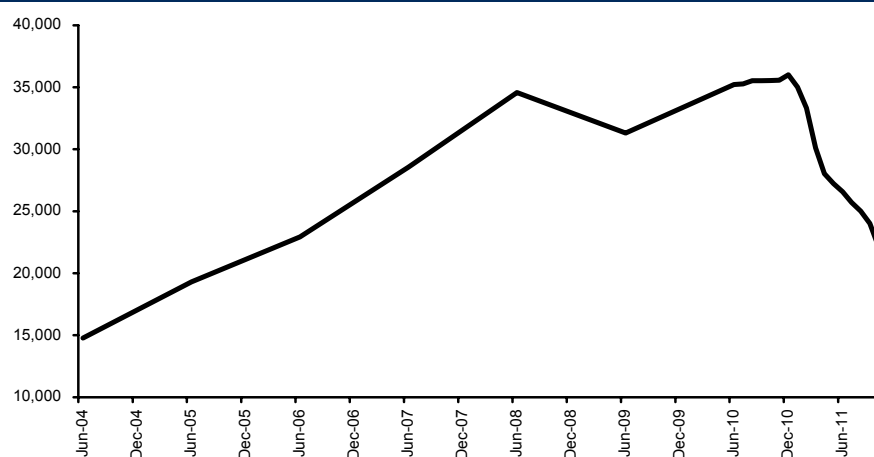


Mena Strategy

What next for the Egyptian pound

We believe there has been an increase in the rate of decline in CBE reserves during November, which would put further pressure on the Egyptian pound. But, Tuesday's US\$1.53bn sale of US\$-denominated bills gives some relief. IMF loans or other bilateral facilities would also help, but time is of the essence.

Chart 1 : Net international reserves (US\$m)



Source: Central Bank of Egypt

Central Bank increases corridor rate

In its meeting last week, the Monetary Policy Committee in Egypt raised the overnight deposit rate by 100bp to 9.25% and the overnight lending rate by 50bp to 10.25%, the first increase since 17 September 2009. These two rates, generally known as the corridor rate, serve as the main policy tools for controlling inflation. The Central Bank of Egypt (CBE) also raised its discount rate by 100bp to 9.5%. According to the CBE, this was because of possible upward pressure on inflation.

Currency at risk

However, we also see it as a move to defend the currency, which has been stable at about E£6/US\$. CBE reserves are down US\$14bn ytd (to end-October 2011) and we believe that November has seen further sharp decline in reserves, which could put pressure on the currency, fuelling inflation and capital flight. The 12-month forward E£/US\$ rate suggests the currency will devalue to about E£7/US\$ from the current level. The Egyptian finance minister has asked the IMF to reconsider its US\$3.2bn lending facility, which would have a stabilising effect, but time pressure is an issue, given the rate of decline in reserves.

What to buy in Egypt

We continue to believe that Egypt is not going to be a quick-fix turnaround story and recognise that stock market volatility is likely to remain high until there is more clarity on the economic and political outlook. However, at least the start of the multi-stage elections has been peaceful. Having said that, we see a number of attractive investment opportunities, including: Orascom Construction Industries (OCI; Buy, TP E£284; and one of our top picks in the region) and National Société Générale Bank (NSGB; Buy; TP E£28.5) – see page 2.

Important disclosures can be found in the Disclosures Appendix.

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Defending the currency

Although the picture for international reserves and the E£ looks concerning, we see a possibility that, in addition to the IMF, the Gulf Cooperation Council (GCC) would be willing to backstop Egyptian reserves given geopolitical circumstances. However, this is likely to be dependent on political clarity. We saw some good news on Tuesday as Egypt raised US\$1.53bn in a sale of one-year dollar-denominated bills, giving some relief. The average yield was 3.87%, well below the 15% yield on the country's one-year Egyptian-pound-denominated notes.

Still downside risk to the economy

In line with our view, the CBE sees downside risks to domestic GDP, stemming from both the political transformation that may continue to have ramifications on both consumption and investment decisions, and from heightened concerns related to global recovery. In the quarter to June 2011, GDP growth was a mere 0.4%. This was better than the 4.3% contraction recorded in the previous quarter, but was a decline in economic activity larger than the CBE had anticipated. The IMF expects GDP growth of 1.8% for 2011/12. However, GDP growth of 1-2% is a major issue for a country that needs high-single-digit growth to keep unemployment at a steady level, in our view.

Default risk still low, even in the event of devaluation

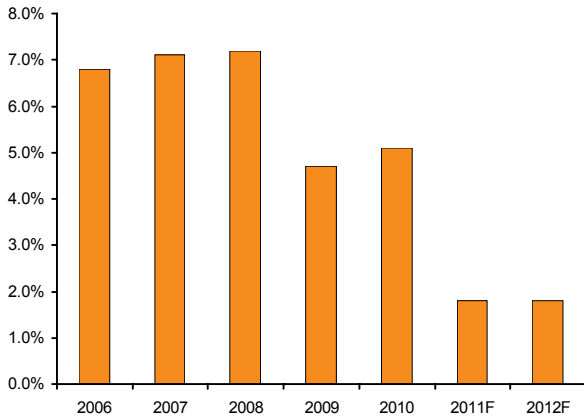
Often one of the greatest costs of devaluation is that it can exacerbate the government's financial problems by raising the cost of external borrowing, but reducing the tax base for paying for it. From this point of view, at least, Egypt is relatively secure, in our view. Nearly 50% of Egypt's exports are energy commodities, while tourism receipts and Suez Canal revenues are essentially dollarised. The number of tourists has declined 36% from January-August, but could recover quickly and Suez Canal revenues have increased 10% from January-October compared with the same period last year. In addition, external borrowing, at just 15% of 2010/11 GDP, is low compared to global peers.

Our top picks in Egypt

OCI (Buy, TP E£284) is one of our top picks in the region. We see strong catalysts for the share, including: 1) the ramp up of new fertiliser capacities over the next 12 months; 2) continued high fertiliser prices; 3) a recovery in the construction backlog; and 4) the creation of a holding company, likely by 1Q12. In addition, the company will actually benefit from a devaluation in the E£, as it generates most of its revenues outside the country.

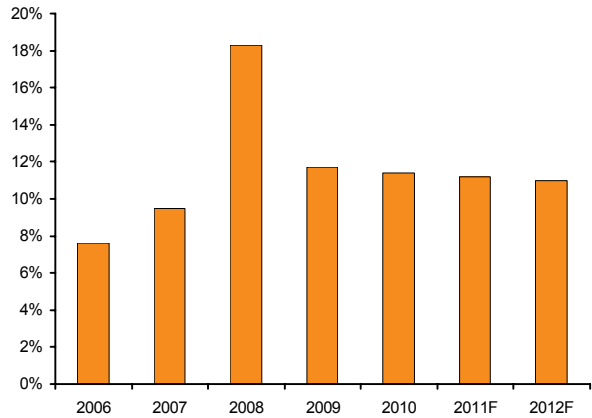
NSGB (Buy, TP E£28.5). Modest rise in the corridor rate should have a positive impact on banks as it should positively affect net interest income while negatively affecting loan growth (particularly as it brings uncertainty) and provisioning. We believe the overall impact on banks will be neutral in E£ terms. NSGB is our top pick in the Egyptian banking sector, as we believe the market is already factoring concerns about devaluation of the E£ and other economic and political risks into valuations. Underlying profitability remains strong for private sector banks, and we see little sign of excessive provisioning.

Chart 2 : Egypt real GDP growth (% change)



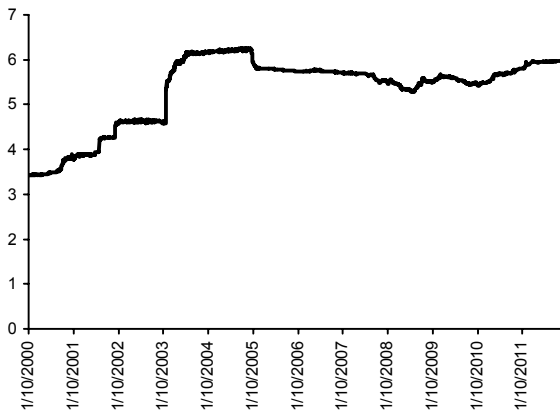
Source: IMF October 2011, Central Bank of Egypt

Chart 3 : Consumer price inflation (% change)



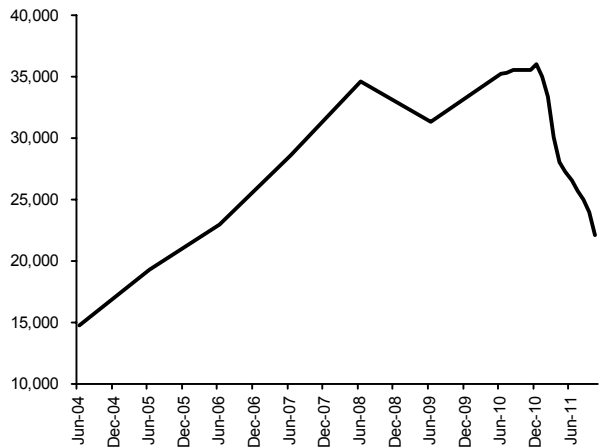
Source: IMF October 2011, Central Bank of Egypt

Chart 4 : Egyptian pound/US\$ exchange rate



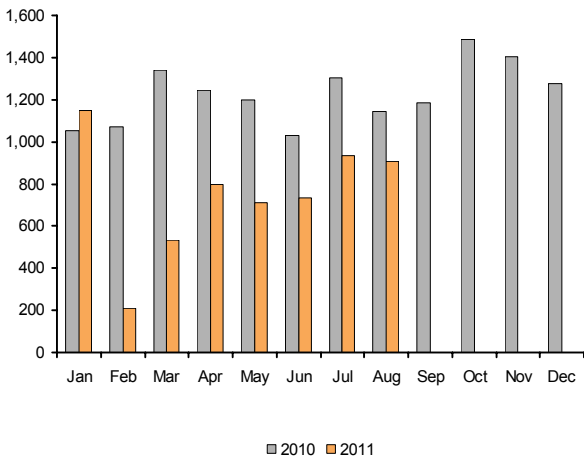
Source: Bloomberg

Chart 5 : Foreign exchange reserves (US\$m)



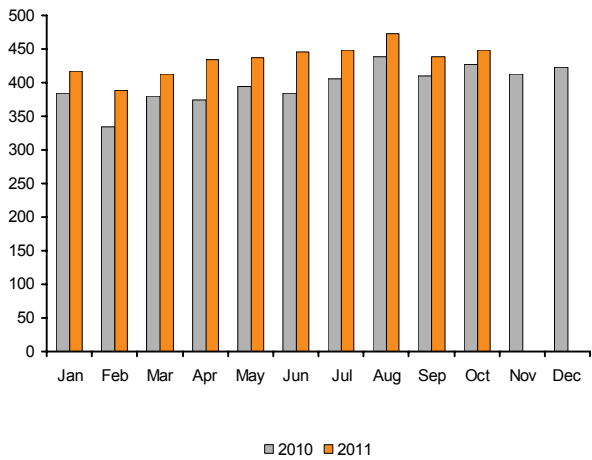
Source: Central Bank of Egypt

Chart 6 : Tourist arrivals ('000) down 36% ytd



Source: Bloomberg

Chart 7 : Suez Canal receipts (US\$m) up 10% ytd



Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

For a discussion of the valuation methodologies used to derive our price targets and the risks that could impede their achievement, please refer to our latest published research on those stocks at <http://research.rbsm.com>

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