



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.

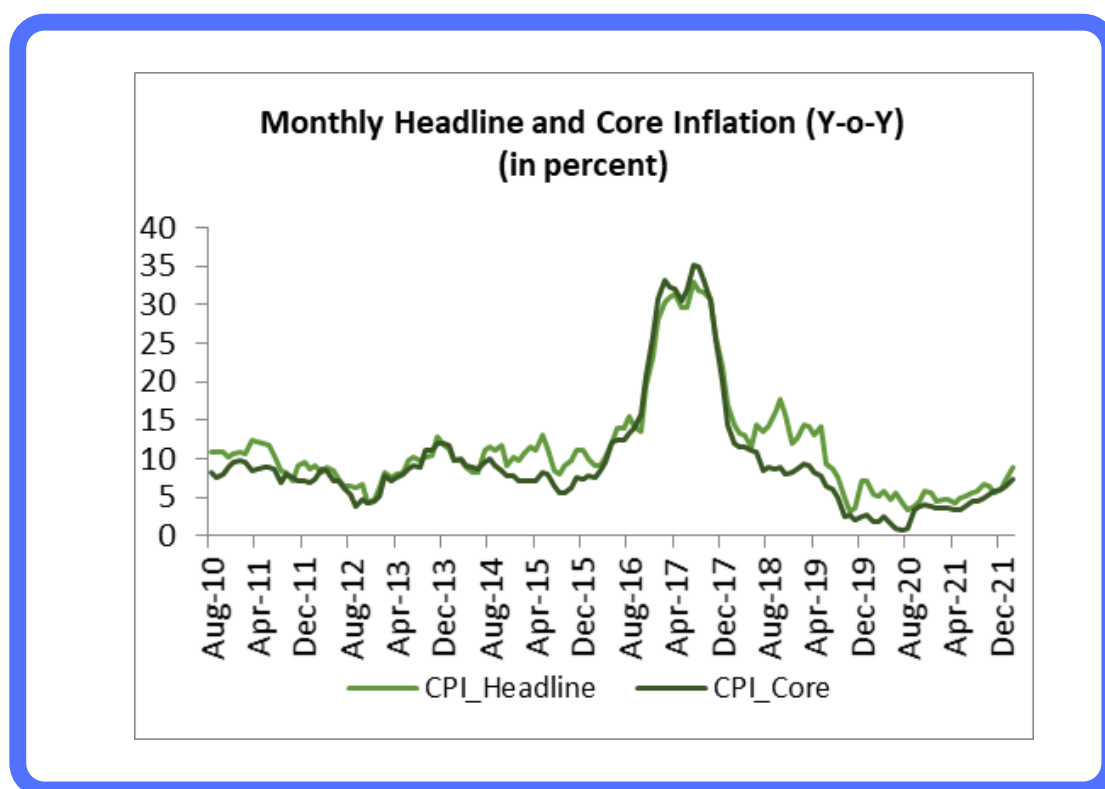
MARCH'S HIGHLIGHT

- In February 2022, urban headline inflation (Y-o-Y) inched up to register 8.8%, compared to 7.3% a month earlier. Meanwhile, core inflation accelerated in February to record 7.2% (Y-o-Y) compared to 6.3% a month earlier, which is the highest rate in 34 months ago.
- In light of the Russian-Ukrainian conflict, it is projected that the wheat and grains prices will increase by 10%-20% in the aftermath of this crisis. Adding to that, the price hike in the international oil prices that reached 122.3 USD/barrel, after it was below the 100 USD/barrel before the crisis. Also, the international wheat price surged to USD 13.4/bushel during March 2022.
- It can be observed that FOREX receipts have relatively restored back its historical levels pre-pandemic period during the first three quarters of 2021. This can be attributed to the gained momentum in the exports proceeds and the portfolio investments backed by strong carry-trade agreements.



PRICES DYNAMICS

- Urban headline inflation (Y-o-Y) inched up to register 8.8% in February, compared to 7.3% a month earlier. The monthly dynamics showed an increase of 1.6% in February compared to 0.9% in the previous month. Meanwhile, core inflation accelerated in February to record 7.2% (Y-o-Y) compared to 6.3% a month earlier. This came on the back of higher m-o-m rate of 1.2% in February 2022, compared to 0.8% a month earlier, which is the highest rate in 34 months ago.
- February's dynamics indicate that the monthly core inflation is on the upward trajectory, emerging from higher factors across the board. This can be attributed to higher implied inflation or inflation expectations indicating that the market expects higher inflation in the short- to medium- terms. Also, irregular factor has reversed from negative to positive this month reflecting unfavorable pass-through effect.



Source: CAPMAS and CBE.

RUSSIAN-UKRAINIAN CONFLICT SPILLOVERS

- The recent Russian-Ukrainian war has its anticipated repercussions on the world in general and on the Egyptian economy in particular. More than half of the domestically consumed wheat is imported from abroad and about 60% of the wheat imports come from Russia and Ukraine.
- It is projected that the wheat and grains prices will increase by 10%-20% in the aftermath of this crisis. Adding to that the price hike in the international oil prices that reached 122.3 USD/barrel, after it was below the 100 USD/barrel before the crisis. Also, the international wheat price surged to USD 13.4/bushel during March 2022.
- Such developments would have its spillovers on the domestic currency affected by the retreatment in the Russian and Ukrainian tourists who are recently discouraged to visit Egypt after the instability witnessed in their home countries.
- On top of that, the financing gap is expected to widen, that would put some pressure on Net Foreign Assets (NFAs), which started to diminish clearly during the last couple of months.

RUSSIAN-UKRAINIAN CONFLICT SPILLOVERS

- Most of the domestic variables indicate no inflationary pressures, however, in light of the recent international dynamics, the source of inflation emerged mainly from global developments. Both output gap and money gap are in the negative territory for at least five consecutive quarters. This implies no inflationary pressures from the domestic fundamentals.
- Thus, commodities channel and inflation are the key risk on the Egyptian economy. Egypt raised the gasoline price via the indexation mechanism by 25 piasters earlier in February 2022 to narrow the gap between domestic and international prices.
- Regarding the wheat, Egypt imports approximately 13 tons per annum at a cost of around USD 4.5 billion. It is expected that for every 10% increase in its price, an additional USD 230 million or 0.1% increase of GDP will be occurred (Goldman Sachs, February 2022). This would represent pressure on the fiscal accounts given bread subsidies.

Headline inflation forecasts for FY2021/22- FY2022/23

The forecasts at hand represent three scenarios with different assumptions:

Scenario 1:

- Producers pass-through effect of 10% increase in the Wheat and Oil prices
- No Action from the CBE

Scenario 2:

- Producers pass-through effect of 10% increase in the Wheat and Oil prices
- CBE decide to increase interest rate by 100 basis points

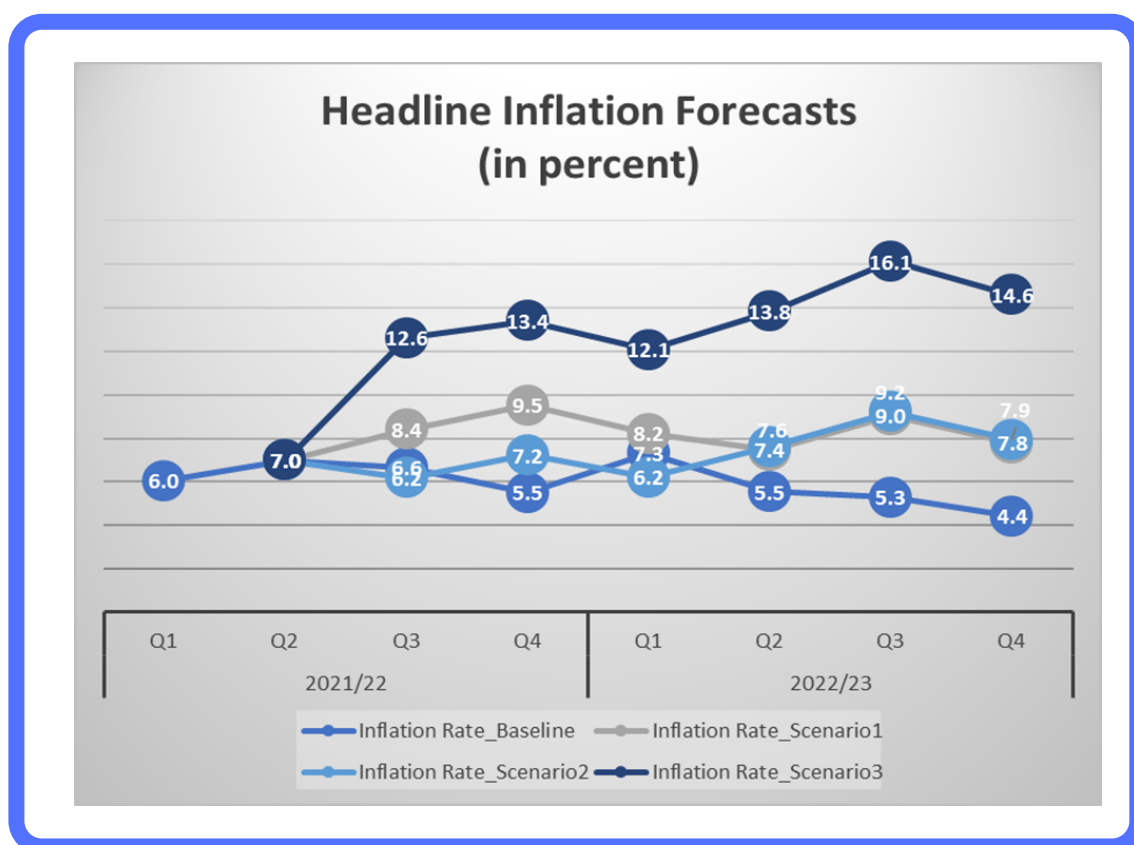
RUSSIAN-UKRAINIAN CONFLICT SPILLOVERS

Scenario 3:

- Producers pass-through effect of 20% increase in the Wheat and Oil prices
- CBE decide to increase interest rate by 100 basis points

The assumptions entail the intervention of the CBE to have a tightening cycle to tame the inflationary pressures and to anchor the inflation expectations that are expected to surge if no adequate actions are taken on time.

According to the baseline scenario, it is still expected that urban headline inflation will be maintained during FY2021/22 at a single digit, albeit it will increase to reach 7.7% based on scenario 1. However, this will decline to only 6.6% if the CBE interferes by a tightening action (scenario 2).



Source: MAP's Estimates.

EXTERNAL DEBT SUSTAINABILITY (IMF FRAMEWORK)

- To get more insights about the sustainability analysis, MAP unit replicated the analysis using IMF debt sustainability framework to come up with the Heat Map for Egypt's debt.
- The analysis includes two Vector Error Correction Models (VECMs), to get the impulse response functions for both the primary balance and the debt level. The time spans from Q2 2009 through Q4 2019.
- The results are economically intuitive and revealed that the accumulated response of primary balance-GDP to total debt-GDP is negative, implying that whenever debt level increases, the primary balance goes down. GDP has a positive impact on the primary balance, and both exchange rate and real treasury bills have negative impacts on the primary balance.

Variance Decomposition					
Period After	P_Balance_GDP	TOTAL_DEBT_GDP	RGDP	EX_RATE	REAL_TBILLS
One Quarter	100.0	0.0	0.0	0.0	0.0
First Year	89.8	2.0	5.5	2.2	0.4
Second Year	72.6	9.4	11.3	5.9	0.8
Third Year	63.1	10.6	16.5	8.7	1.0
Fourth Year	57.8	14.8	17.2	9.1	1.1
Fifth Year	56.1	14.9	17.4	10.4	1.2

Source: MAP's Estimates.

EXTERNAL DEBT SUSTAINABILITY (IMF FRAMEWORK)

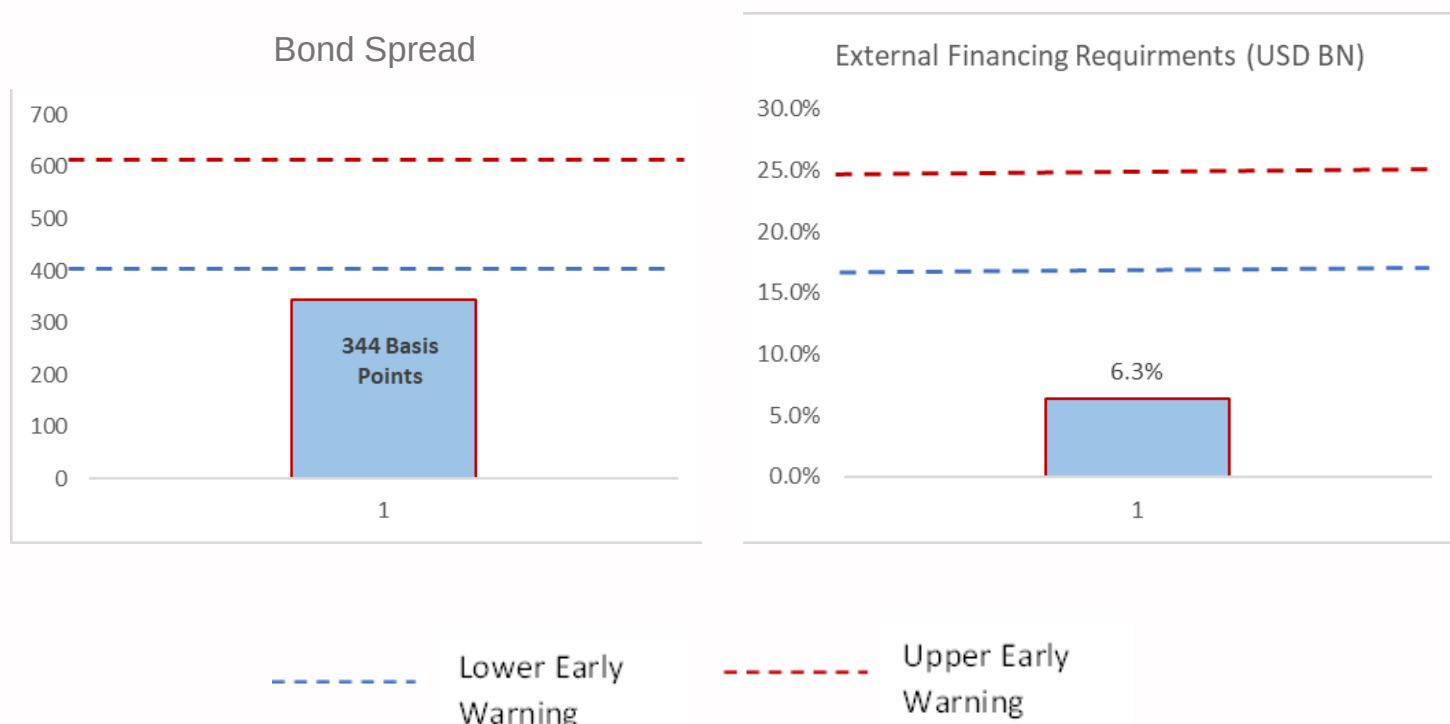
- The same exercise has been implemented on the debt-level instead of the primary balance and it concluded that both primary balance and exchange rate have negative impacts on the debt level.
- Moreover, the positive shock in the real treasury bills resulted in a higher debt level, this conclusion is economically reasonable given the fact that higher interest rates imply higher debt service. In the meantime, GDP appears to be statistically insignificant, suggesting that economic activity shock has no effect on the debt level especially in the short-term.

Variance Decomposition					
Period After	DEBT_LEVEL	P_BALANCE	RGDP	REAL_TBILLS	EX_RATE
One Quarter	100.00	0.00	0.00	0.00	0.00
First Year	86.77	2.73	0.17	6.72	3.62
Second Year	85.29	3.82	0.19	6.07	4.63
Third Year	84.87	4.16	0.17	5.72	5.07
Fourth Year	84.67	4.34	0.17	5.54	5.29
Fifth Year	84.55	4.44	0.16	5.43	5.42

Source: MAP's Estimates.

EXTERNAL DEBT SUSTAINABILITY (IMF FRAMEWORK)

- Regarding the debt profile vulnerabilities, which includes both the country's bond spread profile and the external financing requirements, Egypt appears with a good and acceptable profile for these two indicators. Both indicators are below the safe thresholds, implying that Egypt is in the green region concerning the bond spread and the financing needs gap.
- It is worth to note that the bond spread has increased from 150 basis points in June 2021, to 344 basis points in December 2021, yet it is still below the lower early warning threshold.



Source: MAP's Estimates.

TOTAL FOREX RECEIPTS

- It can be observed that FOREX receipts have relatively restored back its historical levels pre-pandemic period during the first three quarters of 2021. This can be attributed to the gained momentum in the exports proceeds and the portfolio investments backed by strong carry-trade agreements.
- As a result of the anchored inflationary pressures during the last couple of years, the Egyptian economy enjoys a positive real interest rates that attract the foreign investors given a strong interest rate differential in favour of the Egyptian economy.

in USD million	Total	Total	Total
	2019	2020	Q3 2021
Exports Proceeds	28,472	25,049	24,605
Suez Canal Dues	5,835	5,671	4,702
Travel (tourism revenues)	13,030	4,398	5,910
Remittances of Egyptians Working Abroad	26,781	29,603	16,735
Direct Investment in Egypt (net)	8,020	5,852	3,522
Portfolio Investment in Egypt (net)	10,394	2,588	12,135
Total of FOREX Receipts	92,533	73,160	67,609
Monthly Average	7,711	6,097	7,512

Source: Central Bank of Egypt.

SUMMARY AND FUTURE PROSPECTS

- Although that Egypt's economic fundamentals are indicating a resilient status-quo, the growing international developments and the Russian-Ukrainian conflict would possess sizable challenges to the world, including Egypt.
- The Government of Egypt is making a great effort to meet the citizens' needs through set of measures that guarantee the social protection. As such, the recent measures taken to expand targeted social protection and to implement exchange rate flexibility are essential steps to mitigate the repercussions of the international dynamics. Continued exchange rate flexibility will be essential to absorb external shocks and safeguard financial buffers during this uncertain time.
- Prudent fiscal and monetary policies will also be needed to preserve macroeconomic stability. In this context, the Central Bank of Egypt has intervened on 21st of March to increase interest rate by 100 basis points to control inflation expectations as a crucial step in preserving the macroeconomic stability.

LOOKING AHEAD, THE EGYPTIAN ECONOMY REMAINS COMPETITIVE AND SUPPORTED BY WELL-SEQUENCED AND COORDINATED STRUCTURAL REFORMS DESPITE THE REMAINING RISKS OF GLOBAL COVID-19 UNCERTAINTY AND THE RUSSIAN-UKRAINIAN CONFLICT. FISCAL AND MONETARY POLICIES WILL CONTINUE TO SUPPORT THE RECOVERY WHILE PRESERVING MACROECONOMIC STABILITY. STRUCTURAL REFORMS WILL ADDRESS POST-PANDEMIC CHALLENGES, STRENGTHEN BUFFERS, MEET THE FINANCING NEEDS, BOOST THE REAL SECTOR, AND CREATE MORE RESILIENT AND DIVERSIFIED ECONOMY.