepared to increase average energy prices by 20 percent a year over the next three fiscal years and accelerate the pace of adjustment thereafter to achieve international equivalence by 1993/94. The authorities' proposal for 20 percent annual increases would likely imply a fall in real terms. The World Bank's position is that energy prices should be raised by at least 35 percent at the beginning of 1988/89 with increases in real prices of 15 percent in the two following years.

(4) External policies

The staff observed that progress toward achieving a viable balance of payments position and resumption of real growth would additionally depend on enhancing external competitiveness through an efficient exchange market and trade liberalization in order to achieve the needed substantial growth in Egypt's non-oil exports and import competing sectors. Early and full unification of all exchange markets at a competitive rate that would be maintained afterwards, with full pass-through to all domestic prices except for a few socially sensitive items, was an essential element of such a strategy. The staff suggested that, for simplified administration and efficiency, full unification be implemented with the introduction of the 1988/89 budget. To gain full benefits from unification, the unified exchange system should allow the financing of all bona fide foreign exchange transactions, including in particular the full servicing of private sector external debt and its accumulated arrears, and provide for an efficient interbank market. The Egyptian representatives reiterated their commitment to full exchange system unification, but stated that such a step would need further study regarding its impact on the budget and domestic prices. While they were prepared to transfer all transactions to the new bank market by July 1988, the pass-through to final consumer prices of the more depreciated exchange rate could not be implemented for the five basic food commodities for the foreseeable future, while for other items the pass-through could only be achieved over a five-year period starting not before July 1989.

The staff noted that gradual trade liberalization by increasing exposure to competitive forces in international markets would ensure continued progress toward increasing the efficiency of domestic factors of production. Initial steps that could be implemented in this area in 1988/89 would be a start at reducing import quota restrictions and advance import deposits, as well as further tariff rationalization. The World Bank and the Fund staffs could be of assistance in formulating specific measures and schedules in these areas. The representatives responded that Egypt was a developing country and domestic industry would continue to need protection. A ministerial committee was at present reviewing the tariff structure and considering adjusting certain tariff rates, given the depreciation of the exchange rate used for customs valuation in the course of 1987/88.

The staff stated that, in view of Egypt's heavy debt service burden over the foreseeable future, the authorities would also need to pursue a prudent external debt management policy. This objective would be facilitated by the recent introduction of a system of improved monitoring of the external debt position and servicing obligations. While substantial progress in this area had been made with regard to public sector debt, virtually no firm information was available regarding private sector debt and service obligations. The authorities requested continued technical assistance from the Fund on external debt monitoring.

Staff Appraisal

Adverse external developments in conjunction with the impact of structural maladjustments and expansionary financial policies confronted Egypt with increasing prices and balance of payments pressures during the first half of the 1980s. The external current account deficits widened sharply, and their financing required in addition to bilateral assistance, large-scale external borrowings on commercial terms, so that by 1985/86 external debt outstanding had reached a level that was equivalent to nearly double GDP. After 1984 a number of corrective measures were taken; however, these actions were limited in scope and not integrated into a comprehensive policy reform strategy. As the balance of payments came under increasingly intense pressures over 1984/85-1985/86, the concomitant import stringency, combined with inadequate production incentives, resulted in a declining investment/GDP ratio and a slackening of the pace of economic activity from the high growth rates achieved earlier.

In response to these developments, the Egyptian authorities devised a program of economic reforms in the last months of 1986 that was more comprehensive and far reaching than earlier adjustment attempts. The major components of this program were a commitment to a steady annual retrenchment of the fiscal deficit, exchange reform, reductions in cost/price distortions, and an enhanced role for the private sector. However, for political and social reasons, the authorities emphasized that structural policy reforms, in particular in the areas of pricing of essential commodities, interest rates, and unification of the exchange system, had to be implemented gradually. The program, which was supported by the current stand-by arrangement, was seen by the staff and the Executive Directors as a positive first step in a long-term adjustment process that needed substantive policy reinforcement at an early date and over time, as well as substantial financial assistance from donors and creditors.

Implementation of the program has entailed progress in a number of areas, for which the authorities should be commended. Administered prices of a number of products were adjusted; market-based pricing procedures were introduced for oil exports; trade and price liberalization steps were taken in agriculture; a rationalization of the exchange system was started in May 1987 and accelerated over the course of 1987/88; and credit policy toward the private sector remained tight. Despite these positive policy developments, the broad objectives of the 1987/88 program in terms of renewed economic growth and the easing of pressures on prices and the balance of payments are not being met. The two main reasons for this development are the shortfall in external assistance and financing from the levels originally programmed, which has complicated the task of economic management and reduced the capacity to import, and policy slippages from program commitments in such areas as the budget, the exchange system, interest rates, and pricing decisions for a number of key products. In view of the above policy shortcomings and the absence of agreements on a number of policies that were to have been reached during the first program review, no purchase has been made under the arrangement beyond the first drawing, and none is anticipated.

In order to prevent an intensification of the existing severe domestic and external imbalances, and avoid jeopardizing the positive developments realized so far this year, the staff urges the authorities to give the highest priority in the remainder of 1987/88 to the adoption of quick-yielding budget revenue actions, the maintenance of firm control over credit use by other sectors of the economy, and the introduction of a flexible approach to exchange rate management in the new bank market. Meanwhile, preparations should be actively undertaken to devise a comprehensive set of policies for 1988/89 and the medium term that address the structural weaknesses of the economy and ensure that domestic demand is appropriately restrained.

Recent discussions indicate that the authorities, while committed to the reform strategy started in 1986, feel a need for a slowdown in their adjustment effort over the coming years in order to avert additional price increases, which they see as being inimical to economic growth and likely to further heighten social tensions. The staff, however, is of the view that such a more gradual adjustsment approach would ultimately be more costly and disruptive due to intensification of cost/price distortions and further weakening of the balance of payments and growth, necessitating more forceful adjustment in the future. Under this scenario, if donors were not to step up their assistance substantially, the only policy choice would be intensification of existing controls. This would not only constitute a major step backward from the 1986 reform program, but also have a lasting negative impact on future growth, employment, and living standards.

For these reasons, the staff urges the authorities to reassess their policy approach and adopt a medium-term strategy consistent with the objectives of their 1986 reform program. The staff does not minimize the constraints facing such a strategy, viz., a high rate of population growth; low income and domestic savings levels; a weak outlook for the world economy; uncertain world oil prices; pervasive structural weaknesses in Egypt's economy; and the burden of a substantial external debt. Indeed, these constraints need to be taken into account in order to evaluate realistically the pace at which growth can be resumed and progress can be made toward eventual external viability. Such an evaluation entails recognition that balance of payments viability can be achieved only over the long term and will require not only an immediate and considerable strengthening of Egypt's adjustment policies, to be continued well into the coming years, but also sustained assistance from the international community in highly concessional and quickly disbursing forms.

Success of a reinforced adjustment program depends on quick and substantial reductions in the overall fiscal deficit, in order to dampen existing inflationary and balance of payments pressures that would otherwise erode the effectiveness of other policy actions, as well as in the widespread and intense cost/price distortions so that economic decision-making can be based on accurate assessments of costs and benefits and that a more efficient allocation and use of resources can be achieved.

The reduction in the overall fiscal deficit should come from both quick-yielding measures and actions that will durably improve the structure of the budget. The responsiveness and the base of the tax system must be increased in order to durably expand domestic sources of income. The recommendations made by the recent FAD technical assistance missions should form the basis for such policy actions. The revenue measures which the authorities are considering for implementation in 1988/89 are in the right direction, but they do not sufficiently address the structural weaknesses of the tax system and will not permit the large reduction in the fiscal deficit which is required by the present situation. On the expenditure side, tight controls on the growth of all outlays is needed. Subsidies are a highly sensitive issue, but the staff would encourage the authorities to consider implementing measures to reduce their open-ended and wide-spread nature as well as the integration of subsidy and wage policy.

The staff recognizes that frequent and substantial price adjustments have taken place recently; however, these have not been in the context of an integrated approach toward price liberalization. For more efficient operation of the economy as well as for fiscal purposes, production costs should be fully and speedily passed through to final consumers, except for a very limited number of sensitive basic consumer goods that weigh heavily in the expenditure basket of the poorest social groups. Unless such a policy of price liberalization is widely and consistently applied, the existing cost/price distortions in the economy, particularly exchange rates, producer prices, and interest rates, cannot be corrected in a meaningful manner.

Full unification of all exchange markets, with adequate pass-through to market prices, can no longer be delayed. To gain the full economic benefits from such unification, the new exchange system should ensure that access to foreign exchange by the private sector is unrestricted for all bona fide transactions, that an efficient interbank market is established, and that exchange policy has as its central objective an improvement in the competitiveness of the exchange rate to facilitate the achievement of the Government's balance of payments and reserves targets.

Exchange system unification should permit the introduction of greater realism in price determination in agriculture and industry. In the energy sector, the domestic pricing of petroleum products and electricity assumes an overwhelming importance in any policy reform package, given its importance for the growth of budget revenue and exports, the relatively limited amount of Egypt's proven petroleum reserves, and the energy shortages that are projected in the absence of a major investment effort in this sector. The staff encourages the authorities to adopt and adhere to a schedule of adjustment of domestic energy prices that would quickly achieve international equivalence, as had been the objective in the stand-by program. The staff recognizes that upward adjustments in domestic interest rates are a sensitive social issue. However, competitive interest rates are inescapably a key component of any successful adjustment effort.

The above measures will also need to be supplemented by a gradual opening of the economy to international market forces. Consequently, the proposed adjustment policies would need to encompass initial steps toward eventual full liberalization of the trade system over the medium term, in particular reductions in import prohibitions and further rationalization of tariffs. There are a number of other areas where reforms would contribute to greater efficiency, such as the introduction of improved credit control instruments and financial reform of public enterprises and entities.

Cautious public sector external debt policies need to be followed, given the present size of Egypt's external debt and its service profile. While recent measures indicate that the authorities have started to address the issues of private external debt servicing and arrears, further progress is needed, as it would, in conjunction with the implementation of a credible adjustment program, improve Egypt's creditworthiness and attract the needed autonomous external capital flows, including direct investment, that would help the balance of payments and enhance economic growth prospects. Also, the staff urges the authorities to hasten the conclusion of all bilateral rescheduling agreements.

Progress has been made in finalizing a system of external debt monitoring that will permit an improvement in external debt management. However, in the absence of comprehensive, reliable, and up to date statistics in a number of other areas, economic developments are difficult to assess and proper policy actions may not be correctly designed and implemented on time. In this area, the staff is prepared to provide further technical assistance.

Egypt continues to maintain certain exchange restrictions subject to approval under Article VIII, including those evidenced by external payments arrears, advance import deposits, a bilateral payments agreement with a Fund member, and limitations on payments for certain invisibles. Egypt also maintains multiple currency practices arising from the concurrent operation of the central bank and the new bank markets, from free account transactions, and from an advance import deposit requirement. Some progress has been made toward elimination of one of the multiple currency practices, but the staff recommends that Egypt be urged to adopt policies that would permit further progress toward elimination of the restrictive exchange practices. In the absence of such policies, approval is not being proposed for exchange restrictions or multiple currency practices subject to Article VIII, Sections 2(a) or 3.

It is recommended that the next Article IV consultation with Egypt be held on a standard 12-month cycle.

Table 6. Egypt: Factors Affecting Monetary Expansion, 1983/84-1987/88 1/

	1983/84	1984/85	1985/86	1986/87	First Half 1986/87	First Half 1987/88
	(In billions of Egyptian pounds)					
Foreign assets (net) 2/	-0.1	0.1	1.3	-1.2	-0.4	1.6
Of which: net international reserves	...	...	...	1.2	0.5	3.3
Net domestic assets	4.3	5.0	5.8	6.8	2.1	0.5
Claims on public sector (net)	2.7	2.7	2.6	3.7	2.0	1.5
Central and local government 2/ 3/	(2.8)	(2.8)	(2.9)	(3.6)	(1.6)	(2.0)
Other public sector 3/	(-0.1)	(-0.4)	(-0.2)	(--)	(--)	(-0.9)
Cotton financing	(--)	(0.3)	(-0.1)	(0.1)	(0.4)	(0.3)
Claims on private sector	2.0	2.3	3.5	3.0	1.1	0.1
National currency	(1.7)	(1.7)	(2.4)	(1.9)	(0.9)	(0.4)
Foreign currency	(0.3)	(0.6)	(1.1)	(1.1)	(0.2)	(-0.3)
Other items (net) 2/, of which:	-0.4	--	-0.3	0.1	-1.0	-1.1
Exchange rate valuation adjustment	(0.5)	(1.2)	(0.1)	(1.2)	(0.3)	(-1.7)
Capital accounts	(-0.5)	(-0.5)	(-1.4)	(-1.1)	(-0.6)	(-1.3)
Private sector liquidity	4.2	5.1	7.1	5.6	1.7	2.0
Money	1.2	1.6	1.7	0.9	0.4	0.7
Quasi-money	3.0	3.5	5.5	4.7	1.3	1.3
National currency	3.0	2.7	2.8	2.7	1.1	1.5
Foreign currency	1.2	2.3	4.3	2.9	0.6	0.5
	(Growth rates in percent) 4/					
Private sector liquidity	23	22	26	16	5	5
National currency 5/	25	18	16	13	5	6
Foreign currency 5/	18	31	44	20	5	3
Net domestic assets	24	22	21	20	6	1
Claims on private sector	24	23	28	19	7	--
National currency 5/	34	25	29	18	8	3
Foreign currency 5/	9	19	28	21	5	-5
Net claims on public sector	22	18	15	19	10	6
Net claims on central and local government	22	18	15	17	8	8
Memorandum items:						
Twelve-month growth rates:						
Private sector liquidity	...	...	...	...	12	16
Net domestic assets	...	...	...	...	10	14
Claims on the private sector	...	...	...	...	16	11
Net claims on central and local government	...	...	...	...	14	18
U.S. dollar value of foreign currency claims on private sector 5/	--	--	-1	2	2	-6
U.S. dollar value of foreign currency deposits of private sector 5/	8	10	11	1	2	2

Sources: Central Bank of Egypt; and staff estimates.

1/ Consolidates the Central Bank, the commercial banks, the business and investment banks, and the specialized banks. Valuation of foreign currency items is at the Central Bank and commercial bank accounting exchange rates, except for positions with the private sector, which have been valued at outside-banks (free) rates of exchange. Movements in foreign currency items, therefore, include the effects of exchange rate changes. In Appendix III, Table 10, on the other hand, valuation of foreign currency items is at the program rate of LE 1.34 = US$1.

2/ Adjusted to remove the effects of revaluing Central Bank's gold reserves.

3/ Net credit to GASC is included in central and local government credit and excluded from other public sector credit for consistency with the budgetary presentation and the monetary program.

4/ Rates of change over half years are not annualized.

5/ Business and investment banks incorporated in Egypt with majority foreign ownership--which were previously allowed to engage only in business in foreign currencies--were, during 1983, permitted to engage in Egyptian pound business on a bank-by-bank basis. However, their Egyptian pound business was not reported separately from their foreign currency business until December 1983 to February 1984. Thus, for 1983/84, the growth rates for foreign currency deposits and foreign currency credit are biased downwards and the growth rates for Egyptian pound deposits and Egyptian pound credit are biased upwards.

Table 7. Egypt: Net International Reserves and Net Foreign Currency Position of the Banking System, 1982/83-1986/87

(In millions of U.S. dollars)

End of Period	1982/83	1983/84	1984/85	1985/86	1986/87
Net international reserves (NIR)					
of banking system	4,252	4,273	4,578	5,052	5,869
Central Bank	2,233	2,447	2,267	2,590	2,441
Gross official reserves	(2,604)	(2,844)	(2,718)	(2,948)	(3,189)
Gold 1/	[757]	[679]	[578]	[622]	[814]
Payment agreements	[480]	[429]	[346]	[430]	[61]
Foreign correspondents	[1,130]	[1,477]	[1,426]	[1,433]	[1,624]
Of which: earmarked accounts	[696]	[1,019]	[843]	[853]	[905]
Foreign securities	[237]	[259]	[368]	[453]	[690]
Liabilities	(-371)	(-397)	(-451)	(-358)	(-748)
Payment agreements	[-151]	[-86]	[-75]	[-199]	[-81]
Use of Fund credit	[-53]	[-52]	[-43]	[-37]	[-176]
Other	[-167]	[-259]	[-333]	[-122]	[-491]
Commercial banks	1,444	1,493	1,772	1,787	2,846
Business and investment banks	722	582	864	931	893
Specialized banks	-147	-249	-325	-256	-311
Net foreign currency position of					
banking system with nonresidents 2/	2,470	2,232	2,886	3,336	4,170
Net foreign currency position of					
banking system with residents	-4,548	-5,243	-6,037	-6,955	-7,277
Gross claims on residents 3/	2,869	3,369	3,566	3,498	3,670
Gross liabilities to residents 3/	-7,417	-8,612	-9,603	-10,453	-10,947
Overall net foreign currency					
position of banking system	-2,078	-3,011	-3,151	-3,619	-3,107
Of which: commercial banks	...	...	-2,253	-1,795	-945
Memorandum items (increase +)					
Change in NIR banking system 4/	1,029	21	305	474	817
Overall balance of payments 4/	(850)	(99)	(406)	(430)	(625)
Gold valuation	(179)	(-78)	(-101)	(44)	(192)

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

1/ Official valuation. The authorities value gold at the daily average of gold fixing in London during the preceding three months less a discount of 25 percent, or at 75 percent of its final fixing on the last working day of June, whichever is less.

2/ Equals NIR of banking system less gold, payments agreements balances, and earmarked accounts with foreign correspondent banks.

3/ Public and private sector.

4/ Data are not available to isolate the valuation effect arising from movements in U.S. dollar/nondollar exchange rates.

Assumptions Underlying the Medium-Term Balance of Payments Projections, 1987/88-1994/95

The medium-term balance of payments projections (Table 5) were formulated in the context of an integrated macroeconomic policy scenario incorporating a strong adjustment effort. The scenario's external environment assumptions utilized essentially the forecasts of the December 1987 WEO exercise, while the domestic adjustment policy assumptions were those outlined by the staff in the discussion presented in Section III.2. of the paper.

1. External environment

The main external environment assumptions are given in Section I of Table 8 and include the following:

a. Real GNP/GDP of Egypt's trading-partner countries grows at about 2.8 percent annually, while their GNP/GDP deflator in U.S. dollar terms slows from 12 percent in 1987/88, to 6.5 percent in 1988/89, and to nearly 4 percent over the rest of the period.

b. Egypt's crude oil export prices, estimated at US$15 per barrel in 1987/88, rise by 1.8 percent in 1988/89 and 3.5 percent per annum thereafter.

c. The prices for Egypt's manufactured exports and imports rise by 5 percent on average over 1988/89-1989/90 and by 4 percent annually thereafter. At the same time, the prices for Egypt's non-oil commodity imports rise at a moderately higher rate than Egypt's non-oil, noncotton commodity exports. As a result, the terms of trade for the latter would register small annual declines. On average, Egypt's long-staple cotton prices rise by 1.5 percent.

d. The six-month LIBOR averages 8 percent.

2. Domestic environment

The major features of the strong domestic policy adjustment scenario are described in the text and include the following. The overall budget deficit would be reduced from 17 percent of GDP in 1987/88 to 11 percent in 1988/89 and by 2 percentage points of GDP annually over the period 1989/90-1991/92; it would be maintained at 4-5 percent of GDP thereafter. Domestic nominal interest rates would be adjusted in 1988/89, so that by end-year internationally competitive real positive rates are achieved. Domestic credit policies would be formulated to incorporate the responses of this policy development, to ensure a gradual reduction in the rate of inflation, and to meet the real credit requirements of the private sector for an expanding role in investment and production. Exchange rate policy would be formulated to allow for appropriate real effective depreciations in order to support a strong expansion of non-oil exports and efficient import substitution. The varied set of structural reform measures described in the text would be implemented in the indicated time frames.

Under this policy scenario, overall real growth would increase gradually from 2 percent in 1988/89 to 3.2 percent by 1993/94-1994/95. With extensive price corrections in 1988/89-1989/90, inflation would be in the 20-30 range, but would thereafter fall off toward the 4 percent rate projected for trade partner countries by 1994/95. The investment/GDP ratio would be maintained at about 20 percent throughout the period, while the domestic savings ratio would increase from 8 percent of GDP in 1987/88 to about 13 percent by 1994/95.

3. Balance of payments

Under the scenario, non-oil exports are forecast to increase on an annual average basis by 16 percent, from a relatively low base, mainly on account of an expansion in manufactured and agricultural exports assisted by structural reform measures and pursuit of an appropriate exchange rate policy. Oil exports are projected to decline by 15 percent in 1988/89, due to a fall in export volume attributable to an assumed reversion to officially declared production levels and termination of stock depletion of exportable stocks. Thereafter, petroleum receipts would increase by 12 percent annually, as a result of corrective domestic energy pricing policies, which would restrain domestic consumption of petroleum products and allow for higher crude oil export volumes, and moderately rising world prices. In the model, every one dollar change in crude oil prices is estimated to change petroleum receipts by about US$80 million in 1988/89; the comparable figure for 1994/95 is US$170 million.

Import payments are projected to increase by nearly 7 percent per annum, allowing for a 2 percent volume increase estimated as the minimum needed to realize the real non-oil GDP growth rate of 2-3 percent. This real import growth rate reflects in particular policies to contain consumer goods imports and to promote efficient import substitution; the volume of intermediate and capital goods imports would rise at rates about equivalent to those for real GDP.

In the services account, Suez Canal receipts are projected to increase by 5 percent annually, reflecting a 3.5 percent annual growth of world trade and a 1 percent annual increase in the Canal tariff. Tourism receipts are projected to rise by about 7.5 percent per annum, largely as a result of the more flexible exchange rate policy.

Workers' remittances are projected to increase by 6.5 percent annually, in response to appropriate domestic interest rate and exchange rate policies. Official transfers are assumed to remain at US$1 billion a year in nominal terms throughout the period.

In the capital account, disbursements of project and commodity loans would recover gradually from US$600 million in 1987/88 to over US$900 million by 1994/95 (the level realized in 1984/85), while, as cover for suppliers' credits is gradually re-established, these external resources would move in line with the growth of imports of capital and intermediate goods, rising from US$350 million in 1987/88 to over US$1.1 billion by 1994/95 (approximately the 1985/86 level).

It is assumed that the projected financing gaps of 1988/89-1994/95 are covered by new annual debt relief and other exceptional financing on conventional terms, viz., an 8 percent interest rate with 10 years maturity and 5 years grace. Every one percentage point reduction in the interest rate for the financing to close the external gap would reduce the financing requirements over the period 1991/92-1994/95 by US$100-250 million annually, on average, depending on the year for which the calculation is made and the concessionality of the interest rate.

Table 8. Egypt: Assumptions Underlying and Major Trends in the Balance of Payments Projections, 1986/87-1994/95

(Changes in percent)

	Actual 1986/87	Projections 1987/88	1988/89	1989/90	1990/91	1991/92	1992/93-1994/95 1/
I. External environment							
Partner countries 2/							
Real GNP/GDP	2.7	2.8	2.8	2.8	2.9	2.9	2.9
GDP/GNP deflator (US$)	20.2	12.1	6.5	3.7	3.7	3.7	3.7
Egyptian import unit values (US$)							
Oil and oil products	-33.0	16.6	1.8	3.5	3.5	3.5	3.5
Other (non-oil) trade 2/	11.5	9.2	6.4	4.2	4.0	4.0	4.0
Non-oil commodity prices 2/	-2.4	9.5	8.6	5.1	5.6	5.6	5.6
Egyptian export unit values (US$)							
Oil and oil products 2/	-36.4	6.0	1.8	3.5	3.5	3.5	3.5
Manufactures 2/	16.7	9.2	6.4	4.2	4.0	4.0	4.0
Noncotton commodity prices 3/	15.5	20.8	7.2	0.3	1.6	3.2	3.2
Cotton (long-staple)	-0.1	1.7	-0.2	1.2	3.1	1.6	1.6
SDRs in units of US$ 2/	1.23	1.33	1.38	1.39	1.40	1.42	1.42
Six-month Libor 2/	7.1	7.7	8.0	8.0	8.0	8.0	8.0
II. Domestic environment							
Real GDP	-1.6	-1.0	2.0	2.9	3.0	3.0	3.2
Real non-oil GDP	-2.4	-1.5	2.2	3.1	3.3	3.1	3.4
GDP deflator	24.2	21.6	30.0	20.0	15.0	10.0	6.0
Gross investment/GDP	19.5	20.0	20.0	20.0	20.0	20.0	20.0
Domestic savings/GDP	7.8	8.0	9.5	10.1	10.8	11.4	12.2
III. Balance of payments							
Exports of goods							
Total exports	-19.8	8.0	2.7	12.4	14.9	14.4	12.7
Petroleum	-39.6	4.7	-15.1	3.8	13.6	16.4	13.2
Non-oil exports							
Cotton	-3.7	-12.5	24.2	32.2	20.1	11.2	10.1
Other agricultural products	3.4	25.0	17.9	8.3	9.7	11.5	11.5
Manufactured goods	23.8	17.9	16.0	14.6	14.9	14.4	13.4
Imports of goods							
Total imports	-18.6	8.0	8.1	7.0	6.4	6.2	6.5
Food and primary commodities	-20.1	5.8	7.2	11.0	7.8	6.8	7.5
Consumer goods	-23.6	8.5	7.7	5.5	5.5	5.6	6.0
Intermediate goods	-16.6	7.8	8.5	6.2	6.3	6.3	6.5
Capital goods	-15.6	7.8	8.5	6.2	6.3	6.3	6.3
Terms of trade	-22.1	-0.3	-3.3	-2.6	-1.2	-0.8	-0.9
Tourism	17.1	... 4/	7.6	7.6	7.6	7.6	7.6
Workers' remittances	-4.3	... 4/	6.5	6.5	6.5	6.0	5.7
World oil price (US$ per barrel)	14.2	15.0	15.3	15.8	16.4	16.9	17.5-18.8

Sources: Based on data provided by the authorities; and staff estimates and projections.

1/ Averages.
2/ WEO forecasts.
3/ IMF Commodities Division.
4/ Projections for 1987/88 utilize a revised estimation methodology reflecting the exchange system reform measures introduced in May 1987.

Observance of Performance Criteria and Understandings Under Stand-By Arrangement

1. Credit ceilings and net international reserves targets

Tables 9 and 10 below show Egypt's performance on the basis of the official monetary data, 1/ relative to the credit ceilings and net international reserves targets established for end-June and end-September 1987 under the financial program. The June credit ceilings and reserves target were observed; however, it is not clear that the September credit ceilings and reserves target were observed, owing to a number of increasingly serious data problems that are still being investigated. First, the large increase in net international reserves during 1987/88, which continued through December 1987, has not yet been satisfactorily explained. Second, a larger than projected growth in "net other items" assisted the observance of the net domestic assets ceiling at both dates. Third, arrears on external debt servicing of both public and private sectors have accrued during the arrangement. Complete information on the size and composition of these accruals is not available (see below); however, the accrual of any arrears in respect of which payment was not made to the blocked accounts would facilitate the observance of the program ceilings and targets. All nonguaranteed private sector external payment arrears, as well as certain public sector arrears, would fall into this category.

2. External debt

Under the arrangement, the Government was to eliminate all arrears outstanding at end-December 1986, and any incurred after that date, by end-June 1988, and was to avoid incurring any new arrears during the period of the stand-by. Complete information regarding arrears is not available from the authorities. It is understood that not all of the pre-December 1986 arrears have yet been cleared, although it is recognized that the deadline for this action has not yet passed. However, a significant amount of new arrears has also accumulated during the arrangement.

The Government was also to observe limits (1) on new short-term borrowing by, or with the guarantee of, any public sector entity, (including public sector banks) other than normal trade credit, and (2) on new medium- and long-term borrowing up to 12 years by, or with the guarantee of, any public entity on nonconcessional terms. The following table indicates that it is not yet possible to determine whether the ceilings on such new borrowings have been observed, since complete information has not been provided. On the basis of partial information, however, it is evident that the ceilings on the contracting of medium- and long-term debt were exceeded at least during the period January-June 1987.

1/ As noted previously, Egypt's monetary and credit data are subject to substantial compilation and classification problems that make it difficult to assess whether the quantitative criteria were observed.

	January-June 1987		January-September 1987	
	Ceiling	Actual	Ceiling	Actual
	(In millions of U.S. dollars)			
Short-term debt	200	...	300	...
Medium- and long-term debt 1/	350	384 2/	850	663 2/

1/ The ceilings exclude four World Bank approved loans, as well as any new Bank sectoral loans contracted during the period.
2/ Partial data only.

3. Exchange and trade system

During the period of the stand-by arrangement, the Government was not to impose or intensify restrictions on payments and transfers for current international transactions, introduce or modify multiple currency practices, conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons. The Government was also to phase out advance import deposits as conditions allowed and eliminate any import quotas on the private sector during the period of the arrangement.

The staff's evaluation is that the virtual closing of the outside-banks market in conjunction with the arrangements currently operating in the new bank foreign exchange market constitute an intensification of restrictions on payments and transfers for current international transactions. In this regard, access in the new bank market to foreign exchange for current transactions that were previously effected in the outside-banks market but are now not permitted to be effected in that market (e.g., travel and private sector debt service above the 10 percent ceiling established in February 1988) is restricted by two means. (1) Administratively, certain classes of current transactions are not permitted to be effected in the new bank market or in any other foreign exchange market except through use of free account foreign exchange resources, where difficulties in identifying available resources have had the effect of restricting availability. (2) The exchange rate in the new bank market has been determined in such a way that significant numbers of applications for exchange for permitted transactions are placed in a queue of pending applications for unknown periods of time owing to foreign exchange shortages in the market. Moreover, recently the authorities initiated the practice of reviewing import letters of credit applications and rejecting those for commodities considered to be in sufficient domestic supply.

4. Exchange rate management

As part of the exchange reform, it was understood that the exchange rate in the new bank market would be set by the chamber of participating banks on the basis of four indicators: supply, demand, working balances of the banks, and an assessment of general market trends. The initial exchange rate in the market (LE 2.165 per U.S. dollar) was set in accordance with the outside-banks (free) market rate. Thereafter, however, the market moved into mounting imbalances, as evidenced by rising daily deficits (which, by end-March 1988, had reached some US$157 million in cumulative terms, after taking account of cancellations of purchases), growing levels of pending applications for the issuance of letters of credit (US$422 million outstanding at end-March 1988), and growing amounts of letters of credit opened from own resources (US$130 million in March 1988 alone). This imbalance in the market, together with the administrative interference in the market noted above and more generally the severe pressures on the balance of payments, indicates that the management of the exchange rate has not been satisfactory. Although the exchange rate in the new bank market has only occasionally diverged significantly from the available rate quotations for the outside-banks market since May 1987, this latter indicator cannot be considered reliable, as the outside-banks market itself, following the attempt to close it, has been highly fragmented. The divergence between the new bank market rate and the outside-banks rate has resulted in a larger number of exchange rates than intended under the program. In the staff's view, the rate in the new bank market, if freely determined by supply and demand forces, should have depreciated by at least the equivalent of the differential between the international and the domestic rates of inflation, if a realistic indicator for the domestic rates of inflation, rather than the understated CPI, were used.

5. First review of program

During the course of the first review of performance under the stand-by arrangement, the Fund and the Egyptian authorities were to have:

a. focused on budget developments (including pricing policy), progress on exchange reform, and reduction of payments restrictions;

b. established quantitative performance criteria for the period of the arrangement after September 1987;

c. reached understandings on a schedule for completing the unification of all exchange markets;

d. reached understandings on a schedule for increasing nominal interest rates on domestic currency deposits and loans to levels that were positive in real terms and competitive with yields on foreign currency instruments by the end of the program period; and

e. reached understandings on schedules for increasing the prices of energy and electricity to world levels by 1991/92 and on the procurement prices of cotton and rice for the crop year 1988/89--these last-mentioned understandings were to be reached in consultation with the World Bank.

In the event, owing to lack of agreement between the staff and the authorities on a number of important issues, principally the size of the budget deficit and measures that would be taken to contain it, it was not possible to establish quantitative performance criteria for the remainder of the program period. Nor could understandings be reached on a schedule for completing the unification of all exchange markets: although the authorities are considering full unification of the central bank pool with the new bank market at the time of the 1988/89 budget, they do not expect to pass-through to final consumers the more depreciated exchange rate for the foreseeable future for the five basic food commodities, while for other items a six-year period is envisaged for the pass-through. Moreover, the Egyptian representatives indicated that the maximum domestic interest rate increase that could be contemplated for the present was of 1-2 percentage points. In the assessment of the staff, such an increase would leave domestic rates of interest at a significantly negative level in real terms. The Egyptian representatives offered no schedule for raising rates to the levels implied in the arrangement.

Finally, it was not possible to reach agreement with the Egyptian representatives on schedules for increasing the domestic prices of energy and electricity and the procurement prices for cotton and rice. In the particular case of energy, the authorities' most recent proposal was to achieve international equivalence by 1994/95, but with no adjustments in 1987/88 or 1988/89. However, the Government indicated that, in the context of a World Bank energy sector loan, it would be willing to increase petroleum product prices by 20 percent annually over the coming three years with subsequently larger adjustments in order to achieve international equivalence by 1994/95. This proposal would likely entail a fall in real energy prices in the early years. For 1987/88, the Government increased cotton procurement prices by 26 percent, compared with 48 percent proposed by the World Bank. No information is available on the procurement price for rice.

6. Provision of information

The Government undertook in the arrangement to provide the economic and financial data required for monitoring the program. The assessment of the staff is that the quality and timeliness of data provision have been inadequate both for following economic and financial developments in general and for monitoring the program. Data deficiencies are described in more detail in Appendix VI.

Table 9. Egypt: Observance of Credit and Net International Reserves Performance Criteria

(In millions of Egyptian pounds)

	Net International Reserves	Net Domestic Assets	Net Credit	
			Public sector	Central Government
June 1987				
Unadjusted ceilings/targets 1/	7,564	35,015	23,250	23,650
Adjustment due to debt service		408	408	335
Programmed		245	245	245
Actual 2/		653	653	580
Adjustment due to blocked accounts		-313	-313	37
Programmed		3,589	3,589	705
Central Bank		(1,805)	(1,805)	(705)
Commercial banks		(1,784)	(1,784)	(--)
Actual		3,276	3,276	742
Central Bank		(1,385)	(1,385)	(742)
Commercial banks		(1,891)	(1,891)	(--)
Operative ceilings/targets 1/	7,564	35,110	23,345	24,022
Actual	7,756	34,664	23,002	23,602
September 1987				
Unadjusted ceilings/targets 1/	7,631	36,390	24,500	24,850
Adjustment due to debt service		557	557	484
Programmed		360	360	360
Actual 2/		917	917	844
Adjustment due to blocked accounts		-253	-253	80
Programmed		4,434	4,434	1,060
Central Bank		(2,650)	(2,650)	(1,060)
Commercial banks		(1,784)	(1,784)	(--)
Actual		4,181	4,181	1,140
Central Bank		(2,266)	(2,266)	(1,140)
Commercial banks		(1,915)	(1,915)	(--)
Operative ceilings/targets 1/	7,631	36,694	24,804	25,414
Actual	8,871	35,308	23,754	24,833

Sources: Central Bank of Egypt; and staff estimates.

1/ The credit ceilings for June and September 1987 were established on the assumption that the domestic currency counterpart of all external debt service payments that originally fell due in the period January-September 1987 would be placed into a blocked account irrespective of any external rescheduling. Withdrawals from the blocked account might only be made for the domestic currency counterpart of the external debt service actually effected abroad. In the event that the sum of holdings in domestic currency in the blocked account plus the amount of debt service actually effected in Egyptian pounds fell below or exceeded the amount of the total of external debt originally due (interest and principal), the ceilings would be adjusted down or up, respectively, by the amount of the shortfall or excess.

2/ The adjustment due to debt service has been calculated on the basis of actuals, for both periods, that comprise all debt service effected, including debt service on certain arrears that had accrued prior to end-December 1986, for which the arrangement did not require accruals to the blocked accounts. This is because data provided by the authorities do not distinguish clearly between debt service that is subject to accrual to blocked accounts and debt service that is not. The staff's best estimates suggest that, were debt service on these arrears excluded from the calculations, the ceilings on net domestic assets and net credit to the public sector and to the Central Government would still appear to have been observed, albeit by narrower margins. This assessment would be prior to correcting for other accounting problems and misclassifications in the monetary data, which are believed to be increasingly substantive.

Table 10. Egypt: Factors Affecting Monetary Expansion: Performance under Credit Program, 1986/87-1987/88 1/

	March 1987 Program Ceiling/ Target	Actual	March 1987 Program Ceiling/ Target	Actual July-Dec.	
	1986/87		1987/88	1986	1987
	(In millions of Egyptian pounds)				
Net foreign assets 2/	-2,419	-2,007	-4,109	-732	238
Net international reserves	535	669	536	418	2,007
Blocked accounts 2/	-1,805	-2,144	-4,645	-652	-1,751
Net domestic assets	5,157	4,806	7,110	2,002	1,440
Net claims on public sector	4,026	3,799	4,121	1,941	2,042
Central and local governments	(3,520)	(3,486)	(3,414)	(1,540)	(1,855)
Other public sector 2/	(506)	(313)	(707)	(401)	(187)
Gross claims on private sector 2/	1,700	1,973	3,140	992	181 3/
National currency	(...)	(1,907)	(...)	(912)	(412)
Foreign currency	(...)	(67)	(...)	(80)	(-231)
Net other items 2/	-570	-967	-150	-932	-783 3/
Private sector liquidity 2/	2,738	2,799	3,000	1,271	1,678
National currency	...	2,705	...	1,058	1,481
Foreign currency	...	94	...	213	198
	(In percent)				
Growth rates 4/					
Private sector liquidity	9	9	9	4	5
Net domestic assets	17	17	20	7	4
Net claims on public sector	21	20	18	10	9
Net claims on Government	17	17	14	8	8
Gross claims on private sector	12	13	20	7	1 3/

Sources: Central Bank of Egypt; and staff estimates.

1/ For program purposes, valuation of all foreign currency items other than certain components of net other items is at the program exchange rate of LE 1.34 = US$1. In Appendix I, Table 6, on the other hand, valuation of foreign currency items is at the central bank and commercial bank accounting exchange rates, except for positions with the private sector, which are valued at outside-banks (free) rates of exchange.

2/ Figures for these items within the "original program ceiling/target" columns are program projections, and not ceilings or targets.

3/ The expansion of gross claims on the private sector is understated by an undetermined amount in this period on account of a change in the method of accounting of capitalized interest by one major public sector bank. The offset is in "net other items".

4/ Rates for half years are not annualized.

Arab Republic of Egypt - Fund Relations

(As of end-March 1988)

(Amounts in millions of SDRs, unless otherwise indicated)

I. Membership Status

Date of membership:	Original member, 1945
Status:	Article XIV

A. Financial Relations

II. General Department (General Resources Account)

Quota:	463.4
Total Fund holdings of Egyptian pounds:	585.7 (126.4 percent of quota)
Fund credit:	122.3 (26.4 percent of quota)
Of which:	
Stand-by arrangement:	116.0 (25.0 percent of quota)
Extended fund facility:	6.3 (1.4 percent of quota)
Reserve tranche position:	None
Current Operational Budget (maximum use of currency):	Not included
Lending to the Fund:	None

III. Current Stand-by or Extended Arrangement and Special Facilities

Current stand-by or extended arrangement:

Arrangement	Date	Duration	Amount	Utilization
Stand-by	May 15, 1988	Nov. 30, 1988	250	116

Previous stand-by and extended arrangements:

Arrangement	Date	Duration	Amount	Utilization
Stand-by	April 20, 1977	April 19, 1978	125	105
Extended Fund	July 28, 1978	July 27, 1981	600	75

Special facilities: No utilization

IV. SDR Department

Net cumulative allocation:	135.9
Holdings	0.2 (0.2 percent of net cumulative allocation)
Current designation plan:	Not included

V. Administered Accounts

Trust Fund loans	
Disbursed:	183.7
Outstanding:	43.6
SFF Subsidy Account	
Payments by Fund	None

VI. Financial Obligations Due to the Fund

	Overdue Financial Obligations March 31, 1988	Principal and Interest Due			
		Apr.-Dec. 1988	1989	1990	1991
Principal	--	24.85	18.61	34.72	58.71
Repurchases	--	6.25	--	29.00	58.00
Trust Fund repayments	--	18.60	18.61	5.72	0.71
Charges and interest including SDR and Trust Fund (provisional)	--	11.87	15.36	15.11	12.10
Total	--	36.72	33.97	49.83	70.81

B. Nonfinancial Relations

I. Exchange Rate Arrangements

1. Before May 11, 1987

Until May 11, 1987, the within-banks foreign exchange market was divided into two pools. The central bank pool handled exports of petroleum, cotton, and rice; Suez Canal dues; imports of five essential foodstuffs (wheat, wheat flour, edible oils, tea, and sugar), insecticides, and fertilizers; and most capital transactions of the public sector. The commercial bank pool received proceeds of worker remittances, tourism, and exports not going through the central bank pool, while providing foreign exchange for public sector payments not covered by the central bank pool. In addition to the within-banks pools, an outside-banks (free) market, formally illegal but officially tolerated, shared common sources of supply with the commercial bank pool (worker remittances and tourism), and satisfied demand by the private sector for exchange for both visible and invisible transactions. Also, transactions utilizing free accounts were legally permitted.

Transactions in the central bank pool were mainly at the official rate of LE 0.7 per U.S. dollar, although transactions under bilateral agreements, certain aid programs, and the servicing of suppliers' credits relating to public enterprises' imports of capital goods were effected at other rates. Beginning August 1, 1981, the official rate in the commercial bank pool was set at LE 0.84 per U.S. dollar. However, a special premium rate was introduced in April 1983 to attract worker remittances, and a successively larger proportion of transactions was effected at that rate until July 1986, when the official rate was abolished, and the premium rate, then at about LE 1.36 per U.S. dollar, was renamed the authorized bank rate.

2. After May 11, 1987

A new bank foreign exchange market began operations on May 11, 1987. In opening the market, the authorities set the initial exchange rate at LE 2.165 per U.S. dollar in order to reflect the rate in the outside-banks (free) market; this rate represented a depreciation of 37 percent from the previous authorized bank rate. Subsequently, although the daily rate for the market has been determined by a committee of representatives from participating banks on the basis of market supply and demand and other indicators as evolved by the committee, the rate has evidenced only a moderate depreciation from its opening level of about 3 1/2 percent through mid-April 1988 and has diverged from the rate in the outside-banks market. This has resulted in a larger number of exchange rates than intended under the program. With effect from May 1987, the exchange rate in the commercial bank pool was adjusted several times a month by reference to a formula that was initially intended to bring the rate to the level of the new bank market rate by end-June 1988. The commercial bank pool was closed in March 1988 (see below), by which time the rate had reached LE 2.08 per U.S. dollar.

On the supply side, the new bank market's resources were initially drawn mainly from worker remittances, tourist expenditures, the purchase of foreign bank notes, and specified public and private sector export earnings; on the uses side, the new market was permitted to provide foreign exchange for specified public sector visible and invisible transactions, all private sector imports, and certain private sector invisible payments primarily related to imports. All other transactions were required to be financed through the central bank pool, the commercial bank pool, or own exchange accounts. Shortly after the opening of the new market, the authorities took actions that virtually closed down the outside-banks market by arresting many street dealers for participating in illegal currency operations.

At the opening of the new market, in order to prevent multiple applications for foreign exchange, importers were required to place a prior import deposit of 35 percent, which could not be financed by banks, on application for a letter of credit; the remaining 65 percent was required to be deposited at the time the document was issued and could be bank financed. In September 1987, in response to supply-demand imbalances that began to emerge in the market, the authorities required that external payments could not be financed from the new bank market until foreign exchange balances in export retention accounts had been fully drawn down. At the same time, however, profit remittances of joint ventures were permitted to be transacted through the new bank market, provided the companies had no exchange available in working or capital accounts.

A shift of transactions to the new bank market from the commercial bank pool was implemented in November 1987 that virtually achieved the full shift of transactions originally targeted to take place in December 1987 and June 1988. On the supply side, receipts from interest, commissions, and profits of Egyptian banks and companies, certain private and public sector agricultural exports, and manufactured exports from the public sector food, chemical, and media industries were transferred from the commercial bank pool. On the demand side, payments for an extensive list of imports, incorporating virtually all remaining permitted imports, not reserved to the central bank pool, were transferred. After this action, the only subsectors still transacting through the commercial bank pool were the public sector spinning, weaving, textile, and mining industries, as well as foreign and domestic airline and shipping companies. These remaining transactions were moved to the new bank market in March 1988, when the commercial bank pool was formally closed.

Transactions continuing to pass through the central bank pool are estimated to account for approximately one half and one fifth of projected 1987/88 exports and imports, respectively, and about one quarter of invisible transactions.

Initially, service payments on private sector nonguaranteed external debt contracted prior to the opening of the new bank market were not permitted to be effected through that market. Thus, with the attempt to close the outside-banks market, private sector external payment arrears built up after May 1987. In February 1988, the authorities permitted limited access to the new bank market for the servicing of nonguaranteed private sector external debt and domestic bank debt denominated in foreign currencies, provided that debtors' own foreign exchange balances in all foreign exchange accounts had been drawn down. In implementing this regulation, the authorities indicated that they were not applying the drawdown requirement to free accounts. Under this regulation, authorized banks were permitted to sell for debt servicing up to 10 percent of their available foreign exchange receipts each month, with priority given to debt service related to imports. No other capital transactions are permitted in the new market, and purchases of foreign exchange for most private travel abroad is required to be financed from free accounts.

A number of bilateral payments agreements (one with a Fund member, Sudan) remain in force with exchange rates ranging from LE 0.7 to LE 0.4 per U.S. dollar.

II. Last Article IV consultation and further decisions

The last Article IV consultations were held by the staff in Cairo during May-June 1986. The Staff Report (EBS/86/186 and Supplement 1) was discussed by the Executive Board on October 6, 1986. The summing up indicated a 12-month consultation cycle.

The Executive Board's decision adopted October 6, 1986 was as follows:

> 1. The Fund takes this decision relating to the Arab Republic of Egypt's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1986 Article XIV consultation with Egypt conducted under Decision No. 5392-(77/63), adopted April 19, 1977 (Surveillance over Exchange Rate Policies).
>
> 2. The Fund notes the intentions of the authorities to liberalize the exchange system and reduce the number of exchange rates. The Fund considers that the system remains complex and believes that steps should be taken at an early date toward the complete unification of the existing rates. The Fund urges Egypt to settle promptly its external payments arrears. The Fund hopes that Egypt will terminate the two remaining bilateral payments agreements with Fund members as soon as possible.

The current stand-by arrangement was approved by the Executive Board on May 15, 1987. The decision relating to the exchange system adopted by the Executive Board on that date was as follows:

> As described in EBS/87/93, Egypt maintains restrictions on payments and transfers for current international transactions evidenced by external payments arrears, advance import deposits, a bilateral payments arrangement, and a multiple currency practice arising from the three-tier exchange market. These measures are subject to approval under Article VIII, Sections 2 and 3. The Fund welcomes the intention of Egypt to unify the bank market and the free market, to eliminate the external payment arrears, and to phase out the advance import deposits. The Fund encourages Egypt to eliminate the remaining exchange restrictions and multiple

currency practice as soon as possible. In the meantime, the Fund grants approval for the retention of these restrictions and the multiple currency practice as these may be modified in accordance with paragraph 4(e)(ii) of the stand-by arrangement for Egypt, other than the bilateral payment arrangement, until November 30, 1987, or the completion of the next Article IV consultation, whichever is earlier.

III. Technical Assistance

1. CBD

a. In September 1983, a CBD mission visited Cairo to review the system for supervising banks and the program for training bank inspectors.

b. A CBD expert has been stationed in Cairo since December 1984 working on the development of a computer-based, centralized external debt data system. A second CBD expert has been in Cairo since April 1987 as advisor to the Central Bank on management of the foreign exchange market generally and the new bank market in particular.

2. FAD

a. FAD missions visited Cairo six times during 1984-86 to review the import tariff system and to suggest reforms. Reports were submitted to the authorities in October 1985 and December 1986.

b. A FAD mission visited Cairo in August-September 1987 to prepare recommendations regarding the mobilizing of tax resources for the short run and structural reforms of the tax system. The report was submitted to the Government in March 1988.

3. Other

a. Three ETR/MED technical assistance missions visited Cairo over the June 1981-November 1984 period to review the exchange system and make recommendations for unification. An ETR mission visited Cairo in April 1987 to assist in the preparation of the authorities' request for the Paris Club rescheduling of external debt. The consultation/review missions of October/November 1987 and January/February 1987 submitted to the authorities studies relating to the unification of the central bank pool with the new bank foreign exchange market.

b. A STAT technical assistance mission visited Cairo in March 1983 to review the methods used to compile monetary statistics and in February 1986 to review trade statistics. STAT missions visited Cairo in July 1985 and July 1986 to facilitate Egyptian participation in the IBS program and to review external debt statistics.

c. The IMF Institute conducted a seminar in Cairo in November 1983 on Fund policies and Egyptian policy issues.

IV. Resident Representative/Advisor

The resident representative post that was closed in June 1983 was reopened in July 1986.

World Bank Group Operations

The strategy underlying IBRD activities in Egypt during the 1970s and early 1980s aimed at rehabilitating damaged capacity, improving maintenance practices, eliminating critical deficiencies and bottlenecks to development, and helping the setting up and strengthening of institutions. To achieve these goals, the Bank supported development in a wide spectrum of sectors and served not only as provider of direct financing but also as a catalyst for bilateral and multilateral aid by organizing a Consultative Group for Egypt.

Over the last five years, 1982/83-1986/87, 1/ the Bank had approved 15 loans for a total amount of US$1.1 billion. Loan commitments declined gradually from five projects (US$455 million) in 1982/83 to only one (US$45 million) in 1985/86; there have been no new commitments since then. With respect to these loan commitments, the main focus was on industry, which accounted for about 58 percent of the total; second priority was given to agriculture and drainage (27 percent), while loan commitments for transport infrastructure, vocational training, power, and water supply engineering, together accounted for the remainder.

In industry, the Bank tried to foster private sector activities through three development finance company operations aimed at assisting small- and medium-scale industry as well as construction and export activities, and through a loan commitment for agro-industries. Loan commitments for agriculture concentrated on maintaining the productive capacity of the sector through a series of projects to install drainage systems in the Nile Delta and Upper Egypt as well as to provide farm inputs, spare parts, and farm machinery. Most projects included important technical assistance components aimed at strengthening the implementing agencies and other sector institutions. The decline in Bank loan commitments was largely due to delays in reaching agreement on key macroeconomic reforms as well as to Egypt's easy access to concessional aid. Thus, a number of investment projects prepared by the Bank during recent years were either postponed by the Government or financed by other aid donors. During the past five years, the Bank's economic and sector work has concentrated on structural issues, such as trade strategy and investment planning, public sector enterprise reform, the public investment plan, and macroeconomic adjustment.

The Bank's current strategy is designed to assist the Government in implementing the measures which have been defined within the framework of the 1987/88-1991/92 Development Plan. These include restoring macroeconomic balance and fostering sustainable economic growth, through increases in productivity and improvements in investment allocation, resource mobilization, export activities, and employment policies. In this context, sector adjustment loans for agriculture and industry are under preparation. Their further processing is awaiting, inter alia, a strengthening of the ongoing macroeconomic adjustment program,

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1/ World Bank fiscal years beginning July 1.

particularly in the areas of the exchange rate and system, interest rates, the budget, and energy prices. The policy focus of the Agricultural Sector Loan includes a number of measures proposed to continue and strengthen the Government's economic reform program presented to the Bank, the IMF, and other donors in June 1986. Under this reform program, official prices, area allotments, and production quotas were removed for all crops, except for cotton, sugar cane, and 50 percent of rice production. Such liberalizations would continue under the Agricultural Sector Loan. The proposed Industrial Sector Loan would focus on policy changes in four areas: decontrol of domestic prices charged by public enterprises; liberalization of imports; enhanced managerial and financial autonomy and accountability of public enterprises' management; and improved decision-making process for public enterprises' investments.

In addition, projects to overcome critical supply bottlenecks (including power), increase and diversify exports, and foster economic import substitution would be supported. For the longer term, as the stabilization measures became effective and the investment outlook improved, further assistance would be programmed for expanding capacity in the productive sectors. The Bank's past experience in these sectors is being complemented by substantial economic and sector work to provide effective support to the Government in its economic reform measures.

Disbursements had shown a rising trend in the early 1980s and reached US$346 million in 1983/84 as a result of improvements in overall project implementation and of better knowledge of the Bank's disbursement procedures by the Egyptian authorities. There was, however, a marked decline to US$260 million in 1984/85, US$217 million in 1985/86, and US$192 million in 1986/87 as a result of shortage of local currency allocations, delays in procurement, and inadequate project management. These problems are being addressed through project implementation reviews and increased Bank supervision efforts. IBRD and International Development Association (IDA) disbursements in 1986/87 represented an estimated 7.7 percent of Egypt's medium- and long-term capital inflows.

The Bank and IDA shares of total medium- and long-term external debt outstanding and disbursed (excluding military debt) were about 4 percent and 3 percent, respectively, as of June 30, 1987. It is estimated that in 1986/87, debt service payments to the Bank and IDA were about 8.2 percent of Egypt's external debt service payments, and will rise to about 22 percent in 1987/88 when service payments on bilateral debt are exceptionally low as a result of debt rescheduling.

The International Finance Corporation's (IFC) participations and lending commitments for projects in Egypt as of December 31, 1987, totaled US$239.8 million. Most IFC activities have been lending operations. Among the projects financed are a project for an agricultural complex primarily for sugar beet, a building material project in Suez, and a reinforcing bar project at El-Dikheila.

Recently, IFC has approved two projects for oil development and exploration. The IFC has provided technical assistance in the design of incentives to private sector investments and in the development of the capital market. The IFC is considering several other private sector and joint venture projects.

Table 11. Egypt: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

	IBRD	IDA	Total
IBRD/IDA lending operations 1/			
Fully disbursed operations 2/	1,005.0	523.7	1,528.7
Total undisbursed	954.2	65.8	1,020.0
Ongoing operations 3/	1,588.4	467.1	2,055.5
Agriculture and Rural Development	374.7	145.9	520.6
Education	52.4	40.1	92.5
Power, Energy, Industry (includes Telecommunications)	976.3	192.0	1,168.3
Infrastructure (includes Transportation, Urban, Water Supply and Sewerage)	185.0	89.1	274.1
Total 1/	2,593.4	990.8	3,584.2
Repayments	456.3	12.3	468.6
Total now held by IBRD/IDA	2,137.1	978.5	3,115.6
IFC investments 4/	--	--	135.5

Source: World Bank.

1/ Loans and credits as of March 31, 1988.
2/ Fifty-one loans and credits fully disbursed, net of cancellations.
3/ Includes one loan for US$45 million approved by the Board but not yet effective.
4/ As of March 31, 1988. Gross commitments less cancellations, terminations, repayments, and sales.

Statistical Issues

1. Assessment of data

Economic statistics in Egypt show a number of deficiencies that make monitoring and analyzing developments in the economy difficult. The main problems are set out below.

a. National accounts

National accounts data are available up to 1986/87. While the estimates of nominal magnitudes may be reasonably reliable, it is believed that, in data on real developments in the economy, the rate of growth has been greatly overestimated, owing to deficiencies in sampling techniques that the authorities use in all sectors other than the petroleum sector. This assessment is based on the incompatibility between official estimates of real growth for the economy as a whole, on the one hand, and known developments in components (such as imports, gross fixed investment, gross value added in industry, agricultural production, crude oil production, and tourism) as well as movements in real private sector liquidity and bank credit to the private sector, on the other hand. National accounts deflators may, therefore, tend to understate price movements.

b. Monetary accounts

The monetary accounts for recent months have shown sizable and as yet unexplained increases in the net international reserves component of net foreign assets and large and not completely explained movements in net other items. The accounts are marred by an insufficient breakdown of a number of items, such as net international reserves, earmarked deposits, and unclassified assets and liabilities. In addition, only a very partial maturity analysis of bank lending and deposit-taking is available. Finally, the monetary accounts suffer from valuation problems as foreign currency items are valued at the banks' accounting exchange rates, which differ substantially from market exchange rates.

c. Prices

Movements in the major price indices have increasingly failed to reflect what is known from other indicators about inflation in the economy. First, the weights of the wholesale and retail price indices (base 1965/66 and 1966/67, respectively) are outdated. The 1980/81 household budget survey has been processed by the Central Agency for Public Mobilization and Statistics, but as yet new price index weighting schemes have not been introduced. In addition, it appears that movements in the administered price components of the price indices only partially reflect actual changes in administered prices.

d. Interest rates

Data on interest rates on private sector and non-central government public sector deposits with and borrowing from the banking system are readily available. Data on the terms and conditions of central government deposits with and borrowing from the banking system are not made available to the Fund in sufficient detail. In addition, little is known about the terms and conditions of deposit-taking and lending by the Islamic investment firms.

e. Government finance

Final accounts become available, after the close of each fiscal year, only with long lags and are subject to substantial revision. Data on part-year developments are provided with too long a lag to facilitate an assessment of budgetary developments in the current fiscal year and to take corrective measures when needed. Data on the implementation of the development budget are not made available on a regular and consistent basis. Data on foreign financing of the fiscal deficit are difficult to obtain and are probably seriously deficient on account of valuation problems. Finally, discrepancies usually exist between data provided by the Government, on the one hand, and data provided by the central bank from the monetary accounts, on the other, with regard to domestic bank financing of the fiscal deficit.

f. Balance of payments

The balance of payments statement prepared by the Central Bank is based to a large extent on exchange records of transactions effected through the central bank pool, the commercial bank pool, and the new bank foreign exchange market, supplemented by data on own exchange imports and some other transactions. Problems, thus, exist with underestimation, inaccurate classification, or total exclusion of various transactions.

For example, a major limitation of official data is that "below the line" monetary movements are not estimated by the Central Bank; these are estimated by the staff mainly from transactions effected through the foreign exchange budget. These estimates differ widely from estimates derived from the balance sheets of all monetary sector institutions. Other deficiencies of official data relate to: underestimation of tourism receipts and uncertainty relating to the magnitude of actual workers' remittances; the exclusion of transactions of foreign oil companies; the inappropriate and partial recording of transactions of joint ventures; the exclusion of transactions of enterprises operating in free zones; discrepancies in data on external debt flows as recorded in the balance of payments and by the External Debt Department of the Central Bank; the exclusion of grants in kind; no estimate for private sector interest payments or capital transactions; public debt service transactions that exclude arrears incurred; export transactions recorded on the basis of foreign exchange receipts rather than shipments; and the application of inappropriate residency criteria in respect of certain banks.

This report uses staff estimates derived from a variety of sources, including the Central Bank's official balance of payments data, central bank exchange control information on the central bank and commercial bank pools and on the new bank foreign exchange market, central bank bank control information on the monetary accounts of the banking system, central bank external debt information, ministry of economy data on the foreign exchange budget, ministry of planning data on foreign financing of the budget, and data from the EGPC, the Suez Canal Authority, and the Ministry of Tourism.

g. International liquidity

A breakdown of the net international reserves of the Central Bank that shows assets and liabilities by currency, maturity, and quality of instruments is not regularly made available. This has caused difficulties in monitoring the current stand-by arrangement in light of the large and unexplained increases in net international reserves.

With regard to the net international reserves of the banking system, it is not yet clear to what extent valuation problems, the accumulation of advance import deposits in foreign currencies under the new exchange arrangements, and other factors may be responsible for recent increases in net international reserves.

h. External debt

Information on civilian external public and publicly guaranteed debt was, until recently, handled by two separate units of the Government. Debt to multilateral organizations and governments was recorded by the Ministry of Planning, while debt to all other creditors was recorded by the External Debt Department of the Central Bank. Compilation of aggregate debt data was, until recently, undertaken once a year with the aid of short-term technical assistance from the World Bank. A CBD expert was assigned to Cairo in December 1984 to assist in compiling and analyzing the external debt statistics, as well as reconciling official records with creditors' statistics. As a result, debt data previously available only in the Ministry of Planning are now made available to the Central Bank, and a computerized debt-monitoring system will shortly come into operation that will provide up to date statistics on stocks and flows of civilian public and publicly guaranteed external debt.

Data on private sector nonguaranteed debt are not available officially and are estimated by the staff from a variety of sources, including the monetary accounts and creditor sources. Data on public military debt have been made available to the staff only once in the context of the Paris Club rescheduling of May 1987.

2. Reporting of data to the Bureau of Statistics

a. Outstanding Issues

(1) General economic statistics

There remains a consistent and considerable time lag for all of the reported trade data compiled by the Central Agency for Public Mobilization and Statistics (CAPMAS). All the data on export and import values, unit values and volumes were last reported for the period June 1987, whereas central bank data for payments and receipts have been provided up to January 1988. There is also a problem with the conversion factor for converting the CAPMAS data into U.S. dollars for international comparisons.

(2) Government finance

Annual data through 1985/86 for the main central government finance aggregates, other than debt, are published in the 1987 Government Finance Statistics Yearbook (GFSY) and in IFS. Attempts to reconcile the data available to the Bureau with those provided to the Middle Eastern Department (which are used in the Staff Report) indicate that there are coverage differences which have been widening in recent years. Queries on these differences put to the GFS correspondent have not been answered adequately.

The 1986 GFSY publishes for the first time provisional data for many countries. It would be helpful to obtain this data for Egypt for 1987/88, particularly for major components, on the same basis and with the same coverage as for previous years.

(3) International banking statistics

In 1982, the Egyptian authorities tentatively agreed to participate in the Bureau's international banking statistics project, but they have encountered many problems in the data collection and compilation. In December 1987, they informed the Bureau that they were not able to participate in the project. The Bureau intends to be in contact with the authorities on this matter.

b. Coverage and currentness of data in IFS

The table below shows the currentness and coverage of data published in the country page for Egypt in the May 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Egypt, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in May 1988 IFS
Real Sector	- National Accounts	1987
	- Prices: CPI	January 1988
	WPI	December 1987
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1986
	- Financing	1986
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	December 1987
	- Deposit Money Banks	December 1987
	- Other Financial Institutions	December 1987
Interest Rates	- Discount Rate	February 1988
	- Bank Lending/Deposit Rates	n.a.
	- Government Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	July 1987
	Prices:	
	cotton	March 1988
	- Balance of Payments	1986
	- International Reserves	November 1987
	- Exchange Rates	March 1988

Egypt: Basic Data

I. Economic Indicators, 1982/83-1986/87

	Actuals 1982/83	1983/84	1984/85	1985/86	Prov. Actuals 1986/87
	(In percent)				
Annual changes in national product aggregates 1/					
GDP (in constant prices)	9.9	8.0	7.4	4.8	4.2
Agriculture	(4.1)	(4.1)	(3.2)	(3.3)	(2.9)
Industry and mining	(11.8)	(8.8)	(9.9)	(7.4)	(7.3)
Petroleum	(15.9)	(14.4)	(10.6)	(1.0)	(-2.1)
Construction	(20.5)	(6.4)	(3.8)	(4.0)	(-2.4)
Services	(11.1)	(7.4)	(7.6)	(5.5)	(6.2)
Investment, consumption, and savings ratios 1/					
Gross investment/GDP ratio	26.2	24.4	22.6	20.6	19.5
Private consumption/GDP ratio	65.0	68.8	69.2	70.4	77.8
Government consumption/GDP ratio	16.8	17.8	17.6	17.6	14.4
Gross domestic savings/GDP ratio	18.2	13.4	13.2	12.0	7.8
	(In billions of Egyptian pounds)				
Government finances 2/					
Total revenue	9.7	10.4	11.3	12.8	12.4
Tax revenue	(5.2)	(5.4)	(5.9)	(6.5)	(6.8)
Nontax revenue	(4.5)	(5.0)	(5.4)	(6.3)	(5.6)
Total expenditure	14.5	16.8	18.5	21.0 3/	19.9
Overall deficit	4.7	6.4	7.2	8.2 3/	7.5
Net external financing	(0.9)	(1.1)	(1.5)	(1.8)	(1.4)
Domestic bank financing	(2.0)	(2.8)	(2.8)	(2.9)	(3.6)
Domestic nonbank financing	(1.4)	(1.7)	(2.1)	(2.6)	(2.8)
Other 4/	(0.5)	(0.9)	(0.8)	(0.9) 3/	(-0.3)
	(Percentage changes over year)				
Government finances 2/					
Total revenue	17.1	6.4	9.1	13.1	-3.0
Tax revenue	(15.0)	(3.1)	(10.4)	(10.1)	(4.9)
Total expenditure	14.2	15.9	10.0	13.8	-5.1
	(In percent of GDP)				
Government finances 2/					
Total revenue	39.3	37.2	34.8	35.5	28.2
Tax revenue	(21.0)	(19.2)	(18.2)	(18.1)	(15.5)
Total expenditure	58.5	60.3	56.8	58.3	45.3
Overall deficit	19.1	23.1	22.0	22.8 3/	17.1
Net external financing	(3.5)	(3.8)	(4.7)	(5.0)	(3.3)
Domestic bank financing	(8.1)	(10.1)	(8.5)	(7.9)	(8.2)
Domestic nonbank financing	(5.7)	(6.0)	(6.4)	(7.3)	(6.4)
	(Percentage changes over year)				
Monetary accounts 5/					
Private sector liquidity	33.3	22.7	22.4	25.6	16.0
Egyptian pound component	(34.9)	(25.2)	(18.2)	(15.5)	(13.1)
Net domestic assets	27.7	23.7	22.3	21.1	20.4
Public sector	(19.5)	(22.3)	(18.1)	(14.8)	(18.7)
Central and local governments	[...]	[21.9]	[17.6]	[15.5]	[14.0]
Private sector	(27.1)	(24.4)	(23.1)	(28.3)	(18.8)
Egyptian pound component	[27.1]	[33.9]	[25.0]	[28.6]	[17.7]
Prices					
GDP deflator	11.2	4.2	8.6	5.8	17.3
Consumer prices (period average)	15.2	18.0	14.6	15.9	25.2
Balance of payments					
Petroleum exports	...	4.0	--	-23.1	-39.8
Other exports	...	27.3	-7.1	-7.7	13.5
Imports, (c.i.f.)	...	13.2	1.9	-9.4	-18.5
Worker remittances	...	21.9	-10.3	-15.0	-4.3

Egypt: Basic Data (Concluded)

	Actuals 1982/83	1983/84	1984/85	1985/86	Prov. Actuals 1986/87
	(In billions of U.S. dollars)				
Balance of payments					
Trade balance	-5.5	-6.3	-6.6	-6.3	-5.2
Exports, f.o.b.	(3.6)	(4.0)	(3.9)	(3.2)	(2.6)
Imports, c.i.f.	(-9.0)	(-10.3)	(-10.5)	(-9.5)	(-7.8)
Services (net)	0.5	0.1	-0.3	-0.7	-0.6
Worker remittances	3.2	3.9	3.5	3.0	2.8
Current account (excluding official transfers)	-1.8	-2.3	-3.5	-4.0	-2.9
Official transfers	0.8	0.8	1.1	1.2	1.0
Current account (including official transfers)	-1.0	-1.5	-2.4	-2.8	-2.0
Direct investment	0.2	0.1	0.2	0.2	0.2
Project and commodity loans (net)	0.4	0.2	0.3	--	-0.2
Suppliers and buyers credits (net)	-0.1	-0.5	--	-0.2	-0.7
Other official capital (net)	--	-0.3	-0.4	--	-1.2
Other private capital (includes errors and omissions)	0.9	1.4	1.3	1.9	0.9
Overall balance	0.5	-0.5	-0.9	-0.8	-2.9
Net international reserves	-0.9	-0.1	-0.4	-0.4	-0.6
Financing gap	0.4	0.6	1.4	1.3	3.6
Arrears	0.4	0.6	1.4	1.3	0.5
Rescheduling	--	--	--	--	3.1
Memorandum items:					
Central Bank gross reserves 6/	0.7	0.7	1.0	1.0	1.4
(in weeks of following year's imports, c.i.f.)	3	4	5	7	9
Current account deficit (as percent of GDP)					
Including official transfers	4.4	6.4	10.1	13.7	8.7
Excluding official transfers	8.0	9.8	14.8	20.4	13.2
External debt outstanding	...	33.1	36.4	37.7	40.4
External debt service obligations after rescheduling	...	4.0	4.1	4.8	2.5
Rescheduling impact	--	--	--	--	3.1

II. Social and Demographic Indicators

Area

1,001 thousand sq km

Population

Total:	49.7 million (mid-1986)
Rate of growth:	2.5 percent per annum
Density:	45.1 per sq km
GNP per capita:	US$644 (1984/85)

Population characteristics

Crude birth rate (per thousand) (1986)	34
Crude death rate (per thousand) (1986)	11
Infant mortality (per thousand live births) (1985)	93
Child death rate (per thousand) (1985)	11

Income distribution (1974)

Percent of private income received	
by highest 10 percent of households	33
by lowest 20 percent of households	6

Distribution of labor force (1980)

Percent in agriculture	46
industry	20
services	34

Nutrition (1982)

Calorie intake (as percentage of requirement)	128
Protein intake per capita (grams/day)	81

Health

Population per physician (1980)	970
Population per hospital bed (1978)	490

Access to electricity

Percent of dwellings (urban)	77
Percentage of dwellings (rural)	19

Access to safe water

Percent of population (1980)	75

Education

Enrollment rates (percent) in	
Primary education	84
Secondary education	58
Higher education	21

Source: Data supplied by the Egyptian authorities; World Bank report on Egypt: Review of the Finances of the Decentralized Public Sector and World Bank Development Report (for social and demographic indicators); and staff estimates.

1/ Official estimates, which should be interpreted with caution, especially for 1987/88.

2/ Includes, in expenditure, assumptions by the Government of General Authority for Supply Commodities (GASC) deficits and net bank credit to GASC.

3/ Expenditure and the overall deficit exclude LE 0.6 billion assumptions by the Government of debts of nonfinancial enterprises. Other financing is also adjusted to exclude this amount. The deficit on a cash basis is LE 8.8 billion (24.5 percent of GDP).

4/ Mainly the statistical discrepancy between monetary and budgetary data on bank borrowing by the Government. See also footnote 3.

5/ Foreign currency items are valued as follows: for the private sector, at outside-banks (free) market exchange rates; for all other items, at the relevant banks' accounting rates of exchange.

6/ Excludes gold.