February 5, 2020
Approval: 2/12/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/60-4

4:00 p.m., June 29, 2018

4. Arab Republic of Egypt—Third Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for a Waiver of Nonobservance of Performance Criterion and for Modification of Performance Criterion

Documents: EBS/18/61 and Correction 1

Staff: Lall, MCD; Murgasova, SPR

Length: 50 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	**Alternate Executive Directors**
	D. Mahlinza (AE)
	M. Raghani (AF)
	D. Vogel (AG), Temporary
	G. Johnston (AP)
A. Tombini (BR)	
	P. Sun (CC)
	J. Rojas (CE)
	R. Young (CO), Temporary
	O. Bayar (EC)
	A. Castets (FF)
S. Meyer (GR)	
	H. Joshi (IN), Temporary
A. Leipold (IT)	
	Y. Saito (JA)
J. Mojarrad (MD)	
H. Beblawi (MI)	
	N. Jost (NE), Temporary
	K. Virolainen (NO)
A. Mozhin (RU)	
	R. Alkhareif (SA)
J. Agung (ST)	
	P. Inderbinen (SZ)
	R. Masood (UK), Temporary
	P. Pollard (US), Temporary

G. Bauche, Acting Secretary
K. Hviding, Summing Up Officer
M. Gislen, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: R. Elnagar. European Central Bank: T. Persico. European Department: K. Sakr, A. Salem. Finance Department: K. Kitano. Information Technology Department: F. Gheriss. Legal Department: K. Kwak, D. Schwarz. Middle East and Central Asia Department: J. Azour, B. Baduel, Y. Cai, M. Gaertner, N. Gigineishvili, J. Kahkonen, S. Lall, B. Nandwa. Monetary and Capital Markets Department: C. de Barros Serrao.

Strategy, Policy, and Review Department: Z. Murgasova, M. Tashu. World Bank Group: K. Carey. Alternate Executive Director: M. Daïri (MD), P. Fachada (BR), S. Geadah (MI), C. Just (EC). Senior Advisors to Executive Directors: M. Choueiri (MI), T. Ozaki (JA), C. Sassanpour (MD), M. Sidi Bouna (AF). Advisors to Executive Directors: B. Alhomaly (SA), P. Al-Riffai (MI), P. Braeuer (GR), K. Florestal (BR), T. Gade (NO), H. Mori (JA), A. Olhaye (AF), P. Snisorenko (RU), M. Svenstrup (US), C. Wehrle (SZ).

4. ARAB REPUBLIC OF EGYPT—THIRD REVIEW UNDER THE EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY, AND REQUESTS FOR A WAIVER OF NONOBSERVANCE OF PERFORMANCE CRITERION AND FOR MODIFICATION OF PERFORMANCE CRITERION

Mr. Beblawi and Ms. Abdelati submitted the following statement:

Egypt's economy is strengthening on many fronts, reflecting sound policy implementation, improved outlook, and confidence gains. On the macro-side, GDP is estimated to have risen to over 5 percent despite a sizeable fiscal consolidation in the year ending June 2018; the primary fiscal deficit is estimated to have shifted to a small surplus; public debt will have significantly declined as a share of GDP; international reserves nearly tripled from their low point and now exceed their earlier peak in 2010; and inflation was brought down to 11.4 percent in May 2018 after having soared to over 33 percent. Wide ranging structural reforms were implemented, despite the socio-economic and technical challenges. The resulting confidence gains have contributed to deeper access to international financial markets and upgrades from rating agencies. The authorities remain guided by the objectives of their homegrown program and their vision to build on recent gains in macroeconomic stabilization, transform the economy, and deliver better prospects for all. They realize that significant challenges remain to deliver on the promises to the Egyptian people, who wait to see the fruits of their sacrifices, for which they deserve the highest recognition.

Communication has been key to public acceptance. The authorities consistently communicate the rationale for difficult reforms that entail considerable public sacrifice, supported by the leadership's statements, at the highest level, explaining the vision for Egypt. The newly formed cabinet has demonstrated continuity, with the new PM Madbouly approving proposals prepared by the prior cabinet in his first hours in office. President ElSisi has tasked the new cabinet, which held its first meeting on June 21, to (i) work toward a growth target of 7 percent while further reducing the budget deficit, unemployment, and inflation; (ii) keep national security a priority; (iii) improve the quality of life for citizens; (iv) expand protections for low-income earners; (v) improve education; and (vi) improve government services.

The authorities share staff's assessment of the favorable outlook and risks. Continued recovery of tourism and rising natural gas production should help support growth in the near term. The recent broad shift in investor sentiment away from emerging markets could lead to further tightening of financial conditions that will need to be evaluated in the period ahead. Uncertainties also relate to global oil prices, any deterioration in the security situation, or the possible drag on the reform momentum from adjustment fatigue.

The CBE plans to maintain a tight monetary policy and a flexible exchange rate. The tight monetary stance has brought down inflation following the large devaluation and series of price hikes, in order to firmly anchor inflation expectations. The CBE is keenly aware of second-round effects from recent increases to energy and other prices (water, metro, and other public transport, etc.). Consistent with the commitment to a flexible exchange rate, CBE has refrained from any intervention since the floating of the pound. Market supply and demand factors, strong portfolio inflows, and banks' rebuilding of net foreign assets have helped the pound stabilize. All in all, the Egyptian pound lost two-thirds of its value relative to 2010, boosting net exports to become an important contributor to GDP growth this year, and allowing the current account deficit to sharply narrow to an estimated 2½ percent of GDP and it is likely to narrow further. Portfolio inflows, which were on a steady upswing, reaching 7 percent of GDP, have seen a tapering off and outflows in recent weeks due to the dampened sentiment towards Ems across the board and not for Egypt-specific reasons.

The fiscal consolidation is among the largest planned and achieved under a Fund supported program. With budget deficits exceeding 10 percent of GDP for several years, debt service accounting for 30 percent of total spending and 10 percent of GDP, and general government debt surpassing 100 percent of GDP last year, a large fiscal consolidation was inevitable and considered a key anchor to the stabilization effort. Despite the large devaluation and much higher oil prices than projected at the start of the program, which led to an over-run of the fuel subsidy bill by 0.3 percent of GDP, the budget position is expected to shift to a small primary surplus this year.

With further consolidation measures next year, the primary surplus is targeted at 2 percent of GDP and general government debt to decline (from 103 percent of GDP in 2016/17) to 86 percent of GDP in 2018/19. The primary surplus will be maintained at 2 percent of GDP and debt will decline further to 74 percent of GDP by 2022/23. Debt service cost is projected to decline by 4 percent of GDP annually over the medium-term. In addition, an automatic price adjustment mechanism was approved by the Prime Minister in June for implementation during 2018/19 to lock-in fuel subsidy reform gains and avoid the recurrence of fuel subsidies. The Minister of Petroleum just publicly affirmed this week that fuel subsidies would be eliminated completely by next year.

The financial sector has proven to be strong, profitable, well-regulated and supervised, and resilient to shocks, as verified by Fund experts. The large public banks are comfortable with their current and projected capital positions and, given their continued profitability, consider themselves well-positioned to manage the planned expansion of operations mainly from internally generated capital, and to easily withstand moderate shocks. Banks' capital adequacy ratios stood at over 15 percent in December 2017, and NPL ratios had further declined to 4.9 percent with virtually full provisioning (99 percent). Banks expect private sector credit growth to be revived from currently low levels, once interest rates decline from historically high levels as inflation expectations become durably anchored.

The Ministry of Finance is modernizing its operations, improving transparency and accountability, and further enhancing institutional capacity. Notably, a fiscal strategy paper was submitted to Cabinet in December 2017 and an updated statement of fiscal risks is being finalized with procedures for assessing new state guarantees. A report on public enterprises is to be completed this week to provide a more complete picture of public sector operations. Tax collection will be modernized by integrating the organization structure of income taxes and VAT, and utilizing upgraded IT systems and processes. Gender-budgeting is to be introduced in 2018/19 with the help of United Nations Women program, and several initiatives aim to support women's financial inclusion, training, and labor force participation.

Structural reforms aim to facilitate private sector activity and encourage investment. The adoption of a new investment law, establishment of a consolidated investment center, and simplification of licensing procedures were important steps in the past year—and the authorities are working on many other fronts, including those reflected in the MEFP. A working group is being established to review the allocation mechanism for industrial land and identify potentially needed reforms. A new government Procurement Law was recently approved and is expected to encourage broader participation by the private sector, while a single e-Procurement portal will handle all public procurements. Other steps are being considered to support competition and reassure private investors of an even handed playing field. Last April a detailed plan was announced on the divesture of stakes in at least 23 public entities over 24-30 months, of which the first 4 would be completed in the next fiscal year.

A few words of appreciation. The authorities are highly appreciative of everyone on the IMF team. Candid and constructive discussions are building a good partnership. The May conference in which Mr. Lipton participated usefully touched on the many remaining challenges and the transformative reforms that other countries implemented over a decade or more, and emphasized that Egypt needs to accelerate the pace of the planned transformation.

Looking forward. Recent economic gains provide an important motivation to continue with the still large and complex reform agenda so that the benefits can be shared more broadly. The Egyptian people have endured hardships from reforms deemed inevitable to correct earlier imbalances and to place the economy on a path of more inclusive growth. Their endurance, and persistent reform efforts, are critical to realizing the vision of transformative economic change.

Ms. Horsman, Ms. McKiernan and Ms. Young submitted the following statement:

We fully support the completion of Egypt's Third Review Under the Extended Fund Facility. The authorities have maintained their steadfast commitment to the arrangement since the Second Review in December 2017. Their efforts continue to pay off with strengthening growth (above 5 percent of GDP), declining unemployment levels, and narrowing fiscal and external deficits. They continue to adeptly manage a remarkable transition to a flexible exchange rate with headline inflation down to 11.4 percent from a peak of 33 percent less than a year ago. Higher-than-programmed oil prices have led to a larger fuel subsidy bill, but the authorities have implemented offsetting measures to the fiscal balance, while maintaining their commitment to achieving cost-recovery pricing by the end of 2018/19, as reaffirmed by the Minister of Petroleum this week. Overall, we feel a more accurate portrayal of Egypt's performance under this review is best reflected as "largely positive" (reflecting para 35: "a minor deviation from the target") rather than "mixed" (para 2).

The program no doubt faces continued risks, as aptly reflected in the review. A sound macroeconomic framework, strengthened buffers, and solid credibility should position Egypt well to weather moderate adverse scenarios. The staff have identified the importance of a healthy level of foreign reserves as a buffer against the risk of an acceleration in capital outflows. Could staff elaborate on scenarios under which they would favor a drawdown in reserves over a new issuance of Eurobonds to close the financing gap for 2018/19?

Otherwise, we broadly agree with the thrust of the policy mix in the period ahead, with emphasis on the transition to a more market-driven and diverse economy that supports inclusive growth, including with respect to gender.

Mr. Mojarrad and Mr. Sassanpour submitted the following statement:

We thank staff for a concise report and Mr. Beblawi and Ms. Abdelati for their candid buff statement that lays out the key economic challenges facing Egypt.

The Egyptian economy has made significant gains on all fronts under the EFF-supported program: growth is accelerating while inflation has decelerated sharply; unemployment has declined, the twin deficits continue to shrink; public debt is on a downward trend; and the Central Bank of Egypt (CBE) has accumulated sizable foreign reserves. Moreover, the banking sector remains liquid, profitable, well capitalized, and resilient to shocks, reflecting strong regulation and supervision. These positive achievements, reflected in upgrades from rating agencies, owe much to the authorities' ownership of the program and their strong commitment to its steady implementation—for which they should be commended. The highest recognition, however, should go to the Egyptian people and the sacrifices that they are making. The program is being implemented under difficult socio-economic conditions and, while the macroeconomic outlook is favorable, maintaining public support for the reforms would not be easy, considering the program's socially sensitive core that places a heavy burden on the disadvantaged in a country where poverty is still widespread. As underscored by Mr. Beblawi and Ms. Abdelati, communication has been key to maintaining public support. We are encouraged that the new government has endorsed the program design and objectives and, in many cases, has even raised the bar. We agree with the thrust of the staff appraisal and, in view of broadly satisfactory program implementation and the authorities' continued commitment, we support the proposed decision.

The authorities' commitment to a flexible and transparent exchange rate policy, together with the CBE's large foreign reserves, should help preserve competitiveness and provide an effective cushion against external shocks. The CBE's money targeting mechanism has been used efficiently to contain inflation, notably by mitigating the second-round effects of the sharp November 2016 depreciation of the pound and the substantial increases in energy, utility and administered prices. The lowering of CBE policy rates earlier this year was justified in view of the significant deceleration of inflation, and we welcome the indication that, going forward, staff and the CBE agree on the need to remain vigilant and to use inflation expectations and demand pressures to guide monetary policy. The adoption of the revised central bank law that sets price stability as the primary objective of monetary policy and bolsters the CBE's institutional and operational autonomy—along with measures to strengthen the monetary policy transmission mechanism and improve public communication—are key to successful implementation of forward looking and interest rate-based monetary policy, as intended.

On the fiscal front, improvement in the primary balance in the past two years—to an estimated small surplus in 2017/18, is helping to stabilize public finances and set the public debt-to-GDP ratio on a firm declining path. Going forward, the fiscal policy is prudently centered on achieving primary surpluses to anchor public debt. The energy subsidy reform has been, and will continue to be, a key component of fiscal adjustment and we welcome the authorities' intention to achieve full cost recovery for most fuel products within a year (and eliminate electricity subsidies in two years) and to put in place an automatic fuel price indexation mechanism by end-2018 to avoid reemergence of subsidies. The higher fuel, electricity, and water prices would be expected to quickly percolate through the economy. What is staff's assessment of the adequacy of current social safety nets in protecting the more vulnerable? We also welcome the plans to strengthen public financial management and the procurement system, improve transparency and accountability—particularly of economic authorities and SOEs—to fight corruption and limit the scope of rent-seeking behavior. What is the nature of activity of the 23 public enterprises targeted for disinvestment? What are the future disinvestment plans, to the extent known, and are there any plans to trim government ownership in state banks?

For growth to be sustainable and gain traction over the medium term and beyond, and for economic gains to be spread more widely, it is important to unleash the potential of Egypt's private sector through structural reforms. We note that the parliament has already passed a number of important laws in support of the private sector, and the MEFP (paragraph 25) provides a list of other far-reaching measures that the authorities are rightly focusing on to increase competition and efficiency, improve the business climate, and boost private investment. Could staff comment on the impact of tariff and non-tariff barriers on foreign trade, since non-oil trade does not seem to have responded materially to the sharp depreciation of REER in the last two years? Youth unemployment—with unemployment rates of over 30 percent—is one of the major economic and social challenges facing Egypt. However, reinvigorating job-rich private sector activity is a necessary but not a sufficient condition to address the high youth unemployment, which is structural, complex and multi-faceted in nature, with important social implications. Are there any active labor market policies under consideration to help absorb the large and growing cohort of unemployed youth? We welcome the planned introduction of gender-budgeting and initiatives to encourage labor force participation of women and support their financial inclusion.

With these comments, we wish the authorities continued success.

Mr. Rojas Ramirez submitted the following statement:

Egypt's economy has performed satisfactorily under the program. The authorities have implemented sound economic policies leading to economic stability, narrowing of fiscal and external deficits, and reducing unemployment. Program performance was mixed but authorities are fully committed to put it back on track. We thank staff for its set of documents and welcome Mr. Beblawi and Ms. Abdelati for their buff statement. We support the authorities' request for completion of the Third Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for a Waiver of Nonobservance of Performance Criterion and for Modification of Performance Criterion.

The monetary stance has been well conducted anchoring inflation and preserving stability. The external position looks sound with an appropriate level of international reserves. The authorities remain committed to a flexible exchange rate policy and building buffers against external shocks. The banking sector is sound, the system appears profitable with a good liquidity position and with capital levels according to prudential standards. NPL are low and most banks present solid liquidity buffers and balance sheets. The CBE has improved its legal framework for liquidity emergencies and bank resolution.

The fiscal policy is aimed at underpinning inclusive growth based on a sustained fiscal consolidation process and public debt reduction. The authorities have implemented reforms on fossil energy prices and electricity, monitoring SOEs to improve their financial performance, and are undertaking tax reforms for enhancing revenue generation and creating fiscal space. They are also committed to public finance management reform. We note that a fiscal strategy paper was already summited to cabinet in December 2017. A roadmap for pension reform and to improve fiscal transparency and accountability is being prepared.

Structural reforms are crucial for Egypt's economy to achieve sustainable inclusive growth. We concur that structural reforms should be oriented toward institutional reforms and diversification of the economy to enhance and make more efficient industrial land allocation, promoting transparency and improving governance as detailed in the program. These reforms will improve productivity and enhance the business climate to attract international investments. We encourage authorities to continue working on reform implementation, promoting private sector participation, strengthening and optimizing procurement systems, improving SOEs and women participation in the labor force.

Mr. Sun and Ms. Ma submitted the following statement:

We thank staff for the concise report and Mr. Beblawi and Ms. Abdelati for the helpful buff statement. Macroeconomic conditions have continued to improve under the program, thanks to the authorities' reform efforts and the recovery in tourism and natural gas production. As the PC on the primary fiscal balance was missed by a small margin, and modification of the PC on the fuel subsidy bill was due to higher-than-programmed oil prices, we support the decision on the completion of the third review and the two PCs. In view of potential risks, such as higher oil prices and acceleration in capital outflows, we encourage the authorities to keep the reform momentum and improve the structure of the economy to achieve the program objectives.

Monetary and exchange rate policies need to anchor disinflation and maintain adequate foreign reserves. We agree with staff that the recent interest rate cuts are appropriate to support the real economy in light of declining inflationary pressures. We commend the authorities for their commitment to a flexible exchange rate and for the well-measured policy steps following its adoption, which has successfully contained inflation. We take positive note that foreign reserves are assessed to be adequate and the authorities intend to eliminate the repatriation mechanism by end-2018. We wonder how the elimination of the repatriation mechanism would be executed considering possible pressures on capital outflows as a result of tighter global financial conditions. The staff's comments are welcome.

The energy reform is essential to keep fiscal consolidation on track. It is good to note that the 2018/19 primary surplus target of 2 percent of GDP is in line with the program, supported by extensive expenditure and revenue measures. While notable progress has been made in the energy subsidy reform so far, oil prices in Egypt are among the lowest in the world, and higher oil prices remain a major risk. As such, we welcome the price hike in June that raised the fuel prices to 73 percent of the cost, and the authorities' recent announcement to eliminate fuel subsidies by next year. Could staff elaborate on the social impact of the fuel subsidy reform?

As macroeconomic stability takes hold, more reform efforts can be made on the structural front. In this regard, we encourage the authorities to follow staff's thoughtful policy recommendations on priority structural reforms, including industrial land allocation and SOE reforms, with a view to developing the private sector and promoting a market-driven economy.

Mr. Armas and Mr. Rojas Ulo submitted the following statement:

We would like to thank staff for a clear and concise report and Mr. Beblawi and Ms. Abdelati for their informative buff statement.

We support the Egyptian authorities' Request Under the Extended Arrangement Under the Extended Fund Facility (EFF) for Waiver of Nonobservance of Performance Criterion and for Modification of Performance Criterion and thus the proposed Decision. We base our support on the authorities' efforts and important progress achieved through the implementation of different corrective and consistent measures of the economic policy under the EFF. We also commend the authorities for the results obtained, particularly in the external and fiscal sector, unemployment, and inflation. As expressed by the authorities in their Letter of Intent, they maintain their commitment to continue applying sound macroeconomic policies and structural reforms to promote inclusive growth.

Egypt's economy has made important progress under the EFF and the outlook remains positive, calling for maintenance of the reform momentum. In the last year, economic growth has picked up, driven by a favorable external demand and investment which allowed a decline in unemployed and the current account and an increase in international reserves. GDP is projected to increase by 5.5 percent in 2018/19 supported by the rebound in tourism and increasing natural gas production. If the reform momentum is sustained, economic growth is expected to reach 6 percent in the medium term. We support the implementation of structural reforms to consolidate the gains from macroeconomic stabilization achieved in the EFF agreement to promote sustainable, higher, and inclusive growth.

The fiscal consolidation process should continue according to plan and support growth in the long term. Efforts to diversify and modernize the mechanism to increase fiscal revenue and optimize expenditures could facilitate achieving the three-year cumulative fiscal consolidation target of

5.5 percent of GDP, reducing the overall high deficit and allowing public debt reduction. Improving in the fiscal revenues and the modernization of the public employment framework will generate fiscal space for investment in infrastructure and human capital and benefit the performance of the economy in the long term. We encourage the authorities to solidify the fiscal gains by accelerating reforms and adopting measures, such as further energy subsidy reforms, modernizing tax administration, strengthening the PFM framework and public procurement system to promote transparency and reduce corruption. Given the magnitude of the necessary fiscal adjustment in 3 years (5.5 percent of GDP), could staff elaborate more on the risk of reform fatigue mentioned in paragraph 34?

The monetary policy stance appears appropriate and the inflation rate is contained. The Central Bank of Egypt (CBE) should continue monitoring domestic financial conditions and price pressures and stand ready to contain second-round effects from the increases in energy prices. We welcome the authorities' target of a further reduction in inflation to single digits over the medium term. High inflation is a regressive "tax." We concur with staff's recommendation that a flexible exchange rate will help to build international reserves against external shocks and sustain the gains in macroeconomic stabilization. We support CBE's plans to adopt a new monetary policy framework (forward-looking and interest rate-based, with inflation as the nominal anchor) that strengthens the CBE's institutional and operational autonomy. In this regard, could staff clarify whether the CBE's plan is to implement an inflation-targeting regime in the medium term?

The banking system's soundness indicators have improved but efforts are needed to deepen reforms in the financial sector. We commend the authorities for their endeavors to strengthen and improve financial stability and the staff report shows that the sector remains liquid, profitable, and well capitalized. The authorities should continue monitoring the banking sector, maintain a continued decline in non-performing loans, and ensure that smaller banks will be recapitalized and show improvements in their financial conditions. We support the strengthening of financial stability through the amendments enacted in the Banking Law which will set the foundation of the new emergency liquidity assistance and bank resolution frameworks, in line with international best practices.

We support the implementation of structural reforms to improve competitiveness and diversify the economy to achieve inclusive growth. The economy maintains structural challenges stemming from past economic policies which have resulted in a significant misallocation of resources. The limited legal and institutional capacity, together with the availability and access to land, are structural constraints for Egypt's development. We encourage the authorities to continue and accelerate the structural agenda along with deepening and broadening structural reforms which should increase private-investment led growth, diversify the base economic growth, create jobs, and improve the business climate, enhancing the growth potential in the long term.

With these comments, we wish the Arab Republic of Egypt and its people success in their future endeavors.

Mr. Gokarn and Mrs. Dhillon submitted the following statement:

We thank Mr. Beblawi and Ms. Abdelati for their insightful buff statement and staff for their comprehensive report. The Extended Arrangement under the Extended Fund Facility has helped Egypt achieve an impressive repertoire of successes—narrowing external and fiscal deficits; declining inflation, debt and unemployment and across-the-board structural reforms. The strong commitment to program objectives has yielded results with gains in overall confidence and upgrades from rating agencies. Noting the program performance and continued solid ownership by the authorities, we support the completion of the third review under the Extended Arrangement and the request for the modification of the performance criteria on the fuel subsidy bill for end-June 2018. Going forward, committed program implementation will be needed to overcome the still lingering internal and external risks and ensure the overall success of the program.

Fiscal consolidation is on track and the shift to a primary surplus is commendable. Improving transparency and accountability, and further enhancing institutional capacity and modernizing IT and tax collection mechanisms are high on the reform agenda and will surely pay dividends. A vital element of fiscal consolidation is the ongoing energy subsidy reform. The authorities have raised the price of subsidised fuel and additional increases are planned to achieve the objective of full cost recovery by end-2018/19. Further, there have been increases in the excise duty rates and VAT and a projected decline in public wage bill of 0.5 percent of GDP from containment of wage increases. The staff has mentioned that some of the savings from subsidy reform would be used to increase social spending by 0.3 percent of GDP to mitigate the impact of the energy price reform. With episodes of high inflation continuing, could the staff elaborate on the additional actions being undertaken by the authorities to alleviate the adverse effects of the fiscal consolidation measures, including on erosion of real income? Also, what has been the impact of these actions for dealing with the social consequences?

We agree that CBE should maintain its restrictive monetary policy stance to anchor disinflation and a flexible exchange rate policy as a cushion against external shocks. With a goal to reduce inflation to single digits over the medium term, monetary policy should remain alert to increases in energy prices. Exchange rate flexibility has worked and may be an effective shock-absorber to tackle volatility in financial markets of emerging economies. We note that gross international reserves stood at seven months' prospective imports at the end of May and the financing gap for 2018-19 is expected to be met with a Eurobond issuance and/or from gross reserves. In recent months, we know that Egypt has successfully tapped international debt markets to finance the budget deficit and bolster foreign reserves. Could staff offer more details on recent bond issuances as well as the alternatives envisaged for the financing gap if market conditions and investment fatigue play a spoiler?

The financial sector is strong, profitable, well-regulated and supervised, and resilient to shocks. With large public banks comfortable on capital adequacy, CBE could focus on smaller banks as recommended by staff. Further, we positively note the authorities' commitment to the development of clear rules on deploying public funds to maintain financial stability.

Finally, we know that the economic landscape has shifted in favor of more diversified economies. Therefore, Egypt's bold and transformational reforms program must include all areas that undermine growth prospects. The ability of the private sector to create jobs, especially for youth and women, is critical to reap the benefits of the reforms and allay the impact on the vulnerable. To that end, we welcome the series of steps taken by the authorities for enhancing the business environment including the adoption of a new investment law, establishment of a consolidated investment center, strengthening of public procurement and simplification of licensing procedures. We urge the authorities to advance the momentum for more balanced and inclusive growth, for addressing competitiveness, and for tackling corruption.

With these comments we wish the authorities the best in their endeavors.

Mr. Tombini and Ms. Florestal submitted the following statement:

We thank staff for a candid assessment of Egypt's economic outlook and program implementation. We also thank Mr. Beblawi and Ms. Abdelati for their useful statement. Egypt has made notable progress in macroeconomic stabilization, achieving stronger fiscal outturns and reserve position, while GDP growth has accelerated. The current account deficit has declined, including due to increases in tourism receipts and remittances. Inflation fell sharply in the current year owing to monetary tightening, and base effects of the previous year's devaluation and fuel price hikes. We take note that the program implementation remains satisfactory, with all but two end-December 2017 quantitative targets met. In light of the authorities renewed commitment to the program, we support completion of the third review, as well as the requests for waiver of nonobservance of performance criterion, and modification of the end-June performance criterion on the fuel subsidy bill.

Egypt's economic outlook is favorable owing to projected increase in tourism, rise in gas production, stronger business sentiment, and more clarity about the political landscape. Nonetheless, as highlighted by staff, important downside risks have intensified including with regards to global oil price prospects, security conditions, tightening of global financial conditions and increased risk aversion, and potential adjustment fatigue. Undeniably, these risks may weigh in on program performance over the medium-term.

The budget of the incoming fiscal year projects a primary surplus of 2 percent of GDP, in line with the cumulative fiscal consolidation of 5.5 percent of GDP planned for three years. We commend the authorities for the significant reduction of fuel and electricity subsidies, accompanied by targeted support to the vulnerable segments of the population. That said, fuel prices in Egypt remain among the cheapest in the world, according to staff. The adoption of an automatic fuel price indexation mechanism is expected to lead to full cost recovery by the end of the year, taking into account not only oil price and exchange rate movements but also the changes in the share of imported fuel in domestic consumption. We wonder what exactly the latter entails, and what has been the practice around the world. The staff's comments would be welcome.

Monetary policy needs to remain vigilant, given second-round effects of fuel and electricity prices hikes. We welcome that tight monetary stance has rapidly brought inflation down following the large devaluation and public price hikes in 2016/2017, and has helped anchor inflation expectations. As conveyed by Mr. Beblawi and Ms. Abdelati, the Central Bank of Egypt intends to maintain a tight monetary policy and flexible exchange rate. Steps to improve foreign exchange management while allowing the currency to float are especially important in the context of increasing risks of capital outflows.

With macroeconomic stabilization achieved, we agree that program focus should broaden to the structural reform agenda. Measures aimed at improving transparency and accountability of state owned enterprises (SOEs), strengthening competition, improving access to land, increasing participation of women in the labor market and developing capital markets are important steps towards promoting private sector development and more inclusive growth.

Mr. De Lannoy and Mr. Jost submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Beblawi and Ms. Abdelati for their informative buff statement. We take positive note of recent economic developments, the ownership of reforms on the side of the authorities, and the fact that most end-December quantitative targets were met. In this sense, we can support the proposed decision. At the same time, we encourage the authorities to maintain their efforts when it comes to the implementation of reforms and follow-up on program objectives, also in the face of persistent downside risks. We broadly agree with staff's assessment and would like to highlight a few specifics.

We welcome the fact that program conditionality for 2019 includes two structural benchmarks with regard to procurement, aimed at tackling corruption. We thank staff for including governance challenges in the program discussions. As this chair has pointed out earlier, and in agreement with staff, we deem governance challenges to be major obstacles for inclusive growth in Egypt. While we welcome the authorities' efforts to address governance issues, notably by approving the Procurement Law and implementing the e-procurement portal, we believe that important challenges to address the captured economy problem remain. In that sense, we support staff's call for increased transparency, including on the level of SOEs, which would help attracting more broadly based private investment.

We welcome the fact that fiscal consolidation remains on track. The reduction of the debt levels from 103 percent of GDP in 2016/2017 to a projected 87 percent of GDP in 2018/2019 shows that—while stocks remain high—flows point in the right direction. As staff, and given that the deviation was minor, we can support the authorities' request for a waiver of nonobservance of the end-December performance criteria on the primary fiscal a balance. However, we encourage the authorities to maintain their efforts with regard to public finances. While we welcome the initial steps that have been taken, we strongly encourage the authorities to continue their efforts when it comes to reforming energy subsidies, which accounted for 4.1 percent of GDP in 2016/2017. We take note that prices for fuel products in Egypt are among the lowest in the world and agree that regressive fuel subsidies should be replaced with more targeted support to poorer households. Finally, we encourage the improvement of public financial management and the modernization of tax administrations.

Given the challenging circumstances, we take positive note of the performance of the Egyptian banks and sound supervision practices. We welcome the reduction of NPL levels from 6 percent to 4.8 percent. At the same time, we do support staff's call for clear rules regarding the deployment of public funds to maintain financial stability and commend the authorities' initial steps taken to that effect.

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

We support the completion of the third review under the EFF. Egypt has benefited from the significant macroeconomic adjustment performed under its Fund-supported program. As emphasized in Mr. Beblawi and Ms. Abdelati's helpful buff statement, growth has accelerated on the back of higher exports and investment, unemployment has been reduced, and inflation has dropped significantly. The authorities are progressing with program implementation, although we note the delays in the implementation of several structural benchmarks. We urge the authorities to use the improved macroeconomic outlook as an opportunity to push forward with structural reforms that will raise longer-term prospects for higher, sustainable and inclusive growth and improve Egypt's capacity to weather future shocks.

We welcome the commitment of the authorities to exchange rate flexibility. We note that the CBE has refrained from intervening in the foreign exchange market, and we welcome the intention to deepen the forex market, including by eliminating the repatriation mechanism. We also note the CBE's intention to maintain an appropriately tight monetary policy stance. As staff mention, exchange rate flexibility should provide a cushion against the potential increase in capital flow volatility.

We encourage the authorities to continue the steadfast implementation of the energy subsidy reform. Even with higher oil prices, the objective of ensuring full cost recovery by end-2018/19 should be within reach. We underline the importance of adhering to the end-December target for implementing the fuel price indexation mechanism. The elimination of electricity subsidies would also help alleviate the burden of the energy subsidy bill on the budget. We welcome that part of such savings will be used to mitigate the impact of higher energy prices on the most vulnerable.

We strongly support the authorities' expanded reform agenda. We note the intention to correct underlying governance vulnerabilities and economic inefficiencies, as well as to strengthen the role of the private sector in the economy. Strengthening public financial management will be crucial to ensure that the benefits from a potential boost in gas production will be broad-based. We support the authorities' plan to introduce a medium-term budget framework in their revised PFM law. We also welcome the efforts to improve transparency and accountability, including through the Right to Information Law. We concur with staff that the new structural benchmarks to reduce potential land or public spending misallocations and corruption will help strengthen competition and thus improve economic efficiency in the longer-term. Furthermore, reducing the role of the state in the economy, including by divesting stakes in SOEs, will help develop a stronger private sector.

We take good note of the emphasis on the communication of reforms in the buff statement. Communication of the rationale for reforms is all the more critical, given the potential adjustment fatigue mentioned by staff. It is in this context that we encourage the authorities to enable a timely publication of the staff report.

Mr. Virolainen and Mr. Gade submitted the following statement:

We thank staff for their reports and Mr. Beblawi and Ms. Abdelati for their informative buff statement. We support the completion of the 3rd Review under the Extended Fund Facility Arrangement. We commend the authorities for their strong program performance and ownership. The staff's report confirms our view of the economic outlook, and the positive achievements attained under the implementation of the program. We welcome the continued protection of the vulnerable under the program, and the broadening of structural reforms. Effective continued implementation of the required, and agreed, measures will be key to sustained and broader economic growth. We broadly agree with the staff appraisal.

Continued fiscal consolidation is necessary in line with program targets, and the energy subsidy reform plays a key role. We acknowledge the small margin by which the primary balance was missed at end-December, but the fiscal consolidation thus far has nevertheless been impressive and should continue. The fiscal expenditures are vulnerable to rising energy prices through the fuel-subsidy bill. Therefore, we welcome the approval of the automatic fuel price mechanism for most fuel products, and the plan to implement it by end-December. Given the above, we can also approve the waiver of non-observance and the request for modification of the performance criteria.

Further restrictive monetary policy by the Central Bank of Egypt is necessary to mitigate possible inflationary pressures. Looking ahead, specifically in view of rising energy prices and the pass-through of the exchange rate, we are concerned by the projected increase in inflation, and its social impacts and effects on economic growth. In this regard, we take note of the recent hikes in government wages and pensions, which could further increase inflation.

Social protection of the vulnerable is an important element to ensure the program's success. The social aspects of the reform program need to be emphasized in order to avoid social unrest due to increased pressure on individuals' private economy, especially the working and middle class. We therefore welcome the plan to use savings from the subsidy reforms on targeted social spending in the form of effective redistributive systems to mitigate the negative social aspects of the economic adjustment. We are somewhat concerned about the possibility of social unrest, and note that the related regional perspective, and potential spill-overs to Egypt, is not addressed in the report. We would appreciate staff's comments on this issue either in staff responses or in the meeting.

We welcome the broadening of structural reform efforts as a key element in achieving sustained and broad growth in the long term. We commend the specific measures planned to mitigate corruption and decrease administrative burdens such as using e-applications in administrative processes. To attract more investment, and lower the threshold of business establishment for foreign enterprises, and especially SMEs, increased attention should be put on further streamlining administrative processes and increasing transparency. Also, to further stimulate private sector growth, it is important to move to a modern payment system, including a national payment switch for easy b2b and b2c payments, that also allows for grass-root entrepreneurial activities to flourish and assist in the financial inclusion of currently marginalized groups. Finally, we welcome measures to increase the participation of women in the labor force, and to increase their involvement in the economy.

We wish the authorities continued success in their reform and adjustment efforts.

Mr. Agung and Mr. Sanoubane submitted the following statement:

We would like to thank staff for a concise report and Mr. Beblawi and Ms. Abdelati for their helpful buff statement. The wide-ranging reforms led by the Egyptian authorities continue to deliver tangible results with stable macroeconomic conditions and declining unemployment and inflation. Supported by construction, tourism and natural gas sectors, growth has accelerated to 5.3 percent as of Q3, FY2017/2018. We also note positively the broadly satisfactory program performance, despite minor deviation and delay in implementation. We therefore, support the proposed decision. While the near-term outlook is favorable, we note elevated risks from security-related issues, tightening global financial conditions and the increase in oil prices. We encourage the authorities to keep a close eye on these risks while maintaining momentum for macroeconomic reform and accelerating structural measures to foster private sector development. We agree with the thrust of the staff appraisal and would like to highlight the following areas for emphasis.

Continued fiscal consolidation is crucial to achieve the 2018/2019 budget target while keeping public debt on a downward trajectory. On the rationalization of the energy subsidy, we are reassured by the buff statement's explanation on the authorities' communication strategy to ensure public acceptance and most importantly, the notable sacrifices of the people of Egypt. We also note positively the new cabinet's prioritization of security, which should help maintain the momentum of key reforms and tourism sector. The staff's comments on the implication of this commitment on budget spending would be welcome. We consider the introduction of the gender budget as promising as it would support the integration of women into the labor force and the reduction of income inequality. In this connection, we emphasize that extra revenue gains from the modernization of tax collection should be used for health and education, necessary infrastructure projects and strengthening the social safety net. We also look forward to the report on public enterprises as part of efforts to monitor accountability and transparency of SOEs. The findings of this report may also lead to a more efficient way to improve their financial performance and contain public fiscal risks going forward.

Monetary policy should remain prudent while the flexible exchange rate should be the first line of defense against external shocks. In view of the second-round effects of the recent energy subsidy reform, we agree that the authorities should stand ready to tighten their monetary stance, once pressures emerge. In the medium-term, we see merit in transitioning towards inflation targeting. However, a successful move will require meeting challenging preconditions and there is a clear need for the Fund to continue working closely with the authorities through the revisions of central bank legislation and advice on well-sequenced reforms. Given there are signs of tapering off of outflows, we support the authorities' commitment to enhance exchange rate flexibility. Together with the foreign reserves, which have strengthened considerably, this will efficiently help buffer against external shocks.

The reorientation towards a private sector-led model is imperative to unlock growth potential. We see the progress in improving the land allocation mechanism, the new Procurement Law and strengthening the role of Egyptian Competition Authority (ECA) as key steps to improving the business environment and supporting private sector development. We invite staff to comment on the role of the Fund and development partners in these efforts. The authorities' five-year program is also important to streamline the role of the state in the economy and we encourage the authorities to ensure the sound implementation of this program. Do staff see that the expected EGP80 billion gained from the divestment of shares in public enterprises will help lower public debt or address the financing gap over the medium term?

Mr. Alogeel and Mr. Alhomaly submitted the following statement:

We thank staff for an insightful report and Mr. Beblawi and Ms. Abdelati for their informative buff statement. We continue to be impressed by the firm commitment of the Egyptian authorities to a far-reaching reform program, with strong ownership and implementation. We are particularly encouraged to note that prudent macroeconomic policies and reforms, supported by the EFF arrangement, are yielding positive results with improving fiscal stance, rising international reserves, and strengthening growth momentum and market confidence. Against this background, we support the authorities' request for the completion of the third review and the associated decision. We are in broad agreement with the thrust of staff's assessment and policy recommendations.

We take positive note of the favorable macroeconomic outlook, underpinned by improvements in tourism and natural gas production. In this regard, we encourage the authorities to maintain the reform momentum and build on the recent economic gains to strengthen economic resilience and achieve strong and broad-based growth.

We welcome the progress made in consolidating the fiscal position, and the authorities’ commitment to press ahead with further measures to achieve the primary surplus target and put the public debt on a clear declining trajectory. In this connection, we agree with staff on the importance of the ongoing energy subsidy reform and welcome the authorities’ continued efforts to enhance tax administration, which would help allocate the necessary resources for priority infrastructure and social spending needs. We are also encouraged by the steps being taken to strengthen public financial management to ensure an efficient use of public resources.

In view of the continued disinflation, we agree with staff on the appropriateness of the current monetary policy stance. In addition, it is reassuring to note the adequacy of the international reserves, which would help safeguard against external shocks and buttress macroeconomic stability. In the medium-term, the central bank’s plan to put in place a forward-looking monetary policy framework, with inflation targeting, would be a step in the right direction.

With regard to the banking sector, we are comforted to note its resilience, with a declining non-performing loan ration and good levels of liquidity, capitalization, and profitability. We commend the central bank for maintaining sound regulatory and supervisory frameworks and agree with staff on the need for continued close monitoring of smaller banks, which have lower asset quality, capitalization, and profitability.

Finally, we cannot overemphasize the importance of promoting private sector development and investment. Here, we take positive note of the progress made in advancing structural reforms in this area, and look forward to the implementation of the planned measures to create a more conducive environment for businesses to thrive.

With these comments, we wish the authorities all the success.

Mr. Johnston and Mr. David submitted the following statement:

We thank staff for their report and Mr. Beblawi and Ms. Abdelati for their informative buff statement. In 2016, Egypt embarked on a wide-ranging, ambitious and politically-challenging series of reforms, including exchange rate liberalization, tax and subsidy reform, and strong measures to reduce the fiscal deficit. We commend the Egyptian authorities on their progress in implementing sound macroeconomic policies. Conditions have improved in 2017/18 and the near-term outlook looks favorable, although risks (especially external risks) remain. Program performance has been good, including in this review, with the PC on the primary balance being missed by only a small margin. We acknowledge the efforts of the authorities to ensure the reform program remains on track. We therefore support the completion of the third review of the EFF and the associated requests.

We support the authorities' fiscal objectives, including enhancing tax administration, public financial management reforms, and improving fiscal transparency and accountability. We agree with the need to reform the subsidies on fuel and electricity, which would assist with fiscal consolidation and which disproportionately benefit the wealthy. We encourage the authorities to implement these reforms, including the automatic fuel price indexation mechanism designed to maintain cost-recovery ratios and safeguard the budget from unexpected exchange rate and international oil price movements. We also support the modification of the PC on the fuel subsidy for end-June 2018 to cater for the impact of higher-than-programmed oil prices for 2017/18 on the fuel subsidy bill. We note that the financing gap for 2018/19 of around $1 billion is to be financed from the issuance of a new Eurobond and/or from gross reserves. With S&P's recent upgrade of Egypt's sovereign rating to B, can staff advise on whether a Eurobond issuance is likely to proceed?

We commend the authorities' efforts to improve monetary policy management and financial system supervision by revising the central bank law with the assistance of the Fund. The revised law would not only establish a clear monetary policy objective of price stability but also enhance the central bank's independence and improve its management focus. We would be interested in an update on progress with finalizing the draft central bank law that is planned for submission to Cabinet in September 2018.

The reforms are no doubt having an impact—financial or otherwise—on ordinary Egyptians, whose support is ultimately required to make the program a success in the long term. In particular, it will be important to protect the poor and vulnerable while undertaking the tough adjustments needed. Mr. Beblawi and Ms. Abdelati's very helpful buff statement accompanying the EFF request in 2016 mentioned ongoing work to develop a database of vulnerable groups, enhance social safety net programs, and better target assistance to reach deserving households. Can staff provide an update on this work?

Mr. Mahlinza and Mr. Sishi submitted the following statement:

We thank staff for a comprehensive report and Mr. Beblawi and Ms. Abdelati for their informative buff statement. We commend the authorities for their commitment to the homegrown program, and acknowledge the fortitude and patience of the Egyptian people during a difficult yet necessary period of transition. We consider that program performance is quite positive and that the authorities continue to prioritize the building of strong buffers while looking for opportunities to improve the business environment and protect the most vulnerable. Accordingly, we fully support the completion of the Third Review under the Extended Fund Facility. We also concur with staff's assessment that deviations from target have been minor, largely reflecting negative terms of trade effects. In this regard, we support the authorities' request for a waiver of non-observance of the performance criterion (PC) on the end-December 2017 fiscal balance and the modification of the PC on the fuel subsidy bill for end-June 2018.

Prudent fiscal policy aimed at keeping debt on a declining trajectory should serve the economy well during a likely period of tightening global financial conditions. In this regard, we welcome the agreement between staff and the authorities on further fiscal consolidation. Nevertheless, we note that the authorities are planning to delay lower priority expenditures in the 2018/19 financial year as part of their aim to achieve the fiscal target. In this instance, we would be concerned about the accumulation of arrears, and would thus urge caution. The staff's comments on this issue would be welcome. Further, the changing global financial conditions highlight the need for careful management and monitoring of public debt dynamics, with a view towards achieving the medium-term targets in the baseline scenario. In the DSA, we note positively that most debt is still denominated in local currency, although the gap has been closing somewhat. At the same time, while a flexible exchange rate should provide an additional buffer to external shocks, less favorable global conditions may expose the fiscal strategy to higher debt-service costs. In this regard, we wonder whether there are any viable alternatives to the planned Eurobond issuance. The staff's comments on this would be appreciated.

We welcome the concrete steps taken to enhance the effectiveness of monetary policy, and support staff's recommendation for the policy stance to remain tight, to bring inflation down to single digits and anchor expectations more firmly. We also support actions to enhance the CBE's capacity to exercise stronger supervisory functions over the financial sector, including by ensuring that amendments to the CBE law are constructive in this regard.

Finally, we welcome the structural reforms currently being advanced to improve public finance management (PFM) and improve conditions for doing business, as reflected in the MEFP. We note the burgeoning opportunities for higher natural gas production in Egypt, with significant energy cost benefits for the population. In this regard, we urge the authorities to strive for a sustainable exploration and development process, and transparency in the sharing of the economic benefits.

We wish the authorities well in their endeavors.

Mr. Meyer and Mr. Braeuer submitted the following statement:

We thank staff for the informative report and Mr. Beblawi and Ms. Abdelati for their helpful buff statement. Supported by the ongoing implementation of the reform program, the Egyptian authorities have made further progress towards stabilizing the economy and strengthening resilience. The growth performance has improved, the external balance has strengthened and inflation rates have continued their downward trend. While the economic outlook remains positive, external risks have increased recently given higher-than-expected oil prices and some tightening of global financial conditions. As staff rightly notes, maintaining the sound macroeconomic policy framework established under the program will be crucial to preserving the positive economic momentum. As reform fatigue poses a significant risk to the overall success of the adjustment process, we strongly encourage the authorities to broaden and accelerate structural reform implementation to facilitate sustainable and private-sector led growth.

While the program performance is mixed, we nevertheless consent to the completion of the review and the requests for a waiver of non-observance and for the modification of a performance criterion. We take note that the primary fiscal balance target was missed by a small margin and that the global oil price increase will likely lead to a somewhat higher-than-programmed fuel subsidy bill despite progress to adjust domestic fuel prices. This once again highlights the need for further consolidation and to achieve full cost recovery in the energy sector. We thus encourage the authorities to fully implement the measures under the program and maintain their reform ownership.

On fiscal policy, we encourage the authorities to continue their prudent stance, further improve the fiscal balance, and reduce the high level of public debt. We take note that the authorities are on track to achieve a modest primary surplus inter alia due to higher taxes paid by the CBE, an increase in excises and under-execution of other spending, which compensate for an expected overrun on the fuel subsidy bill. In this context, we note that "the fiscal performance benefitted from an increase in taxes paid by the CBE on interest income from their stock of government bonds, after these bonds were adjusted to reflect market interest rates." We also take note that the capital transfer of EGP 6 billion for the recapitalization of the CBE, which inter alia became necessary due to below market interest rates on the stock of government bonds held by the CBE, has not been included in the calculation of the primary balance under the program. Could staff provide further information on the relationship between the increased tax payments to the government from the CBE and the need for recapitalization of the CBE?

Moreover, we encourage the authorities to make further progress on the ongoing energy subsidy reform in order to reach the objective of full cost recovery by end-2018/19. The implementation of the recently approved automatic fuel price indexation mechanism will be a crucial step in this regard. To complement this important reform, the authorities should ensure that targeted social spending will be increased adequately to mitigate the impact of the energy price reform on the most vulnerable. We would welcome additional staff comments on the reasons for the delay in the approval of the fuel price indexation mechanism. Moreover, could staff comment on whether there are still implementations risks before the approved mechanism becomes effective by end-December 2018?

We agree that the current monetary policy stance appears appropriate. We welcome the authorities' intention to gradually reduce inflation to single digits. In the short term, the authorities should stand ready to tighten monetary policy should upward inflation pressures emerge. We take positive note that the authorities remain committed to a flexible exchange rate, which can help maintain the economy's competitiveness, preserve foreign exchange reserves and act as an absorber against potential shocks. We welcome that the CBE intends to adopt a forward-looking and interest-based monetary policy framework with inflation as the nominal anchor. In this regard, we encourage the authorities to further strengthen the respective capacities and further develop the communication strategy of the CBE.

We take note of the deletion of the intended elimination of the repatriation mechanism and the relevant structural benchmark (see

FO/DIS/18/97). We would welcome further elaboration on the reasons for the deletion of this measure and possible consequences for the objective to enhance exchange rate flexibility, and the calculation of net international reserves. Could staff also comment on the justification regarding the transparency policy.

While we take positive note that the financial sector generally appears to be sound, we note that pockets of vulnerabilities persist. Even though the banking system overall remains liquid, profitable, and well capitalized, two large banks might face additional capital needs in the future and may be required to sell non-core assets. Moreover, we note that several smaller banks might need recapitalization by the shareholders over the coming months. We thus encourage the authorities to remain vigilant and further improve the monitoring of the banking sector and strengthen financial regulation. We share the view that there is a need for clear rules on deploying public funds to maintain financial stability.

On structural reforms, we strongly encourage the authorities to decisively implement the comprehensive structural reform agenda, as laid out in the MEFP, to set the stage for more inclusive, private sector-led growth. Given the long-standing structural challenges stemming from inward-looking policies and an expansive role of the state, a reorientation of the economy seems inevitable. The orientation towards a new growth model should substantially improve the efficiency of resource allocation and allow to absorb the significant increase of the labor force in the coming years.

Mr. Leipold and Mr. Persico submitted the following statement:

We thank staff for the informative report and Mr. Beblawi and Ms. Abdelati for their helpful buff statement. We support the completion of the Third Review under the Extended Fund Facility, and the authorities' requests for a waiver of the nonobservance of a performance criterion (PC) and for the modification of a PC. We broadly share the thrust of the staff appraisal and offer the following remarks for emphasis.

The accelerating growth offers the opportunity to reduce unemployment and sets the stage for tackling still high inflation. On the back of increasing gas production and recovering tourism, the favorable outlook offers a prime opportunity to continue fiscal consolidation and reduce public debt. At the same time, the authorities should take advantage of the momentum to accelerate the envisaged and most needed structural reforms, aiming at inclusive and private-led growth. Though Egypt has demonstrated an overall notable resilience to shocks, both external and domestic downside risks persist.

We commend the authorities for the fiscal consolidation achieved and encourage them to continue their stabilization efforts. The authorities should step up their efforts to strengthen tax administration and remove energy subsidies, both to achieve fiscal targets and to create fiscal space for social spending and investment. In this regard (also considering the double-digit inflation), we welcome the commitment to use some of the subsidy-related savings to raise social spending, so as to mitigate the impact of energy price on the most vulnerable sectors of the population.

Gross national public debt exceeded the level forecast in previous projections, while debt sustainability continues to be a key aim of the program. In taking positive note of the downward debt trend projected in the Debt Sustainability Analysis (DSA), we caution against domestic downside risks. The recent reduction in debt maturity is a welcome improvement, and we invite the authorities to be prudent on new short-term exposure. Compared to the last review, has the scenario of risks and vulnerabilities affecting the DSA changed to any extent?

The monetary policy stance has been appropriate to date, but inflation remains a concern. The financial sector is sound and should continue to well channel remittances. Notwithstanding the rapid reduction of inflation, monetary policy should be kept tight to reach its target. We welcome the authorities' continuous commitment to flexible exchange rates. The financial sector remains liquid, while the ongoing implementation of the resolution framework should enhance its resilience. At the same time, we note the positive contribution of remittances, which—coming mainly from the Gulf economies—constitute also an indirect absorber of increasing oil prices. In this respect, the authorities should continue their efforts to implement the FATF recommendations for a sound AML/CFT system, and to channel remittance inflows into the formal banking system.

Market-friendly reforms are needed to promote private- and export-led growth. In the context of capital outflows, improvements in the business environment and security are essential to address key impediments to growth. In particular, we share staff advice to streamline the process of industrial land allocation, strengthen competition and advance the reform of public procurement. In this regard, we welcome the authorities' commitment to adopt international good practices on public governance as spelled out in the Memorandum.

While the requested waiver and modification of the PCs might be understandable in light of the current global context, the program's mixed performance is unfortunate. As the delay in addressing the subsidy issue is of concern, we appreciate the authorities' commitment to introduce the indexation of fuel prices from end-2018. However, as our chair – along with several others – stressed on the occasion of the second review, the elimination of subsidies remains paramount for program success. Finally, we wonder whether the timing of the updated PCs and Indicative Targets is viable as the cutoff date of end-June 2018 gives the authorities very limited time to meet them. The staff's comments are welcome.

Mr. Mozhin and Mr. Snisorenko submitted the following statement:

We thank staff for their succinct report and Mr. Beblawi and Ms. Abdelati for their informative buff statement. We support the authorities' request for the completion of the third review under the Extended Fund Facility and for the waiver of nonobservance of the performance criterion on primary balance and for modification of the performance criterion on fuel subsidy bill.

We commend the authorities for their continued firm commitment to the ambitious economic reform program that ensured fairly successful implementation of the program and stabilized the economy. The current account deficit and inflation declined sharply, while growth is accelerating. Macroeconomic outlook remains positive with real growth projected at 5.5 percent in 2018/19 and at six percent over the medium term. The current account deficit is projected to fall to 2.6 percent of GDP in 2018/19 and further to two percent over the medium term. At the same time, major challenges persist, including high unemployment and relatively high inflation.

Against this background, we support the current restrictive monetary policy stance and welcome the authorities' commitment to adopt an interest rate-based monetary policy framework with inflation as a nominal anchor. Introduction of the flexible exchange rate has ensured the stability of the pound and accumulation of foreign exchange reserves that provides a necessary buffer to sustain external shocks. Could staff provide estimates of capital outflows from Egypt in recent months? Could staff also explain the reason for and the implications of the repricing of government bonds held by the central bank? (para 2) The staff's elaboration on the appropriateness of taxes on income from government bonds paid by the central bank would be welcome. (para 12)

On the fiscal side, the authorities made a good progress in moving the government debt to the downward path. While fiscal consolidation is well on track with a primary surplus target of 2 percent for 2018/2019, the authorities should keep an eye on the possible negative social implications. Safeguarding social cohesion in the context of the ongoing energy price reform becomes especially relevant against the background of high global oil prices. In the context of relatively high levels of poverty, social spending should be well targeted on protecting the most vulnerable segments of the population. The staff's comments on the distributional effect of the ongoing reforms and the quality of coordination of various social protection schemes would be welcome.

Finally, we noted that the business climate in Egypt is still in need for further improvement. In 2018 the ranking in the World Bank Ease of Doing Business rating has fallen from 122 to 128 with a particularly weak performance in such areas as payments of taxes, trading across borders, and enforcing contracts. Improving the overall business climate and implementing structural reforms is essential to resolve impediments to growth and to tackle high unemployment. In this context, we welcome the expanded structural reform agenda outlined in the Memorandum and call for consistent and steady implementation of the structural reforms.

With these remarks, we reiterate our support for the proposed decisions and wish the authorities every success in program implementation.

Mr. Bayar and Mr. Varga submitted the following statement:

We thank staff for the report, and Mr. Beblawi and Ms. Abdelati for their helpful buff statement. The Egyptian authorities have implemented sound reforms on all fronts since 2016, which has helped the country achieve sustained macroeconomic stability over the past year. Growth rebounded strongly and vulnerabilities decreased, as inflation decelerated and the twin deficits fell. While all macroeconomic indicators continue to improve, inflation and public indebtedness still remain elevated. Therefore, we encourage the authorities to continue with their reform agenda, particularly through eliminating energy subsidies, reforming the monetary framework, and reducing the state's role in the economy. Notwithstanding the two performance criteria and one structural benchmark that were missed, we deem the program's performance satisfactory, and support the completion of the Third Review under the Extended Fund Facility and the two proposed decisions on the performance criterion. However, we would appreciate staff's comments on how the recent turmoil in emerging markets might affect Egypt's ability to close its financing gap for 2018/19 with the planned Eurobond issuance.

Eliminating all energy subsidies remains a key policy challenge to ensure fiscal consolidation. We welcome the recent significant hike which helped mitigate the effects of higher oil prices on the budget, and commend the authorities for their previous commitment to increasing fuel prices to achieve cost recovery levels by mid-2019. As this has been a high-priority objective since the program's outset, we regret that the deadline has been scheduled for after the program's fifth and final review. In view of the increasing trajectory of oil prices and in the absence of an automatic pricing mechanism, the risk for further delays in achieving the objective is not trivial. Considering the structural benchmark on the automatic pricing of fuel products had been missed already twice, staff decided to drop it for the next review. We would welcome any assurances the authorities have provided to staff on the traction of this commitment.

As the floating exchange rate serves the economy well, the authorities' decision on the exchange rate regime change sets an example for the region. We concur with staff that the current tight monetary stance is appropriate, as it has already helped to significantly reduce inflation close to single-digit levels. We note, however, that inflation is set to increase gradually from its current levels, and would appreciate staff's view on the Central Bank of Egypt's (CBE) decisions earlier this year to cut policy rates by a cumulative 200 bps. On the longer term, we welcome the steps already taken by the authorities to reform the central bank law and the monetary policy framework. We encourage the authorities to tap the Fund's technical assistance to build the complex infrastructure necessary for a forward-looking inflation-targeting regime. Could staff confirm that the proposed new law will significantly increase the CBE's independence and ban deficit financing for the future?

A more sustainable and inclusive growth of the economy will ultimately hinge on the traction of the reforms addressing Egypt's long-standing challenges. We welcome the progress in the authorities' structural reform agenda addressing some of the main hurdles as highlighted in the buff statement. We encourage the authorities to take deeper and broader steps, including for strengthening public procurement system, promoting transparency and tackling corruption, as well as better integrating women into the labor force, which would improve resource allocation and reorient Egypt toward a private sector-led growth model. These steps will be quintessential to seize the demographic opportunity Egypt's fast rising labor force presents.

Mr. Saito, Mr. Ozaki and Ms. Mori submitted the following statement:

We thank staff for a comprehensive paper and Mr.Beblawi and Ms.Abdelati for their informative statement. We commend that the Egyptian authorities undertook policy actions under the program and that these efforts are increasingly yielding results of favorable macroeconomic condition. We are encouraged to see the policy continuity of newly formed cabinet explained in the buff statement and expect the authorities to continue to implement reforms under the Fund supported program. Against this background, we support the authorities' request for the completion of third review under the Extended Arrangement under the Extended Fund Facility and the waiver and modification of Performance Criteria (PC). As we broadly agree with the thrust of the staff appraisal and the policy recommendations, we will limit our comments to the following points:

Macroeconomic Conditions

We positively note that macroeconomic conditions have continued to improve, with external and fiscal deficits narrowing, inflation and unemployment declining, and growth accelerating supported by higher net exports and investment. In this context, strong growth in private remittance inflows is one of key factors of the improving current account deficit. Could staff elaborate more on the cause of the growth and whether staff think this trend is a temporary or continuous? We expect the authorities' steadfast implementation of program to mitigate potential risks stemming from tightening of global financial conditions, further increase in global oil prices, deterioration of the security situation.

Fiscal Policy

We welcome that the planned fiscal consolidation remains on track and public debt is reducing despite the negative impact of higher-than-projected world oil prices. In the meantime, energy subsidy reform is important to secure room for social spending and enable more efficient resource allocation amid the increase in oil price. We therefore welcome that the Prime Minister approved an automatic fuel price indexation mechanism for most fuel products. In this regard, we note that the authorities are requesting a modification of the PC on the fuel subsidy bill from EGP 108 billion to EGP 121 billion. Could staff elaborate more on the fiscal impact of this mechanism such as whether this mechanism will fully eliminate fuel subsidy, or the fuel price will immediately be raised to the cost-recovery level once the mechanism is introduced? At the same time, we encourage the authorities to continue to improve targeted measures to mitigate the impact of the reform on the most vulnerable. In this regard, could staff elaborate more on the programs to directly support poor household, which will substitute energy subsidies?

Monetary and Exchange Rate Policy

The current tight monetary policy stance is appropriate to anchor continued disinflation and achieve single digit inflation. We support the staff and authorities' agreement that monetary policy should remain cautious to contain second-round effects from the recent increases in energy prices, and further policy changes should be guided by inflation expectations and demand pressures. We welcome that the authorities are committed to flexible exchange rate to maintain competitiveness and cushion against external shocks and have intention to deepen the interbank foreign exchange market.

We take note that the Central Bank of Egypt (CBE) plans to adopt a forward-looking and interest rate-based monetary policy framework, with inflation as the nominal anchor. Since strengthening the CBE's institutional and operational autonomy is crucial for this purpose, it is a concern that Structural Benchmark of submission to Cabinet draft amendments to the CBE law is extended two consecutive time from original December 2017. In this light, although staff report states "to ensure that it is fully consistent with the objectives" as a reason of this extension, we would appreciate it if staff could explain more about the point staff think not sufficient and the rational staff think this 3-month short extension is enough to complete the work.

Structural Reform

We expect the authorities to achieve private sector-led growth and job creation to absorb significantly increasing labor force. To achieve sustainable inclusive growth in the medium term, improving business environment through enhancing transparency of land allocation, strengthening competition and addressing corruption, and divesting minority shares in selected SOEs as well as supporting integration of women in the labor force are indispensable. Thus, we encourage the authorities to continue their structural reform effort under the program.

Mr. de Villeroché, Ms. White, Mr. Castets, Mr. Chotard, and Mr. Masood submitted the following joint statement:

We thank staff for a very clear and comprehensive report, as well as Mr. Beblawi for his insightful buff statement. Considering the proper implementation of the sound macroeconomic reforms under the program, as well as the broadly satisfactory program performance, we support Egyptian authorities' request for the completion of the third review. Going forward, we encourage the authorities to take advantage of the macroeconomic stability restored by their continued efforts since the beginning of the program to promote a more inclusive, job-rich and private sector-driven growth model. We share the thrust of the staff report and make the following comments for emphasis.

Recent Macroeconomic Developments and Outlook

We welcome the rebound in most of the economic indicators, with GDP growth increasing, notably thanks to the dynamism of tourism and gas sectors. Inflation remains high but has started to decline (14.4 percent expected in 2018/19). The Egyptian economy however still faces weaknesses (lower but persistent twin deficits, high though diminishing public debt ratio, recent capital outflows), which call for continued resolute implementation of the program, as well as for accelerated structural reforms, notably to sustain private sector growth.

Program Implementation

We commend the authorities for the satisfactory implementation of the three-year extended fund facility arrangement agreed in November 2016. We note that all quantitative targets were met, except for the performance criteria on the primary fiscal balance, which was missed though not materially. Two structural benchmarks were also met, though with delay. In light of this performance, we support the authorities' request for the completion of the third review, for the waiver of non-observance of one performance criterion, and for staff to proceed with the associated disbursement of two billion dollars. As for the reviews to come, we also support the request to modify one performance criterion, reflecting higher than programmed oil prices.

Fiscal Policy

We positively note that the fiscal targets of the program are on track, with an expected 0.2 percent of GDP primary surplus in 2017/18, and

2 percent of GDP in 2018/19. Overall, we welcome that, by the end of the program, the total fiscal adjustment initially foreseen should be achieved, enabling the debt to GDP ratio to be brought back to 74 percent in 2023. Going forward, we encourage pursuit of the energy subsidy reform. On this aspect, we would like to know why the structural benchmark related to the set up of a fuel price indexation mechanism was not met. The staff's comments and appraisal are welcome. In parallel, we encourage the authorities to implement mitigating measure to the most vulnerable populations and to better target social safety nets, notably the food subsidy program. In this regard, we found staff report quite silent on the impact of the adopted measures on the poorest. The staff's update and appraisal on the mitigating measures for the poorest would be welcome. In particular, have the additional increase in diesel, kerosene and fuel oil prices been matched by additional strengthening of the social safety nets?

Monetary Policy, External Sector and Financial Sector

We concur with staff that the current monetary policy seems appropriate, and commend the authorities for remaining committed to a flexible exchange rate. The central bank initiated monetary easing in Q1 2018, as inflationary pressures eased. Monetary easing may continue by the end of the year, but should remain moderate and driven by price development. As for the exchange rate, we welcome the authorities' commitment to preserve the credibility of the foreign exchange market functioning by limiting central bank's interventions. We would however highlight the importance of following closely the implementation of new measures aimed at further enhancing the flexibility of the exchange rate (notably those related to foreign exchange reserve management).The staff could also consider the potential constraints on domestic borrowing, given strict collateral requirements and low existing access to finance. On the external sector staff cites the banking sector could only withstand 'moderate' risks. How vulnerable is Egypt (banking sector) to capital outflows given its financing gap and available reserves? Given global financing conditions, would Egypt to able to fill a large financing gap than predicted?

Structural Reforms

We reiterate our call to accelerate structural reforms in order to move Egypt to a more inclusive and private sector oriented economy. We positively note that the authorities are increasingly committed to streamline the role of the state, whose prominent historical intervention in the economy led to misallocation of resources and over-regulated markets. We also support further opening to international investment and reforms aiming at leveling the playing field for market participants, the two dimensions being intrinsically intricated. We encourage them to pursue reforms in this direction especially in light of growing levels of youth unemployment (currently at 34 percent in 2017). Against this background, access to land, still characterized by inefficient allocation procedures, should also be overhauled. We therefore welcome the authorities' commitment to explore in liaison with staff options to correct this, and encourage them to finalize their action plan as soon as possible. Similiarly, energy sector reform are vital to getting the most out of the industry and achieving sustainable levels of government spending. How do staff intend to review the fuel price ratio reaching 100 percent if it happens as planned in June '19 after the final staff review mission? Lastly, we encourage the authorities to deepen the fight against corruption, whose perception as being high in Egypt hampers economic development. Could staff clarify the step by step process they will be following/monitoring the delivery and quality of: Right to info law (MEFP 125), Divesting minority shares in SOEs (MEFP 125) and Transparency of state owned enterprises (MFP 115)?

Mr. Raghani, Mr. Sidi Bouna and Mr. Olhaye submitted the following statement:

We thank staff for the well written report and Mr. Beblawi and Ms. Abdelati for their insightful buff statement.

The Egyptian authorities continue to make impressive headway in their efforts to implement their reform agenda to support the achievement of the program objectives. The result is a more favorable economic outlook, as stabilization strengthens, with a reduction of external and fiscal deficits, and decreasing inflation, while growth is accelerating and employment is increasing. and. The program performance remains broadly satisfactory and appropriate policies implemented by the authorities will help to mitigate downside risks. We therefore support the authorities' request for the completion of the third review under the EFF as well as the request for a waiver of nonobservance of a performance criterion and for modification of a performance criterion. Going forward, we encourage the authorities to pursue structural reforms, and aim to overcome legacy structural challenges. We broadly agree with the trust of the staff appraisal and policy recommendations, hence will limit our comments to the following points:

Monetary and Exchange Rate Policy

Focus on anchoring inflation expectations remains important to macroeconomic stability and in this respect, we welcome Central Bank of Egypt's (CBE) aim to reduce inflation to single digits in the medium term. Moreover, the authorities' intention to establish an interest rate-based monitoring framework in the medium term is welcome, in this context a gradual approach will be appropriate. The staff's clarification on the timeline is welcome. We welcome the authorities' commitment to maintain a flexible exchange rate to preserve competitiveness and safeguard the international reserves.

Financial Sector

The banking sector remains sound, well-capitalized, and profitable. We welcome the authorities' reaffirmed commitment to financial stability and commend them for the improvement of the aggregate capital adequacy ratio, the reduction in nonperforming loans (NPLs), the maintenance of robust liquidity positions, and the preparedness to respond to possible credit risks. Additionally, the CBE's new emergency liquidity assistance and bank resolution frameworks that is now in line with best practices will bolster financial stability.

Fiscal Policies

The authorities continue to make positive strides on fiscal adjustment and are well positioned to achieve primary surplus target of 0.2 percent of GDP in 2017/2018 and are on course to achieve the three-year cumulative fiscal consolidation of 5.5 percent of GDP. Their commitment to the 2018/2019 budget targets as well as the associated reduction of general debt from 103 percent of GDP in 2016/2017 to 86 percent of GDP in 2018/2019 are commendable. However, as rightly noted by staff we also caution against an increase of government debt outside of the budget sector. Reaching the revenue target of 0.4 GDP, driven by higher value-added tax (VAT) and tobacco excises, higher stamp duties and improved tax administration appears achievable and encourage the authorities to maintain their pace.

The steady decrease of the fuel subsidy bill is encouraging and the 1.8 percent of GDP decline expected in 2018/19 is welcome, especially within a global environment of increasing oil prices. While the energy subsidy reform remains a critical element of fiscal consolidation and the authorities' steadfastness in this regard is important, in the short run we recognize the negative effect it will have on the population’s welfare. Thus, we stress the importance of enhancing targeted safety nets for the least vulnerable. The staff’s comments on additional efforts made by the authorities to enhance the social safety net are welcome.

Structural Reforms

We encourage the authorities to hasten structural measures to enhance inclusive private sector development that is export oriented and most importantly, is well poised to leverage the population dividend. We take note of the authorities’ efforts to reform industrial land allocation and encourage swift implementation as it will be instrumental to propel private sector activity and job creation. Additional structural measures that include strengthening the public procurement system with the new Government Procurement Law and the forthcoming e-Procurement portal, the Egyptian Competition Authority, the minority divestment in select SOEs, and the efforts to expand the integration of women in the labor market are all positive steps forward.

In the energy sector, we note the imports of liquefied natural gas (LNG) may be reduced substantially in the near term due to an anticipated boost in production and here, we commend the authorities for the swift development of this sector. The staff’s comments on the implications of increasing LNG production on energy consumption patterns, export revenues, and job opportunities is welcome?

With these comments we wish the authorities all the success in their endeavors.

Mr. Claver-Carone and Ms. Svenstrup submitted the following statement:

We thank Mr. Beblawi and Ms. Abdelati for their helpful buff statement.

The Egyptian authorities continue to make solid progress implementing their ambitious homegrown reform agenda. Their efforts have helped to stabilize Egypt’s macroeconomic position, with growth on the rise, year-over-year inflation cut below half of the peak last year, and fiscal and external deficits contracting. We were disappointed, however, to see the missed indicative target on EGPC arrears clearance and delays in a few key structural benchmarks. We trust that these issues—notably further progress on EGPC recovery—will be improved by the next review. Nonetheless, performance under the Fund-supported program has remained broadly on track, and we thus support the third review under the Extended Fund Facility.

Egypt still faces considerable risks going forward, and more work is needed to fully entrench stability. Inflation appears to have turned a corner thanks largely to the CBE’s prudent monetary policy last year, although it remains elevated. Given the risk of second-round effects from fuel price increases, we agree with staff in urging the authorities to pursue a cautious and data-driven monetary policy that prioritizes further lowering inflation. We note the two previous delays in the submission of the updated CBE law, which is a critical precursor to the CBE’s move to inflation targeting over the medium term. Recognizing that thorough vetting and technical assessment of the law has taken additional time, we nevertheless expect that this structural benchmark will be completed by the new September deadline.

We commend the authorities’ continued commitment to preserve the credibility of the exchange rate float and to refrain from FX intervention. The elimination of the repatriation mechanism by end-2018 is another key benchmark, necessary to deepen FX markets and support monetary policy transmission.

The authorities’ welcome efforts on fiscal consolidation are expected to yield a primary surplus in FY2017/18, the first in several years for Egypt, and will help contain inflation and put public debt on a downward trajectory. The authorities’ plan to fully eliminate all fuel subsidies (except LPG) by the end of the program is a critical part of this, contributing about 2 percentage points of GDP in progressive fiscal consolidation over the next two years. We look forward to the full implementation of the automatic fuel price indexation mechanism by end-December to ensure ongoing cost recovery for fuel products.

As discussed at the recent IMF-Government of Egypt high-level conference on inclusive growth and job creation, structural reform is critical for Egypt to reap the full benefits of the current stabilization process and to foster job-creating private sector growth and development. We commend the authorities’ plans on this front, as detailed in the MEFP and structural benchmarks. In particular, greater transparency for SOEs, strengthening of the Egyptian Competition Authority, and land reform efforts are highly welcome. We note that this broad reform agenda has translated into a high number of very substantive structural benchmarks – by our count, eight for the fourth review and seven for the fifth review. We recognize that a several of these benchmarks reflect prudent phasing to help facilitate the gradual implementation of more ambitious measures. Given previous delays, we would appreciate staff's views on the authorities' commitment and capacity, as well as the political space, to implement this broad range of significant structural reforms. Have staff discussed prioritization with the authorities?

Mr. Beblawi made the following statement:

I thank the staff team for their constructive work in Egypt and I thank Directors for their support to Egypt and the broad acknowledgement of a strong performance. The authorities recognize that many challenges lie ahead and that more needs to be done to realize their goals for Egypt's economy and its population.

Some Directors noted that a more accurate portrayal of Egypt's performance under this review would be best reflected as largely positive, rather than mixed. Other Directors referred to mixed performance quoting from the first page of the report, even though the divergence from the performance criteria was small and in no way compromised program objectives specifically.

When the end-December performance criterion on the primary fiscal balance was missed by only US$5.6 million, which is so small that I cannot provide the figure as a percentage of GDP, the staff called it a minor deviation on page 15 of the staff report. One indicative target on the clearance of arrears of EGPC, the petroleum company, was missed by US$200 million, which reflected its constrained financial position due to higher oil prices and new financial outlays needed to speed production at the Zohr gas field.

With respect to structural benchmarks, all were met before this Board date. One was met on time, and two were met with a delay of a few months. In light of this, we hope to see more positive language describing the performance, including in the summing up.

My second point relates to the macro stabilization achievement. The economy has seen a remarkable turnaround, as recognized by many Directors, despite the turbulence and uncertainty that has affected many emerging markets, with growth exceeding 5 percent, fast-declining inflation, much higher reserves, upgraded sovereign credit rating, and most importantly, the shift to a primary budget surplus and a large decline in debt-to-GDP ratio by more than 16 percentage points.

I emphasize this because it deserves to be emphasized. I would like to draw Directors' attention to the fact that the two years' adjustment to the primary surplus under the Egypt program was one of the highest out of the largest 21 Fund programs over the past 20 years. Meanwhile, the access level offered to Egypt was one of the lowest among those 21 programs and much lower than what was hoped for.

My third and last point, many Directors asked about the impact of the reform on the poor and the middle class. The impact has been significant. All of society is seeing the prices of services and basic commodities double and triple since the devaluation. The authorities have included in the budget a social package to mitigate the impact of energy price reform. As noted in the staff's responses, existing financial safety net programs are being expanded to cover those who are eligible but who are not yet covered, and to improve targeting with the help of the World Bank and other partners. But this is a long-term project. Convergence is expanding only gradually, and it is not clear what fraction of those who deserve assistance are covered.

I will end with a word of appreciation. The authorities appreciate the Fund's support and the staff's effort to have constructive discussions, even though there is not always complete agreement on the feasible timing for the implementation of some measures. They value the dialogue which helps sharpen their own policy formulation. They appreciate the constructive visit last month to Egypt for the constructive, high-level dialogue.

Mr. Alkhareif made the following statement:

We thank the staff for their work and Mr. Beblawi for his informative buff statement and introductory remarks. We issued a detailed gray statement in which we supported the proposed decision. Today I will raise the following few points for emphasis.

We continue to be encouraged by the firm commitment of the Egyptian authorities to a far-reaching reform program with strong ownership and implementation. The authorities' prudent macroeconomic policies and reforms, supported by the Extended Fund Facility (EFF) arrangement, are yielding positive results by improving the fiscal stance, raising international reserves, and strengthening the growth momentum and market confidence.

We welcome the progress made in consolidating the fiscal position and the authorities' commitment to press ahead with further measures to put public debt on a clear declining path. That being said, the importance of social spending in mitigating the impact of reforms on the most vulnerable cannot be overemphasized.

We also agree with Mr. Beblawi that the authorities' good communication about the need for and the impact of reforms is key for public acceptance of the reforms.

Going forward, we encourage the authorities to maintain the reform momentum and build on the recent economic gains to further promote employment and achieve strong, sustainable, broad growth.

Mr. Meyer made the following statement:

We thank staff for their informative report and Mr. Beblawi and Ms. Abdelati for the helpful buff statement. As we have issued a gray statement, I will focus my intervention on some key issues.

Egypt has made considerable progress under the program, and the macroeconomic situation has improved noticeably. However, macroeconomic risks are rising, mostly due to external factors. It will therefore be crucial to follow through on the ambitious reform agenda to preserve the positive economic momentum. Going forward, it will be key to make use of the improved macroeconomic situation and push forward a decisive economic transformation. We acknowledge that this is a challenging endeavor. As Mr. Claver-Carone has pointed out, the ambitious reform agenda has translated into a high number of substantive structural benchmarks. We encourage the authorities to stay committed and decisively implement the comprehensive structural reform agenda. Ensuring more inclusive private sector-led growth will require tackling persistent impediments to growth like corruption and administrative inefficiencies. I would encourage the authorities to also take advantage of the opportunities that come with the Compact with Africa.

Let me provide one example. German development programs are very active in Egypt, particularly focusing on renewable energy, sustainable development, water and waste management, and education. However, this collaboration could be more effective and efficient if there were improved cooperation with the Egyptian authorities, and substantial progress on governance issues is seen as an important precondition on the side of the German authorities. I would ask Mr. Beblawi to transmit this message to his authorities.

For the reform agenda to be successful, it will be critical to maintain public support. Against this background, I agree with Mr. Virolainen that there is a need to emphasize the social aspects of the reform program. Social protection of the most vulnerable is important to ensure program success and essential to mitigate the negative social aspects of the economic adjustment. With this, I wish the authorities all the best.

Mr. Castets made the following statement:

We thank the staff for the report. We issued a joint gray statement with the U.K. chair, so I would like to make a few points for emphasis and thank Mr. Beblawi and Ms. Abdelati for the insightful buff statement.

Considering the proper implementation of the sound macroeconomic reforms under the program as well as a broadly satisfactory program performance, we supported the Egyptian authorities' request for the completion of the third review. Specifically, we positively note that the fiscal targets of the program are on track, and Mr. Beblawi alluded to this. As expected, the primary surplus will be 0.2 percent in 2017-18 and 2 percent of GDP in 2018-19, so that is quite an achievement.

Overall, we welcome that by the end of the program, the total envisioned fiscal adjustment should be achieved, enabling the decline of public debt. In addition, we welcome the authorities' continued commitment to preserve the credibility of the foreign exchange market's functioning by limiting central banks' interventions. We will pay attention to Mr. Beblawi's call regarding the qualification of the program performance through December and will encourage the Egyptian chair and the staff to try to find a way to qualify the performance.

Third, and as also alluded to by Mr. Beblawi and Mr. Meyer, we would encourage the authorities to pay strong attention to the mitigating measures to protect the most vulnerable population in Egypt, in particular to protect them from the impact of the increase in oil and fuel prices. In that regard, we also would like to reiterate this chair's call to get more detailed data on the precise extent to which the most vulnerable are protected from these increases. We understand that it is a difficult question given the limited data available to the staff, and we understand that some work is ongoing, and maybe that the World Bank is involved in that work, but still, we reiterate that the time mismatches regarding the moment when the price increase begins and the impact on the poorest is a real issue for this chair.

Third, we encourage the authorities to take advantage of the macroeconomic stability provided by their continued efforts in the beginning of the program to promote a more inclusive, job rich, and private sector-driven growth model. We also support further opening to international investment and reforms aimed at leveling the playing field for market participants, the two dimensions being intrinsically interrelated. Against this background, access to loans still characterized by inefficient allocation procedures should also be overhauled.

Lastly, we encourage the authorities to deepen the fight against corruption, the perception of which is high, and which hampers further economic developments.

Mr. Tombini made the following statement:

I thank the staff for the report and for the detailed answers to Directors’ questions. I also thank Mr. Beblawi and Ms. Abdelati for their buff statement and for the introductory remarks.

Egypt’s economy is doing much better today than at the start of the stabilization program two years ago, and the outlook is also positive despite important downside risks. Program performance has been strong. The authorities are on track to meet fiscal consolidation targets. Disinflation has been successful despite significant price realignments, and the country has embarked on a profound structural reform program to achieve inclusive growth and job protection, including through larger participation of the private sector in the economy.

We commend the authorities for delivering on their ambitious reform package, and we are pleased that the results can be seen already.

About halfway through the three-year program, this is the time to avoid reform fatigue and push forward with program implementation. We understand from Mr. Beblawi’s and Ms. Abdelati’s statement that the social mitigation programs and communication campaigns played an important role in the program’s success so far. We wonder if the staff could share with us the main elements of the communication campaign that were at the base of its success and what lessons, if any, would be useful to other countries.

On recent capital outflows caused by, among other factors, monetary policy normalization in advanced economies, we take note that the staff does not yet have detailed information and that market analysts estimate portfolio outflows in the range of US$3 to 4 billion. This is not a low figure in the context of Egypt. We invite the staff to monitor the situation and, if necessary, advise authorities on possible actions if outflows aggravate.

On a more specific point, in reference to one of the questions raised by Directors, the staff replied that remittances are growing due to "improved confidence in Egypt's economic prospects, the liberalization of the exchange rate regime, and the attractive rates of returns on Egyptian assets." In a number of countries, including seven in my chair, remittances have more of a social and family support function. Can the staff comment on whether remittances are mostly used for portfolio allocation purposes in Egypt?

Finally, we welcome efforts to enhance the integration of women in the job market, such as targeted vocational training. We also note that the program has plans to implement gender budgeting, starting in 2018-19 in collaboration with the UN. Could the staff elaborate on what this policy will entail and about the strategy to increase women's participation in the labor market in Egypt?

Mr. Saito made the following statement:

We thank the staff for a comprehensive report and Mr. Beblawi and Ms. Abdelati for their informative buff statement and remarks. We are pleased to see that macroeconomic conditions have continued to improve supported by the authorities' reform efforts under the program. We issued a gray statement, and we would like to make two comments for emphasis.

First, energy subsidy reform is the key of fiscal consolidation. In this regard, we welcome the authorities' efforts so far, including rising energy prices and approving the automatic fuel price indexation mechanism. We also welcome the authorities' commitment to reach full cost recovery by the end of this fiscal year, which would avoid recurrence of the subsidies. We encourage the authorities to continue the steadfast implementation of this reform while protecting the most vulnerable.

Second, the Central Bank of Egypt's current tight monetary policy stance is appropriate to anchor disinflation. However, given the risks stemming from the oil price increase, the authorities should remain cautious to second-round effects, and further policy changes should be guided by inflation expectations and demand pressures. Planned revision of the central bank law is crucial, as it will establish the clear monetary policy objective of price stability and enhance the central bank's autonomy. In this regard, with support from the Fund, we expect the authorities to submit a draft central bank law to the cabinet by the modified deadline of September 2018. We would like to know whether the authorities have sufficient capacity to implement the law or if further technical assistance (TA) is planned after the revised law comes into effect.

Mr. Virolainen made the following statement:

I thank the staff for the good report and Mr. Beblawi and Ms. Abdelati for their informative buff statement and Mr. Beblawi for his introductory remarks. We issued a gray statement in which we support the completion of the review, so I would like to highlight a few points for emphasis.

We commend the authorities for their good program performance and ownership, and we welcome the continued protection of the vulnerable under the program. Continued fiscal consolidation is necessary in line with program targets, and the energy subsidy reform plays an important role in this respect. In view of the rising energy prices and the pass through of the exchange rate, further restrictive monetary policy by the central bank appears appropriate to mitigate possible inflationary pressures.

We also welcome the broadening of structural reform efforts and commend the specific measures planned to mitigate corruption.

Finally, to attract more investment, it is necessary to further streamline administrative processes and increase transparency. There is a need to increase the role of the private sector in the economy and further reduce the government’s—including the military’s—involvement.

Ms. Young made the following statement:

We would like to throw our support behind Mr. Beblawi and his call for a stronger qualification with respect to performance. The nature, magnitude, and corrective actions with respect to the missed targets warrant this. We also believe it would ensure greater consistency across other program reviews where generally mixed performance has a far more loaded connotation.

We do take into account the significant adjustments that have already been taken by the authorities, but more importantly, the further and more challenging adjustments that are yet to come, and we believe that ownership and commitment will be very important going forward. We support Mr. Beblawi's call.

Mr. Jost made the following statement:

I thank the staff for the report and Mr. Beblawi for the buff statement. Like many others, we welcome the positive developments and particularly, the ownership by the authorities.

I have two points for emphasis. One is on governance. This chair has called on the staff to bring up this issue a few times in the past, and they have done so, and we welcome that explicitly. However, there are still efforts to be made, and we encourage both the authorities and the staff to continue working on governance issues going forward.

The second point, and it has been raised by some Directors as well, is on fuel subsidies, which are regressive, and there have been welcome efforts in this area as well. We understand the difficulties that go with trying to raise fuel prices, but we nonetheless would like to encourage the authorities to continue working on that from here on, and I would like to support the comments made by Mr. Virolainen on private sector involvement.

Mr. Mahlinza made the following statement:

We would also like to thank staff for the report and Mr. Beblawi and Ms. Abdelati for their buff statement, as well as Mr. Beblawi's opening remarks. We issued a gray and would like to highlight just a few points.

First, we want to commend the authorities for their commitment to the homegrown program and also acknowledge the effort and patience involved with the implementation of this program under difficult circumstances. We also want to emphasize the importance of prudent fiscal policy and welcome the agreement between the staff and the authorities on further fiscal consolidation. In this respect, we also wanted to welcome the commitment to implement the fuel price indexation mechanism and encourage them to put their implementation efforts toward achieving full cost recovery.

On monetary policy, we welcome the concrete steps that have been taken by the authorities to enhance effective monetary policy. We also support the actions to enhance the central bank's capacity to exercise stronger supervisory functions over the financial sector and the amendments to the central bank law.

Mr. Leipold remarked that the conversation had convinced him to provide more nuance to his chair's characterization of Egypt's performance as mixed. In light of the circumstances, he agreed with the Canadian chair that a there should be a more positive portrayal of Egypt's performance, which had been marked by a steadfast commitment to the arrangement since the December 2017 review.

Mr. Agung made the following statement:

> We commend the authorities for their strong program ownership, which continued to deliver impressive gains in strengthening growth momentum, improving the budget and inflation, rebuilding market confidence, and increasing international reserves. Building on this remarkable milestone, this chair encourages the authorities to preserve their prudent macroeconomic policies while advancing structural reforms aimed at fostering inclusive growth and private-sector development.
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> In addition to our gray statement, we would like to raise the following points for further emphasis. We note positively from the staff's written response to technical questions that the authorities have been placing strong focus on social measures complemented by a sound communication strategy to mitigate the impact of energy subsidy reform. While there is a clear need to create fiscal space through tax measures and subsidy reform, we encourage the authorities to work closely with development partners to enhance service delivery mechanism and ensure that resources reach the poorest sector of society.
>
> Finally, in the upcoming review, the Board could benefit from comprehensive coverage of social programs that aim to protect the vulnerable segment of the society. Like Mr. Tombini, we also encourage the staff to provide assessment and policy advice on managing financial market volatility in the current environment of tightening financial conditions.

Mr. Mojarrad commended the authorities for their strong ownership, which had helped achieve a significant and positive turnaround in Egypt's economic conditions and prospects. He joined Mr. Castets and other Directors in supporting Mr. Beblawi's concerns about the characterization of the performance as mixed. He encourage the staff and the authorities to work toward a more adequate qualification.

Mr. Joshi made the following statement:

We thank the staff for the comprehensive report, and Mr. Beblawi and Ms. Abdelati for the informative buff statement. We commend the authorities for the impressive performance under the program. This program has helped Egypt maintain substantial progress in improving the external and fiscal deficit, including debt dynamics, while reducing inflation and unemployment.

A strong report on multifaceted structural reforms underpins the authorities' strong commitment to program objectives. We welcome the series of steps taken by the authorities to enhance the business environment, including the adoption of a new investment law, establishment of a consolidated investment center, strengthening of public procurement, and simplification of licensing procedures.

The overall impact of these efforts has resulted in gains in overall confidence and upgrades from rating agencies. We are encouraged by the program performance and the authorities' solid commitment. We believe that such commitment would continue to mitigate external and internal risks to the economy and would ensure the success of the program going forward. We wish the authorities the best and all success.

Mr. Sun agreed with Ms. Young, Mr. Leipold, Mr. Mojarrad, and others that there should be a more accurate reflection of the progress the authorities had made in terms of progress performance.

Mr. Raghani supported the authorities' request for the completion of the third review under the EFF and the requests for a waiver of non-observance of performance criteria. He supported a more accurate characterization of the authorities' performance under the program.

Mr. Mozhin remarked that it was clear that the authorities believed that their performance had been underestimated. He noted that it would not be difficult to change the characterization from "mixed" to "broadly positive."

The staff representative from the Middle East and Central Asia Department (Mr. Lall), in response to questions and comments from Executive Directors, made the following statement:[1]

I would like to thank Mr. Beblawi and Ms. Abdelati for the buff statement. It truly is a partnership between the team and the authorities facilitated by the EDs office, and we appreciate that very much. Thanks also to Directors for their gray statements and the questions.

Before I respond to the questions that were posed, I have one update: that the Monetary Policy Committee of the Central Bank of Egypt met yesterday and maintained the interest rate stance as expected, and we are supportive of that. Given the recent changes in fuel prices, it seems to be appropriate; and this would ensure that inflation stays within the target of the central bank for the end of the year and going into next year.

In terms of the specific questions asked, there was the question on communication. In terms of the fuel price increases and others, I would characterize the broad strategy as one of not surprising people with reforms; and the authorities have foreshadowed that reforms are coming, explained the logic, and put it in the medium-term vision of the country and the economy, as outlined in the buff statement.

In particular, we had shared with the authorities the international comparisons of fuel prices at the retail level globally that is in the staff report, and some versions of that and different ways of slicing that have also been communicated through the press, through media, through social media as well; and senior officials, including ministers, have been on TV explaining the logic for the reforms and what needs to be done and foreshadowing what is to come.

This type of engagement has been useful in clarifying both not just what is coming, but why it is needed and why that aligns with the vision for the economy and reforms, and that has been very effective in making sure that the reforms were well understood.

On the question on remittances, one of the things that was happening before the adjustment process took place was much of the inflows were coming through informal channels and not making it through the banking system, and so much of that was not being recorded. Moreover, Egyptians

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

working especially in the Gulf region were holding back some of the remittance inflows. They cover the spectrum from low-skilled workers to medium- and high-skilled workers, so there is a portfolio rebalancing component both in terms of holding assets overseas and as foreign deposits in the banking system, but also between the informal and formal channels; and all these seem to have worked in favor of moving more remittance inflows back to Egypt and back to the formal banking system, especially after the exchange rate liberalization and the removal of uncertainties about convertibility risk.

There was a question on gender budgeting, and this is being done in cooperation with UN Women, and the idea is to focus specifically on what the impact of certain fiscal policies would be based on gender, something that traditionally has not been done. For example, when it comes to the provision of childcare services, let us take the counterfactual that the removal of childcare services would disproportionately affect women as opposed to men. With the broader aim of closing the gender gap, it is how fiscal policy and the budget can be used to make that happen beyond legal reforms such as equal pay, and that is also the process that the authorities have in mind going forward.

In response to the question on the central bank law, we believe the authorities have quite a strong capacity to implement the law and to adhere with it. At the moment, TA and the close engagement with the Fund is aimed at making sure that all elements of the law are in line with best international practice. To some extent there is a question of whether the law itself should be very specific or whether the law can be general. The Fund's advice was to make the law quite specific so that it is not up to interpretation, depending on whoever might be in charge of the central bank, and that is what is being worked out. But in terms of implementation, we do not see any concerns going forward.

On the general question on social programs and the effect of reforms, we agree with comments made by all Directors. This is an important component. There are a few issues. One is the impact. At the time of the last review, we relied on the World Bank's estimates using fiscal incidence analysis, which showed that for the earlier set of price adjustments and inflation, the bottom 40 percent were more or less fully compensated for the effects of the reforms and the next 40 percent by about half.

It is difficult to do that in real time because we would need household-based surveys, and those are done with not as high a frequency as we would like; but we will certainly note the point, and we will continue to work with the World Bank in trying to get a better sense of that.

From the authorities' point of view and our extensive discussions with the Ministry of Social Solidarity, the issue in terms of providing social assistance to those who need it the most is not about a hard budget constraint, but about targeting. They are careful to make sure that the database is being developed and "cleaned" carefully so that it does not lead to a proliferation of wasteful spending. That is why the Takafol and Karama programs, for instance, were scaled up in a big way in the last few years, but the scaling up from now on gets increasingly difficult—from 2.3 million households, it is not likely that it will be scaled up to 3 or 4 million households in the next year, because they are applying a much more rigorous test for that. The view of the authorities is also that in terms of supporting the lower-middle class and the middle class, the important efforts have to be from reforms that create jobs, and they do not want to go back to just a different form of a very extensive and expensive welfare system, but would rather create enabling conditions for living standards to rise through jobs and growth. They want to be careful about how they are rolling out the social assistance programs and do not want to create the condition where every reform is seen as immediately being fully offset, because that undermines the overall consolidation goals, as well as the efficiency goals.

Regarding the issue of financial volatility, we are in close contact with the authorities with regards to capital flows, and we exchange views, including on potentially how to handle more severe episodes of capital outflows; so we feel quite comfortable that the policy settings and the authorities' alertness to this should be enough to manage even episodes of significant volatility.

In terms of the characterization of program performance, it is fair to say that although there have been some delays in two of the benchmarks and there was only a technical miss of the December performance criterion on the budget, overall given strong ownership, program performance has been quite strong.

Mr. Castets made the following statement:

I thank the staff for the detailed answers, including on our question on social protection. I hear that the authorities consider that it is mostly a targeting issue. But in the last review, the total level of social spending and social protection in Egypt compared to peers was extremely low in percentage points of GDP. Further elaboration will be welcome in the upcoming report, because we keep thinking that the acceptability of the program is linked to how we protect the poorest.

It would be useful if the Egyptian example could fit into our broader review of the engagement of the IMF on social protection, since we are touching on this complex issue of targeting that is enhancing social protection in general.

Mr. Meyer supported Mr. Castets's point that it would be helpful for to dig deeper on the issue of the Fund's engagement in social protection. With regard to the characterization of the program's performance, he remarked that characterizing the performance as "broadly satisfactory" or "broadly adequate" would strike the right balance.

Mr. Beblawi, in a brief concluding statement, thanked Directors for their support and assured them that Egypt was committed to continuing the program. He remarked that in spite of all the pain and suffering faced by most people, there was a common understanding and the people were behind the government.

The following summing up was issued:

Directors commended the authorities for strong program implementation and generally positive performance, which has helped improve macroeconomic stability and rebuild buffers. They noted that the outlook is favorable with prospects for higher growth, lower inflation, declining current account and fiscal deficits, and a healthy level of international reserves. However, given the persistent downside risks, Directors encouraged the authorities to take advantage of the improved macroeconomic outlook to maintain the reform momentum.

Directors welcomed the authorities' continued commitment to fiscal consolidation, noting that the authorities are on track to achieve the planned three-year consolidation plan. Directors commended the recent reduction in fuel subsidies as a critical step in improving economic efficiency and supporting fiscal consolidation. They welcomed the recently approved automatic fuel price indexation mechanism, and called on the authorities to achieve full cost-recovery for most fuel products by end-2018/19 while continuing to strengthen social protection for the vulnerable.

Directors commended the Central Bank of Egypt for successfully containing inflation pressures. In view of possible second round effects in energy prices, monetary policy should, however, remain cautious with a view to anchoring inflation expectations and containing demand pressures.

Directors emphasized that flexibility of the exchange rate and adequate international reserves were critical to sustain macroeconomic stability and mitigate external risks. They advised the central bank to continue to refrain from interventions in the interbank foreign-exchange market. Directors recommended that the repatriation mechanism be eliminated to allow for a deepening of the interbank foreign exchange market.

While banks remain financially healthy and resilient, Directors took note that the two largest state banks may require recapitalization in the next two years to support high credit growth. They urged the Central Bank of Egypt to remain vigilant with respect to these and several other small banks, whose capital adequacy, asset quality, and profitability are below sectoral averages. Directors recommended that the central bank develop clear rules on deploying public funds for maintaining financial stability.

Directors welcomed the broadening of structural reforms to support inclusive growth and job creation and to improve governance. They welcomed the program's emphasis on improving industrial land allocation and strengthening competition, public procurement, and transparency of state-owned enterprises. Directors also noted that further deepening of reforms to reduce state intervention and support market reforms is essential to lay the foundations for sustainable and inclusive rapid growth.

The Executive Board took the following decision:

Arab Republic of Egypt—Third Review Under the Extended Arrangement Under the Extended Fund Facility, and Requests for a Waiver of Nonobservance of Performance Criterion and for Modification of Performance Criterion

1. The Arab Republic of Egypt has consulted with the Fund in accordance with paragraph 3(d) of the Extended Arrangement under the Extended Fund Facility for the Arab Republic of Egypt (EBS/16/110, 11/7/16) (the "Arrangement") in order to review program implementation.

2. The letter dated June 20, 2018 from the Governor of the Central Bank of Egypt (the "CBE") and the Minister of Finance (the "June 2018 Letter"), together with its attached Memorandum of Economic and Financial Policies (the "June 2018 MEFP"), and its Technical Memorandum of Understanding

(the "June 2018 TMU"), shall be attached to the Arrangement, and the letter dated November 7, 2016 from the Governor of the CBE and the Minister of Finance, together with its attachments, shall be read as further supplemented and modified by the June 2018 Letter and its attachments.

3. Accordingly, the Arrangement for the Arab Republic of Egypt shall be amended as follows:

a. The targets as of June 30, 2018 and December 31, 2018 for the performance criteria set forth in paragraphs 3(a)(i) through 3(a)(iv) of the Arrangement shall be as specified in Table 1 of the June 2018 MEFP and further specified in the June 2018 TMU.

b. The continuous performance criterion set forth in paragraph 3(b)(i) of the Arrangement shall be as specified in Table 1 of the June 2018 MEFP and further specified in the June 2018 TMU.

c. The consultation set forth in paragraph 3(c) of the Arrangement shall be as provided for in paragraphs 21–22 of the June 2018 TMU.

4. The Fund decides that the third review specified in paragraph 3(d) of the Arrangement for the Arab Republic of Egypt is completed, and that the Arab Republic of Egypt may make purchases under the Arrangement in accordance with the terms of the arrangement: (i) notwithstanding the nonobservance of the end-December 2017 performance criterion on the ceiling on primary fiscal balance of the budget sector, specified in paragraph 3(a)(iv) of the Arrangement, on the condition that the information provided by the Arab Republic of Egypt on its performance under this performance criterion is accurate; and (ii) on the further condition that the information provided by the Arab Republic of Egypt on the implementation of the measure specified as a prior action in Table 2 of the June 2018 MEFP is accurate. (EBS/18/61, 6/20/18).

Decision No. 16404-(18/60), adopted
June 29, 2018

APPROVAL: February 12, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. Given the magnitude of the necessary fiscal adjustment in 3 years (5.5 percent of GDP), could staff elaborate more on the risk of reform fatigue mentioned in paragraph 34?

- The authorities' reform program has encompassed a broad range of measures including liberalization of the exchange regime, introduction of the VAT, tightening of monetary and fiscal policies, reduction in fuel subsidies, and a wide range of structural reforms to support inclusive growth and job creation. These reforms have already started to yield clear results in terms of macroeconomic stabilization, the recovery in growth, and the decline in unemployment. However, some reforms already undertaken and currently underway will naturally take longer to produce a payoff in terms of generating sustained improvements in living standards. This lag between when measures are implemented and when the payoff becomes increasingly evident raises the risk that the appetite for completing the reforms may diminish before the full results are evident, which in turn would prevent the full benefits from the reform program from being realized.

2. In this context, strong growth in private remittance inflows is one of key factors of the improving current account deficit. Could staff elaborate more on the cause of the growth and whether staff think this trend is a temporary or continuous?

- The strong growth in remittances has benefitted from improved confidence in Egypt's economic prospects, the liberalization of the exchange rate regime, and the attractive rates of return on Egyptian assets. This has encouraged migrant workers to transfer more of their savings held abroad to Egypt than in previous years. The rate of growth in remittances is expected to moderate over the medium-term as this transfer of savings reaches a new steady state consistent with the improved fundamentals.

3. The staff's comments on the implications of increasing LNG production on energy consumption patterns, export revenues, and job opportunities is welcome?

- As the extraction of natural gas increases, domestic LNG production is expected to rise and help reduce imports. Gradually, natural gas is also expected to replace other sources of energy consumption as more households get connected to the grid (substituting for butane cylinders) and new electricity generation plants come onstream that use natural gas instead of fuel oil. Domestic demand is projected to be met entirely by domestic production by 2019/20 after which Egypt will become a net exporter of LNG.

Monetary and Exchange Rate Policies

4. We wonder how the elimination of the repatriation mechanism would be executed considering possible pressures on capital outflows as a result of tighter global financial conditions. The staff's comments are welcome.

- The elimination of the repatriation mechanism would apply to new inflows which would then all be channeled through the interbank foreign exchange market, helping improve its liquidity and depth. To the extent that capital outflow pressures were to emerge in late 2018 due to global conditions, the elimination of the mechanism on inflows would have no bearing on investors with regard to their decision on whether to roll over their existing holdings or exit the local currency treasury market, and hence on the volume of outflows. Those investors who entered through the mechanism would still be able to exercise their option to utilize it to repatriate their investments even after the elimination of the mechanism for new inflows.

5. Could staff clarify whether the CBE's plan is to implement an inflation-targeting regime in the medium term?

6. Moreover, the authorities' intention to establish an interest rate-based monitoring framework in the medium term is welcome, in this context a gradual approach will be appropriate. The staff's clarification on the timeline is welcome.

- Response to questions 5–6. Implementation of inflation targeting (IT) is the authorities' medium-term goal. Egypt is moving towards meeting the conditions for full-fledged inflation targeting (FFIT), with continued progress on reforms and the recent improvement in economic conditions. The CBE's institutional capacity will be strengthened with the adoption of the new Central Bank Law, which will make price stability the main objective of monetary policy, and will also strengthen CBE's autonomy. At the same time, significant efforts are being undertaken to improve the liquidity management and forecasting framework and to further develop technical and organizational capacity of the CBE staff. These important institutional preconditions would pave the way for a smooth adoption of inflation targeting.

7. We would be interested in an update on progress with finalizing the draft central bank law that is planned for submission to Cabinet in September 2018.

8. ***Since strengthening the CBE's institutional and operational autonomy is crucial for this purpose, it is a concern that Structural Benchmark of submission to Cabinet draft amendments to the CBE law is extended two consecutive time from original December 2017. Although staff report states "to ensure that it is fully consistent with the objectives" as a reason of this extension, we would appreciate it if staff could explain more about the point staff think not sufficient and the rational staff think this 3-month short extension is enough to complete the work.***

- Response to questions 7–8. In early 2018, the authorities requested Fund technical assistance in drafting the Banking law. Given the breadth of the revisions, extensive TA has been provided through series of LEG/ MCM missions and continuous engagement from headquarters. A 3-month extension is requested to allow sufficient time to consolidate all recommendations and prepare the draft law for the submission to Cabinet.

9. ***Could staff confirm that the proposed new law will significantly increase the CBE's independence and ban deficit financing for the future?***

- The new law is intended to strengthen the autonomy and operational independence of the CBE, including by limiting the scope for monetary financing of the deficit.

10. ***We would welcome further elaboration on the reasons for the deletion of this measure and possible consequences for the objective to enhance exchange rate flexibility, and the calculation of net international reserves. Could staff also comment on the justification regarding the transparency policy.***

- The references to elimination of the repatriation mechanism will be deleted in the published version of the staff report only as these fall under the category of premature disclosure of policy intentions, in line with the Fund's transparency policy. The measure remains part of the program and is expected to be implemented as planned.

11. ***Could staff provide estimates of capital outflows from Egypt in recent months?***

12. ***How vulnerable is Egypt (banking sector) to capital outflows given its financing gap and available reserves?***

- Response to questions 11–12. The staff does not have information on capital outflows in recent months as BOP data is released on quarterly basis. However, market analysts estimate portfolio outflows in the range of $3–4 billion. A further increase in EM risk aversion could lead to more outflows given non-residents continued to hold a significant amount of government securities, estimated at around $20 billion. However, Egypt's strong FX position—$43 billion in official reserves plus

$8.6 billion in non-reserve FX deposits acquired through the repatriation mechanism—provide sufficient buffers to prevent disorderly market conditions. The flexible exchange rate provides an additional cushion. Egypt's banking sector is well-positioned to withstand liquidity and exchange rate pressures from the capital outflows.

13. ***We note, however, that inflation is set to increase gradually from its current levels, and would appreciate staff's view on the Central Bank of Egypt's (CBE) decisions earlier this year to cut policy rates by a cumulative 200 bps.***

- The decision by the central bank of Egypt to reduce its policy rates by 200 basis points during the first quarter of 2018 was appropriately timed and calibrated. It was consistent with the observed disinflation, inflation expectations, and the CBE's objective of bringing inflation down to the low teens in 2018. The CBE has since then remained on hold, including most recently at the MPC meeting of June 28. The projected increase in inflation during the next fiscal year reflects the transitory impact of the recent regulated price increases (fuel and electricity) while demand pressures remain contained.

Social Safety

14. ***What is staff's assessment of the adequacy of current social safety nets in protecting the more vulnerable?***

15. ***Could staff elaborate on the social impact of the fuel subsidy reform?***

16. ***With episodes of high inflation continuing, could the staff elaborate on the additional actions being undertaken by the authorities to alleviate the adverse effects of the fiscal consolidation measures, including on erosion of real income? Also, what has been the impact of these actions for dealing with the social consequences?***

17. ***Could staff elaborate more on the programs to directly support poor household, which will substitute energy subsidies?***

18. ***The staff's update and appraisal on the mitigating measures for the poorest would be welcome. In particular, have the additional increase in diesel, kerosene and fuel oil prices been matched by additional strengthening of the social safety nets?***

19. ***We stress the importance of enhancing targeted safety nets for the least vulnerable. The staff's comments on additional efforts made by the authorities to enhance the social safety net are welcome.***

20. The staff's comments on the distributional effect of the ongoing reforms and the quality of coordination of various social protection schemes would be welcome.

21. Mr. Beblawi and Ms. Abdelati's very helpful buff statement accompanying the EFF request in 2016 mentioned ongoing work to develop a database of vulnerable groups, enhance social safety net programs, and better target assistance to reach deserving households. Can staff provide an update on this work.

- Response to questions 14–21. Fuel subsidies in Egypt disproportionately benefit the rich. The authorities' social strategy is to move from universal subsidies towards targeted measures. Reducing fuel subsidies impacts households both through higher prices for energy used for personal transport, cooking and heating, and through higher prices for other goods and services that use energy as an input. The authorities expanded the coverage of Takafol and Karama programs from 940 thousand households in 2016 to 2.3 million households now, and have increased the benefits per household. The food subsidy is being reformed through improved targeting. In addition, the authorities are implementing measures to move households out of poverty and support the middle class through structural reforms. A new program "Forsa" was started in 2017 to complement Takafol and Karama and aims to connect youth with opportunities to work. Programs that benefit the middle class have been broadened as well. Social pensions and the income tax threshold for low income taxpayers has been increased. In addition, the government has increased social pensions by 15 percent and set aside 0.3 percent of GDP to mitigate the impact of the recent fuel price increase. Ultimately, the authorities' program to promote inclusive growth and create jobs will become the strongest form of social protection by improving living standards.

  In the absence of detailed household survey data, staff was unable to perform the fiscal incidence analysis of the latest phase of the fuel subsidy reform.

22. We are somewhat concerned about the possibility of social unrest, and note that the related regional perspective, and potential spill-overs to Egypt, is not addressed in the report. We would appreciate staff's comments on this issue either in staff responses or in the meeting.

- The authorities' ambitious reform program, which is aimed at higher and inclusive growth and job creation, has started to pay off. Growth is rebounding, unemployment is declining and inflation is falling. In addition, more budget spending was directed toward social protection, including to expand the well-targeted Takafol and Karama programs, and to increase food subsidies. Importantly, and as also indicated in the authorities' buff statement, the authorities have been communicating with the whole population continuously through various platforms about the need for and direction of reforms, the progress already achieved, and the overall vision for the economy and living standards that are guiding the reforms. This engagement has played an important role in ensuring broad-based support for reforms.

Fiscal Policy

23. We also note positively the new cabinet's prioritization of security, which should help maintain the momentum of key reforms and tourism sector. The staff's comments on the implication of this commitment on budget spending would be welcome.

- Further improving the security situation in Egypt is an important priority of the government, including to attract investors, support tourism and promote inclusive growth. Information on specific future spending commitments in this area, however, was not made available to the mission.

24. What is the nature of activity of the 23 public enterprises targeted for disinvestment? What are the future disinvestment plans, to the extent known, and are there any plans to trim government ownership in state banks?

25. Do staff see that the expected EGP80 billion gained from the divestment of shares in public enterprises will help lower public debt or address the financing gap over the medium term?

- Response to questions 24–25. In April 2018 an inter-ministerial committee approved and announced a detailed plan to divest stakes in at least 23 state-owned enterprises over the next 24-30 months. This includes SOEs in the energy sector, logistics, real estate, as well as shares in several state-owned banks. The proceeds from the divestment of state assets will increase fiscal resources that could in part be used to finance priority expenditure within the overall fiscal envelope, anchored to maintaining a primary surplus of about 2 percent of GDP over the medium term. Some of the proceeds could also be used to strengthen the financial position of the SOEs and used to finance much-needed investment outlays.

26. Nevertheless, we note that the authorities are planning to delay lower priority expenditures in the 2018/19 financial year as part of their aim to achieve the fiscal target. In this instance, we would be concerned about the accumulation of arrears, and would thus urge caution. The staff's comments on this issue would be welcome.

- The authorities' main fiscal objective for 2018/19 is to achieve a primary surplus of 2 percent of GDP. To this end, as a contingency measure, they are committed to delaying lower priority spending as needed if expenditure overruns or revenue shortfalls put the primary balance target at risk. This was successfully executed in 2017/18 when higher global oil prices led to energy subsidy overruns.

27. Could staff provide further information on the relationship between the increased tax payments to the government from the CBE and the need for recapitalization of the CBE?

28. Could staff also explain the reason for and the implications of the repricing of government bonds held by the central bank? (para 2) The staff's elaboration on the appropriateness of taxes on income from government bonds paid by the central bank would be welcome. (para 12)

- Response to questions 27–28. Primarily because of significantly increased sterilization costs (both higher sterilization volumes and interest rates), the CBE was expecting significant losses for the fiscal year, requiring recapitalization. This was partly due to the income loss from below-market pricing of its holdings of government bonds. After repricing these securities to close to market prices, the CBE's income position improved significantly, but it still required a capital injection of about EGP6 billion. Since interest payments on government bonds are taxed, the increased interest payments with the repricing have resulted in higher taxes for the budget.

29. Compared to the last review, has the scenario of risks and vulnerabilities affecting the DSA changed to any extent?

- The debt sustainability analysis and the risks to it have remained broadly unchanged compared to the 2nd review.

Structural Reforms

30. Could staff comment on the impact of tariff and non-tariff barriers on foreign trade, since non-oil trade does not seem to have responded materially to the sharp depreciation of REER in the last two years?

- The main challenge facing Egypt's trade regime is non-tariff barriers and the complexity of the tariff system. According to the WTO's 2018 Trade Policy Review, import prohibitions and restrictions are maintained across a range of items for economic, environmental, health, religious, safety, sanitary, and phytosanitary reasons. Egypt's simple average applied MFN tariff rate was 19.1 percent in 2017, and 12.3 percent excluding alcoholic beverages. While these rates compare favorably to other countries, Egypt's tariff system is rather complex as reflected in the high coefficient of variation. As part of their reform program, the authorities are planning to simplify the trade regime and reduce non-trade barriers (MEFP ¶25).

31. Are there any active labor market policies under consideration to help absorb the large and growing cohort of unemployed youth?

- In the current context, the main driver of job creation would be high and inclusive growth, for which the authorities are implementing a broad range of measures, including legislative reforms to support SMEs and entrepreneurship, such as the micro-finance law, the single company law, and streamlining the SME tax regime. In addition, the Egyptian government has developed vocational training programs specifically targeted at youth and women, and is providing them with financial support and training.

32. The adoption of an automatic fuel price indexation mechanism is expected to lead to full cost recovery by the end of the year, taking into account not only oil price and exchange rate movements but also the changes in the share of imported fuel in domestic consumption. We wonder what exactly the latter entails, and what has been the practice around the world. The staff's comments would be welcome.

- Egypt is both an importer and a producer of refined fuel products, and supply costs differ accordingly. The supply cost of imported fuel products depends, among other things, on the international price, the cost of transport, the exchange rate, fees and insurance related to imports. The cost structure is different for domestically refined fuel. The fuel price indexation formula, designed by the Egyptian authorities, reflects this variation in costs in retail prices. Experiences around the world differ depending on country circumstances and specific cost structures.

33. We would welcome additional staff comments on the reasons for the delay in the approval of the fuel price indexation mechanism. Moreover, could staff comment on whether there are still implementations risks before the approved mechanism becomes effective by end-December 2018?

34. Considering the structural benchmark on the automatic pricing of fuel products had been missed already twice, staff decided to drop it for the next review. We would welcome any assurances the authorities have provided to staff on the traction of this commitment.

35. On this aspect, we would like to know why the structural benchmark related to the set up of a fuel price indexation mechanism was not met. The staff's comments and appraisal are welcome.

- Response to questions 32–34. The fuel price indexation mechanism was approved in June instead of February as more technical work was required to adequately model the production cost structure of each fuel product. The authorities are planning to implement the mechanism by end-December 2018.

36. Could staff elaborate more on the fiscal impact of this mechanism such as whether this mechanism will fully eliminate fuel subsidy, or the fuel price will immediately be raised to the cost-recovery level once the mechanism is introduced?

- The indexation mechanism will preserve cost-recovery ratios. Since it is planned to be introduced before full cost-recovery is reached, it will not eliminate the subsidies, but rather will mitigate the impact on the budget from unexpected changes in the exchange rate and global oil prices. The authorities remain committed to reaching full cost-recovery by the end of 2018/19, after which the indexation mechanism will ensure that prices adjust in line with market developments and avoid the recurrence of subsidies.

37. How do staff intend to review the fuel price ratio reaching 100 percent if it happens as planned in June '19 after the final staff review mission?

- The final increase in fuel prices to reach full cost-recovery is expected by June 15, ahead of the end-June Board meeting. This gives staff sufficient time to verify.

38. We see the progress in improving the land allocation mechanism, the new Procurement Law and strengthening the role of Egyptian Competition Authority (ECA) as key steps to improving the business environment and supporting private sector development. We invite staff to comment on the role of the Fund and development partners in these efforts.

- The World Bank has been working with the authorities to improve the land allocation process, revise the Public Procurement law in line with international best practice, and strengthen the competition framework. Fund staff has been closely engaged with their counterparts at the World Bank to identify structural benchmarks that will complement their ongoing efforts and help address key obstacles to private sector development in each of these areas. Fund staff has also engaged with the European Commission on possible cooperation in the area of competition reforms.

39. Could staff clarify the step by step process they will be following/monitoring the delivery and quality of: Right to info law (MEFP 125), Divesting minority shares in SOEs (MEFP 125) and Transparency of state owned enterprises (MFP 115).

- The staff will inquire on progress towards the Right to Information Act and the divestiture program at the time of the next review mission and discuss the next steps. Progress towards transparency of SOEs is monitored with two structural benchmarks for end-June 2018 and end-December 2018.

40. Given previous delays, we would appreciate staff's views on the authorities' commitment and capacity, as well as the political space, to implement this broad range of significant structural reforms. Have staff discussed prioritization with the authorities?

- The delays in implementing some of the structural benchmarks were usually short and often reflected capacity constraints. To address these constraints, Egypt is receiving extensive technical assistance from the Fund, the World Bank and other development partners. The authorities' program ownership continues to be strong, and the reforms and their sequencing as outlined in the MEFP have been agreed to be realistic, feasible and enjoying broad political support.

Program Issues and Financing

41. Could staff elaborate on scenarios under which they would favor a drawdown in reserves over a new issuance of Eurobonds to close the financing gap for 2018/19?

42. Could staff offer more details on recent bond issuances as well as the alternatives envisaged for the financing gap if market conditions and investment fatigue play a spoiler?

43. We would appreciate staff's comments on how the recent turmoil in emerging markets might affect Egypt's ability to close its financing gap for 2018/19 with the planned Eurobond issuance

44. We wonder whether there are any viable alternatives to the planned Eurobond issuance. The staff's comments on this would be appreciated

45. With S&P's recent upgrade of Egypt's sovereign rating to B, can staff advise on whether a Eurobond issuance is likely to proceed?

46. Given global financing conditions, would Egypt to able to fill a large financing gap than predicted?

- Response to questions 40–46: The authorities issued \$7.2 billion in 2017 and \$6.5 billion so far this year in the international market with each issuance being significantly oversubscribed. S&P's recent upgrade of Egypt's sovereign rating to B, in recognition of the improving macroeconomic outlook and sound policy implementation, would further strengthen demand for Egyptian securities. If global financial conditions remain benign and demand for Egyptian bonds continues to be strong, Eurobonds would be preferable as it is much cheaper than domestic borrowing. But if foreign investors were to retreat significantly from EMs and bond yields were to increase sharply, the CBE may consider closing the gap from its reserves. In this case, gross reserves would decline slightly to \$43.8 billion, which is 140 percent of the Fund's ARA metric.

47. Finally, we wonder whether the timing of the updated PCs and Indicative Targets is viable as the cutoff date of end-June 2018 gives the authorities very limited time to meet them. The staff's comments are welcome.

- The revised quantitative targets for end-June have been discussed with the authorities and are attainable. As noted in the staff report and the MEFP, the ceiling on the fuel subsidy bill (PC) was increased in view of the higher than projected global oil prices, and the floor for the clearance of EGPC arrears (IT) was reduced to reflect the company's continued financial difficulties, also aggravated by the rise in oil prices.