



MACRO ANALYSIS
POLICY UNIT (MAP)

MONTHLY ECONOMIC REVIEW



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The Monthly Economic Review is produced by MAP Unit. It highlights the most critical economic updates and aims at tracking the main developments in the real, fiscal, monetary and external sectors. In addition, the Monthly Economic Review helps to monitor the economic response and recovery in light of COVID-19 crisis, considering different challenges and future prospects as well.

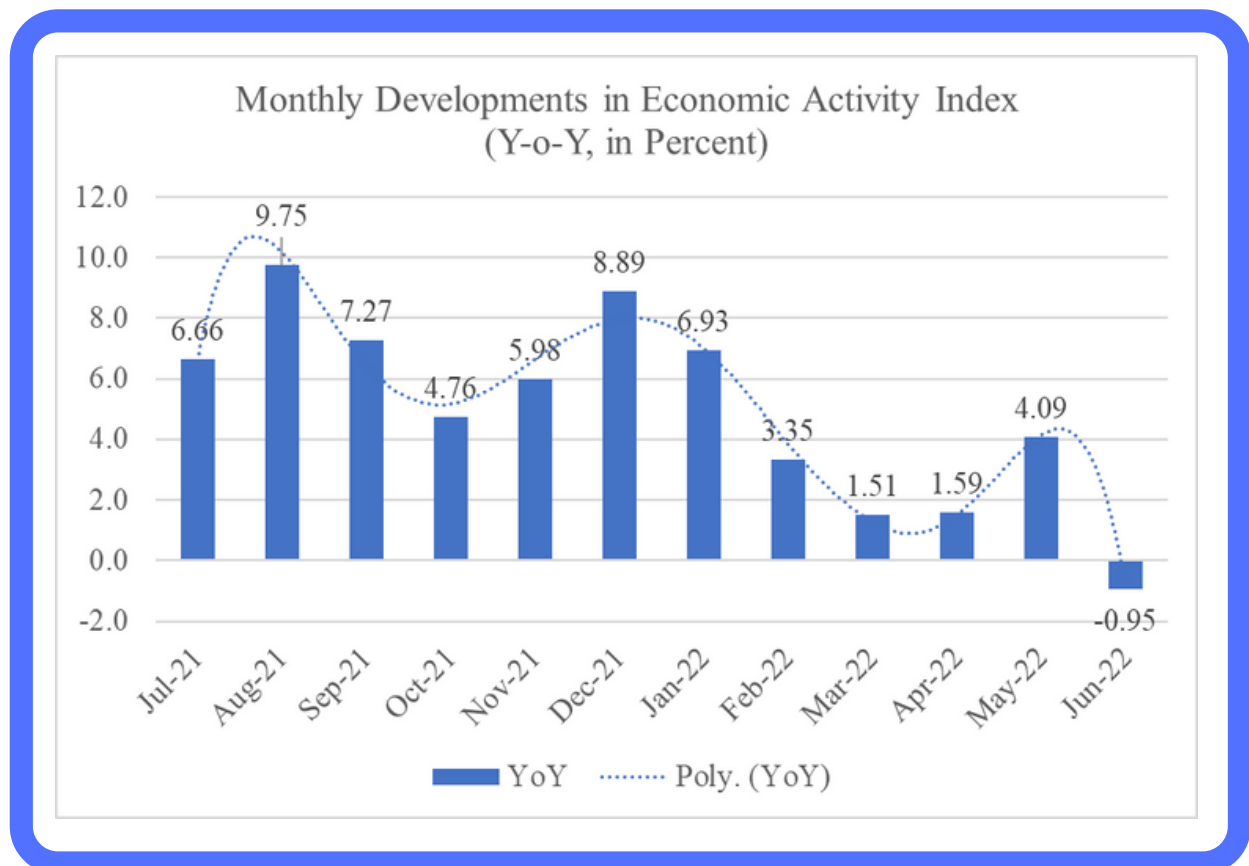
SEPTEMBER'S HIGHLIGHT

- Real economic activity index indicated a growth rate of 1.6% during Q4 FY2021/22. The index is proxied by three sub-indicators namely, PMI, real money balances M2 and the manufacturing and extractions monthly index. Meanwhile, Real GDP growth rate recorded 3.2% during the same quarter fueled by the growth of all sectors across the board.
- Input costs are growing since March 2022, examples are given by prices of both cement and steel experienced a surge since March 2022 and continues through June 2022, partial effect emerged from the exchange rate devaluation amounted for an average of 60% of the prices dynamics during the period March-June 2022. While another portion emerged from the second-round effect of the supply-side shocks represented in higher staff wages, a phenomenon known as the price-wage spiral.
- The September Yield curve started to show some flattening pattern which is usually a transitional phase for an inverted curve. This implies market participants uncertainty about the monetary policy actions and some economic concerns about the economic outlook.



REAL SECTOR ECONOMIC ACTIVITY INDEX

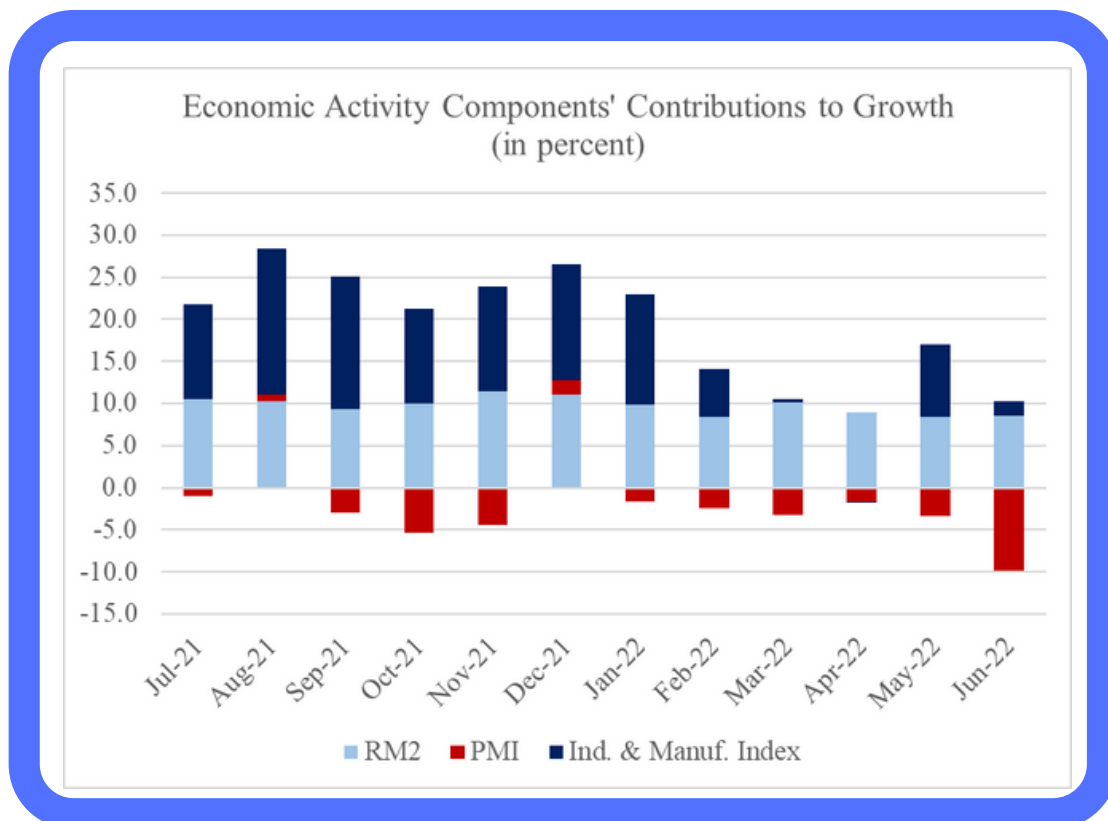
- In an attempt to construct a monthly index to reflect the real economic activity in Egypt, MAP unit constructed a nowcast GDP economic activity index utilizing three monthly sub-indicators; namely: real money balances (real domestic liquidity M2), Purchasing Managers' Index (PMI) and the manufacturing and extractions index (MEI).
- While giving weights to the index proxies, we applied the conference board methodology by assigning standardized weights based on the inverse of the standard deviation of each sub-indicator.



Source: MAP's Estimates, Ministry of Planning and Economic Development.

REAL SECTOR ECONOMIC ACTIVITY INDEX

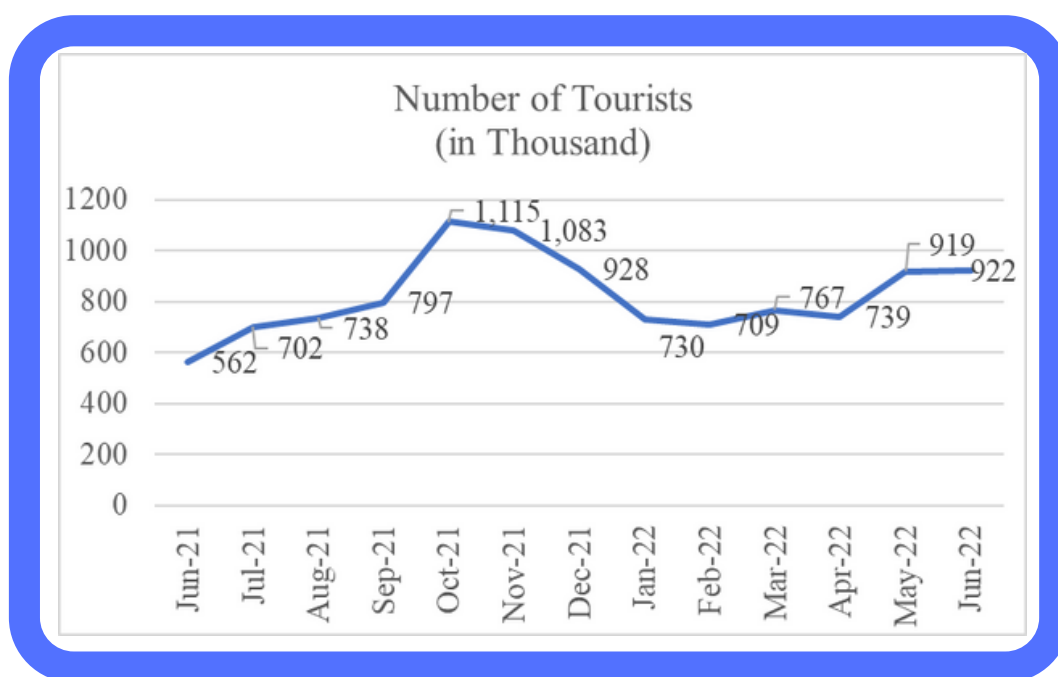
- The nowcast series for GDP had a downward trend over the last 12 months, with a deteriorating performance of the index during the period Feb-June 2022, reaching a monthly growth rate of -0.95% in June (YoY). This came on the back of negative contribution of the PMI in the overall index, in addition to retreated performance in the MEI during the same period. These developments mirror the tight business conditions faced by the non-oil private sector, adding to that the worsened supply-side profile, especially for those who work in the manufacturing and extractions sectors.
- On the contrary, we noticed that real money (being a proxy for the demand on goods and services) contributed positively all the way through over the last 12-month period, reflecting the demand conditions which is still the main momentum for economic activity in Egypt, and can reflect partially the sources of inflation.



Source: MAP's Estimates, Ministry of Planning and Economic Development.

INDICATORS FOR ECONOMIC ACTIVITY

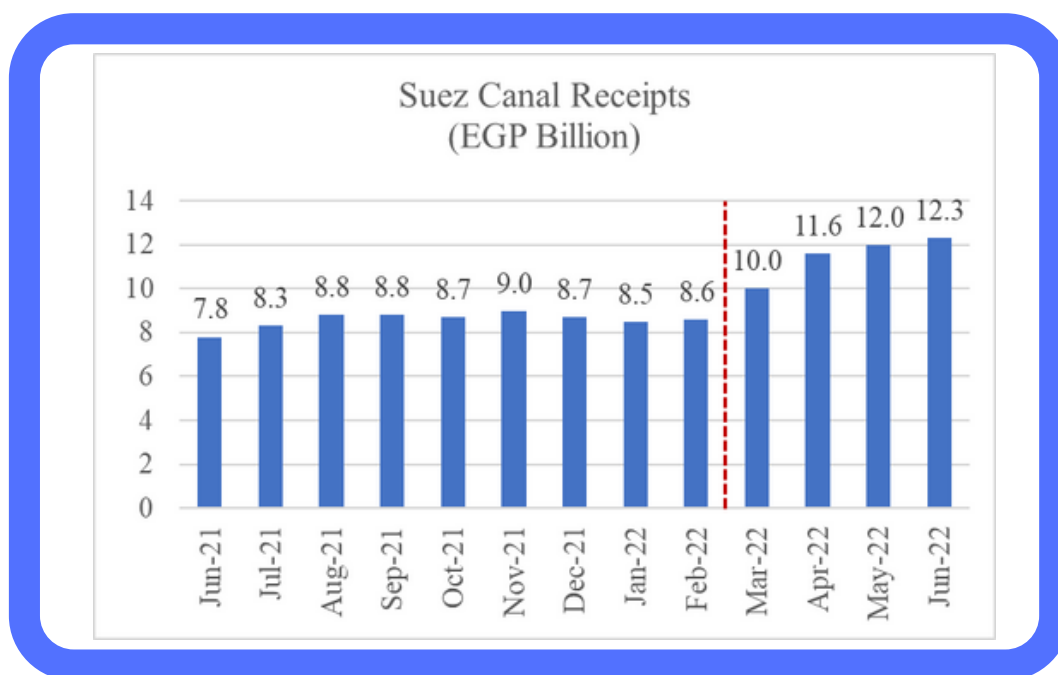
- Tourism sector witnessed a strong rebound during the period Oct/Dec 2021 from the repercussions of COVID-19 pandemic and number of tourists and tourism receipts started to get back to the pre-pandemic levels.
- Nevertheless, the sector was hit by another external shock and was exposed to another risk represented in the spillovers of the geopolitical conflict between Russia and Ukraine which has detrimental effect on the number of tourists came from these two countries, in which tourism receipts recorded about USD 4.0 billion during the period Jan/May 2022 with a monthly loss of USD 100 million.
- Nonetheless, such a loss was mitigated by the increase in number of tourists coming from Germany, Saudi Arabia, and United Kingdom.



Source: CAPMAS.

INDICATORS FOR ECONOMIC ACTIVITY

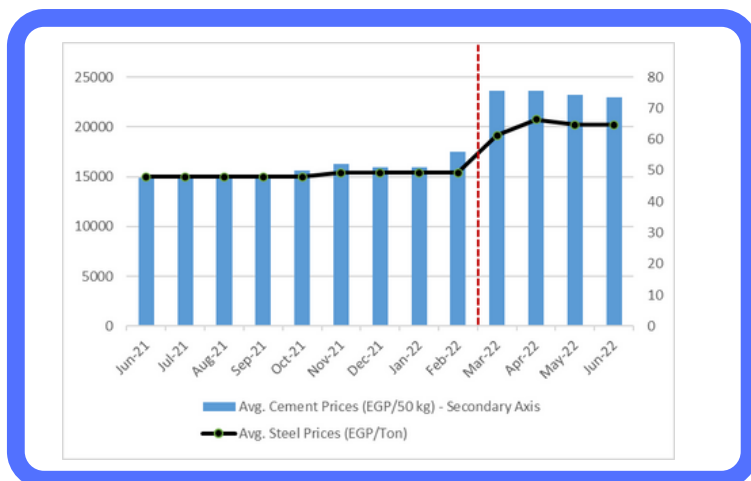
- The Suez Canal receipts, according to a statement published by the Central Bank of Egypt, picked-up to historical records in March fueled by the preferential pricing mechanism introduced to encourage new customers. In the meantime, March 2022 coincides with the devaluation witnessed in the EGP by 16%, a measure taken by the Central Bank in its exceptional meeting on 21st of March 2022 to lower the pressure on the Net International Reserves (NIR) and the Net Foreign Assets (NFA), after huge capital outflows get out of the Egyptian economy in the aftermath of the Russian-Ukrainian conflict, amounted for USD 17.2 billion during first 9 months of FY 2021/22.
- In this context, the accumulated devaluation in the Pound over the period March-June 2022 accounted for 18.5%, while the accumulated growth in the Suez Canal receipts reported about 38% over the same period, implying that about 50% of the growth in the receipts came from the EGP devaluation i.e. price effect.



Source: Suez Canal Authority.

INFLATION DYNAMICS: INPUTS AND OUTPUT

- Prices of both cement and steel experienced a surge since March 2022 and continues through June 2022, partial effect emerged from the exchange rate devaluation amounted for an average of 60% of the prices dynamics during the period March-June 2022.
- In the meantime, Purchasing Managers' Index (PMI) input costs index growth indicated an accumulated rate of 30% during the period March-June 2022, partially caused by higher staff wages and higher prices emerged from full pass-through effect from exchange rate.



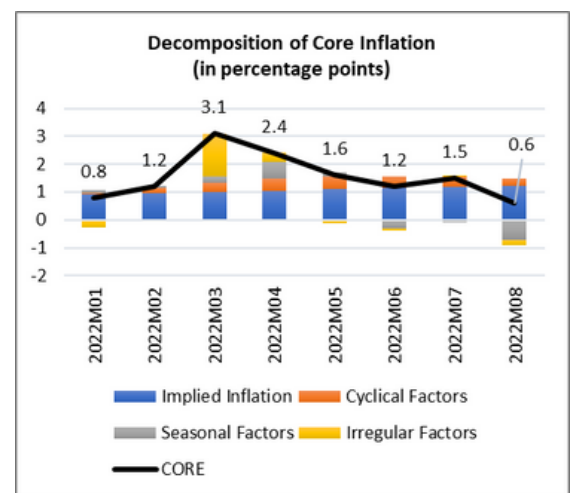
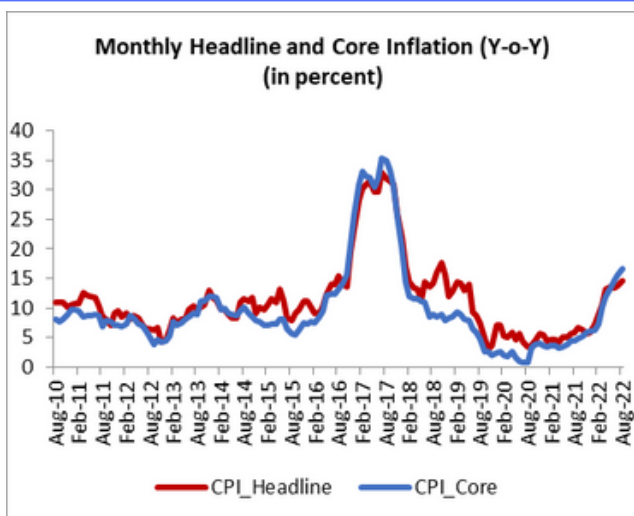
Source: CAPMAS.



Source: IHS Markit.

INFLATION DYNAMICS: INPUTS AND OUTPUT

- Urban headline inflation (Y-o-Y) increased in August to 14.6% up from 13.6% a month earlier. The monthly dynamics has been also accelerated by 0.9% in August compared to 0.1% during the corresponding month of 2021. Meanwhile, core inflation is still on the upward trajectory surging to 16.7% in August compared to 15.6% a month earlier. This has been accompanied by a monthly rate of 0.6% in August up from negative 0.3% in August 2021.
- Against this background, the August acceleration can be attributed to the materialization of the second-round effect of the supply-side shocks either from the external sources; primarily the disruptions in the global supply chains, or the internal sources emerged from the hike in the fuel prices took place in July.



Source: CAPMAS and CBE.

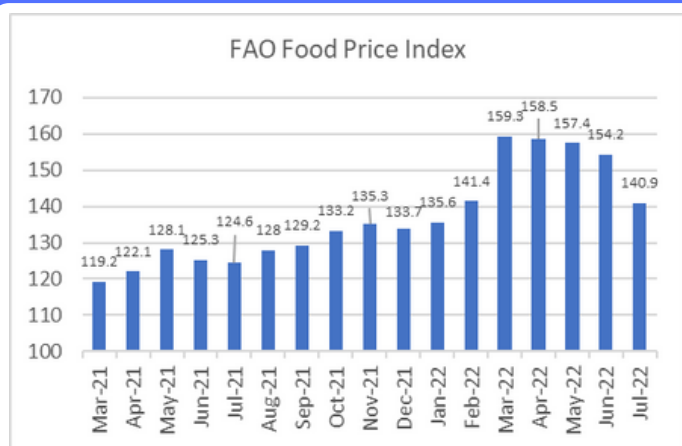
Source: MAP's Estimates, MPED.

INFLATION DYNAMICS: INPUTS AND OUTPUT

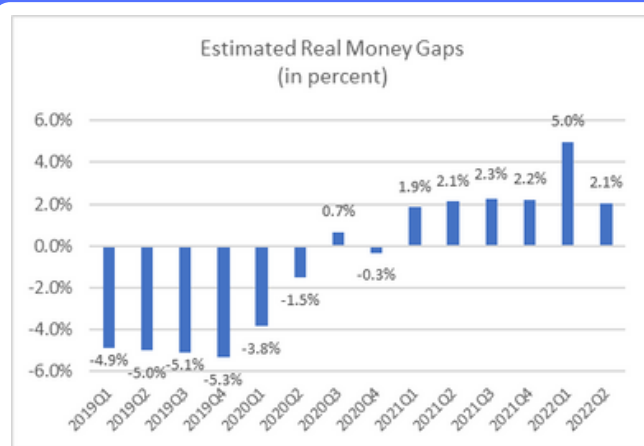
- **Sources of demand-driven inflation ...** The monthly dynamics for the period January-August 2022, indicates that core inflation has been on the downward trajectory, to record 0.6% in August, down from 1.5% a month earlier. Both implied inflation (inflation expectations) along with the cyclical factors (positive real money gaps) have contributed positively to monthly core inflation. Meanwhile, both seasonal factors and irregular factors have partially offset the increase in monthly rate. Seasonal factors are attributed to nil monthly inflation in the food group since some items witnessed a monthly deceleration such as the fruits (-8.3%), meat and poultry (-5.0%) and fish and sea food products (-1.0%) despite other items experienced an acceleration.
- Coming to the negative contribution of the irregular factor, this can be backed by two reasons:
- The eased international food prices index for the fifth month in a row,
- Recently, a softened movement in the EGP vis-à-vis USD. It can be easily observed that in March 2022, the irregular factor was the major contributor to the monthly core inflation on the back of strong pass-through effect.

INFLATION DYNAMICS: INPUTS AND OUTPUT

- Inflation upside and downside risks... In light of the recent economic dynamics, it is noticed that the main source of inflation emerged from domestic sources primarily the positive real money gaps which represent a forward-looking indicator for the inflationary pressures and has been manifested on a double-digit core inflation for five consecutive months.
- In the meantime, international upside risks on inflation through the commodity channel started to tame out in April 2022 and onwards as represented in the FAO food price index. It has softened since then supported by the eased cereal and vegetable oil prices, according to FAO.



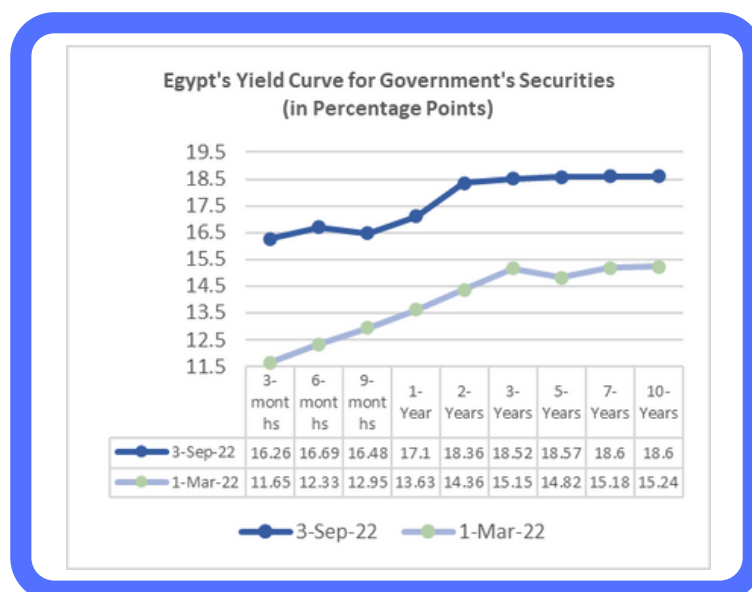
Source: FAO.



Source: MAP's Estimates, MPED.

EGYPT'S YIELD CURVE AND MONETRAY POLICY

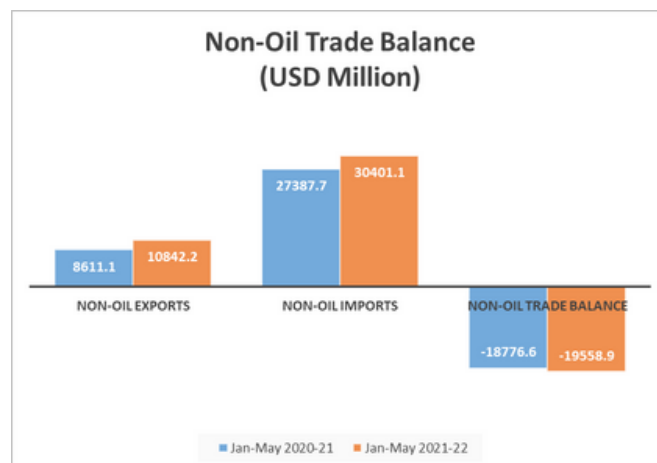
- The September yield curve is no longer with a normal convexity especially when one compares 10-years to 2-years yields. It started to show a flattened slope, which is usually a transitional signal for an inverted curve.
- Implications for the Monetary Policy... The short end of the curve reflects the monetary policy, knowing that a small movement in short term yields will compound into a larger movement in the long-term yields. Long term bonds are very sensitive to rate changes. In this context, the uncertainty over how much the CBE will continue to tighten monetary policy is flattening the curve, this time by short-term rates rising more than longer-term rates.
- Furthermore, for an investor, a flat yield curve means there is no immediate benefit to investing in a bond with higher maturity. Or there is no incentive for investors to invest in long-term securities or for the lender to lend for a longer duration.



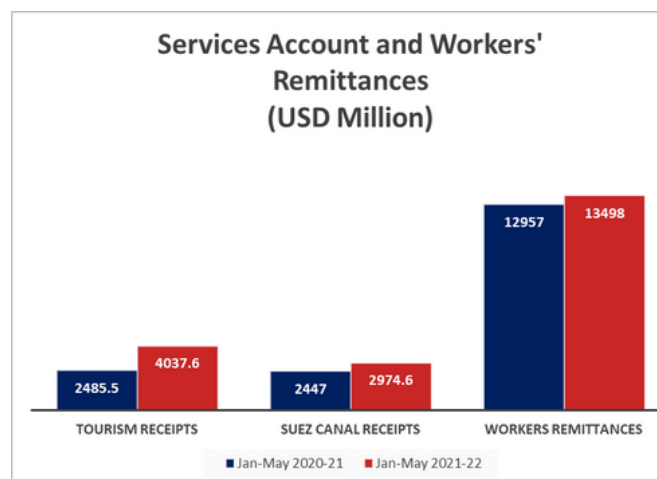
Source: World Government Bonds, accessed on September 03rd, 2022.

EXTERNAL SECTOR: CURRENT ACCOUNT COMPONENTS

- Non-oil trade deficit witnessed a slight pickup by about 4% during the period Jan-May 2022 compared to the corresponding period of 2021. This came on the back of higher growth of non-oil imports by 11%, nonetheless, this was partially offset by higher non-oil exports receipts by 26% during the period Jan-May 2022.
- Main components of services account revealed that despite the increase in the tourism receipts by about 62% during the period Jan-May 2022, yet the Russian-Ukrainian war has adverse externalities on the number of tourists coming from both countries.
- Coming to the workers' remittances, it experienced minor increase by about 4% during the period Jan-May 2022, in this context, statistics revealed that a surge in remittances occurred during March and April 2022, coinciding with Holy month Ramadan, also the issuance of the deposit certificates with 18% annual yield had a positive impact.



Source: CBE.



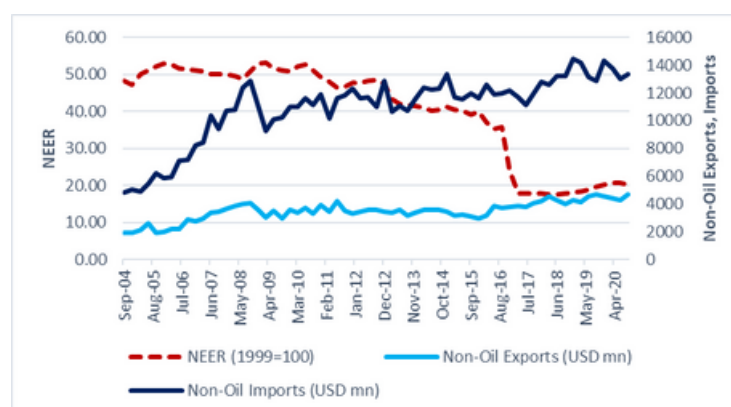
Source: CBE.

EXTERNAL SECTOR: CURRENT ACCOUNT COMPONENTS

- There exists a negative relationship between the Nominal Effective Exchange Rate (NEER) and both non-oil exports and imports. This implies that a depreciation in the Pound would be associated with an increase in both exports and imports, albeit with a minor magnitude that result in widened non-oil trade deficit. Also, the estimated elasticities revealed that that both non-oil exports and imports are relatively inelastic to nominal exchange rate movements.
- This can be partially justified by the underlying structural conditions in both exports and imports sectors, wherein the structure of the imports depends primarily on strategic goods that its demand will depend barely on the price movements. Moreover, it can be also attributed to inputs of production and raw materials that are essential for the production and export processes. It is true that the value of exports increases but this is associated with higher value of imports which increases the non-oil trade balance deficit.

| Estimated Elasticity | Correlation Coefficient (r) | |
|---|-----------------------------|-----------------------------------|
| -0.07 | -0.67 | Non-oil Exports Receipts and NEER |
| -0.03 | -0.60 | Non-oil Imports Receipts and NEER |
| Increase in Exports | | EGP Devaluation |
| Increase in Imports | | EGP Devaluation |
| MLC = Absolute (-0.07) + Absolute (-0.03) = 0.105 < 1 | | Marshall Lerner Condition |

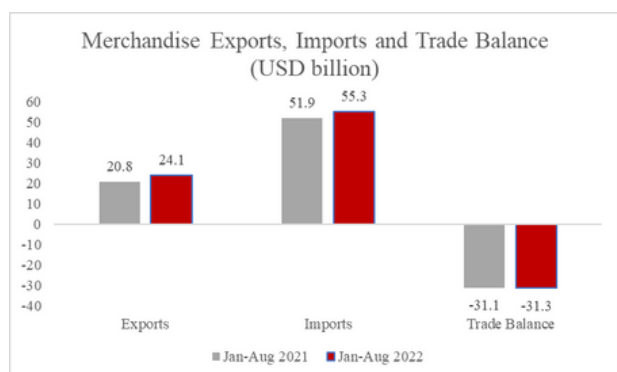
Source: MAP's Estimates, MPED and CBE.



Source: MAP's Estimates, MPED and CBE.

EXTERNAL SECTOR: TRADE BALANCE (JAN-AUG 2022)

- Trade deficit slightly widened to USD 31.3 billion during the period Jan-Aug 2022, compared to USD 31.1 billion during the same period of 2021. This came on the back of elevated merchandise imports by 6.6% to record USD 55.3 billion during Jan-Aug 2022. This has been partially mitigated by higher exports growth of 15.9% to reach USD 24.1 billion during the same period.
- Coming to the geographical distribution of exports, during the period Jan-Aug 2022, Emirates witnessed the highest growth by 46% followed by Britain and Italy with 38% each. As for the geographical distribution of imports, Brazil indicated a significant imports growth of 89%, also Egypt's imports from India experienced a large growth of 48% between Jan-Aug 2022 and corresponding period of 2021.



Source: General Organization for Exports and Imports Control (GOEIC).

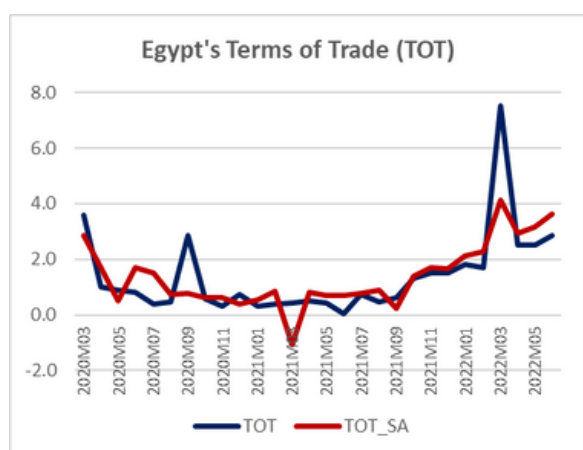
| Geographical Distribution of Exports (USD million) | | | | | | |
|--|---------------|--------------|-------|--------|----------|---------------------------|
| | United States | Saudi Arabia | Italy | Turkey | Emirates | Britain and North Ireland |
| Jan-Aug 2021 | 1510 | 1262 | 1135 | 1237 | 791 | 666 |
| Jan-Aug 2022 | 1662 | 1613 | 1566 | 1418 | 1155 | 920 |
| Growth Rate | 10.1 | 27.8 | 38.0 | 14.6 | 46.0 | 38.1 |

| Geographical Distribution of Imports (USD million) | | | | | | |
|--|-------|---------------|-------|---------|--------|--------|
| | China | United States | India | Germany | Brazil | Turkey |
| Jan-Aug 2021 | 8669 | 3672 | 1859 | 2798 | 1334 | 2253 |
| Jan-Aug 2022 | 9924 | 4555 | 2743 | 2712 | 2517 | 2499 |
| Growth Rate | 14.5 | 24.0 | 47.6 | -3.1 | 88.7 | 10.9 |

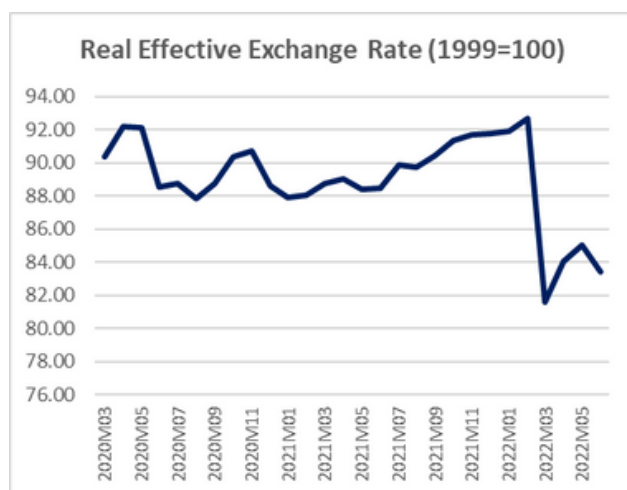
Source: General Organization for Exports and Imports Control (GOEIC). Calculated.

EXTERNAL SECTOR: TERMS OF TRADE AND REER DYNAMICS

- One implication for the elevated domestic prices is the upward sloping terms of trade, in other words price of exports exceeds the price of imports since October 2021 with a spike in March 2022. Coming to the REER developments, despite higher TOT in March, it has been observed that the devaluation of 16% in the EGP took place in March 2022, has pulled the REER downwards implying improved competitiveness in favor of the Egyptian economy. This needs to be reflected on the real volumes of both exports and imports in the near future, i.e. the economy would reap the fruits of the devaluation steps in terms of better trade balance, consequently lower current account deficit.
- Nevertheless, the Egyptian Pound has proved to be counter-cyclical. in the sense that a positive income shock in a country deteriorates the current account, the adjustment occurs through a devaluation of the currency (i.e., the currency depreciates in good times). It occurred that the average growth rate during the last ten years (2012-2022) to be 4%, associated with an average nominal depreciation of 13% during the same period. As such, the competitiveness of the Egyptian economy cannot be attained through devaluation, rather this can be achieved through anchored inflation dynamics and maintaining reasonable inflation differentials with the main trading partners.



Source: General Organization for Exports and Imports Control (GOEIC). Calculated.



Source: MAP's Estimates, MPED, CBE, IFS and FRED databases, Calculated.