



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. It 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.

AUGUST'S HIGHLIGHT

- An increase in the monthly Headline Urban Inflation (Y-o-Y) and the monthly core inflation to record **5.4%** in July 2021, compared to **4.9%** in June 2021 and **4.6%** (Y-o-Y) compared to **3.8%** in June respectively.
- September's Yield Curve is clearly higher than that of August, recorded a spread of **2.16 percentage points** which is also higher than the spread of six months ago which registered **1.72% points**.
- The last 11 months witnessed a **positive money gaps** which implies that there is a underlying inflationary pressures that can materialize in the the shot-term.
- **Egyptian industrial sector:** Issuing a law facilitating the procedures for granting industrial licenses and issuing its executive regulations. In addition to issuing the executive regulations of the Law of Preferring Egyptian Industrial Products in Government Contracts no. 5 for 2015.



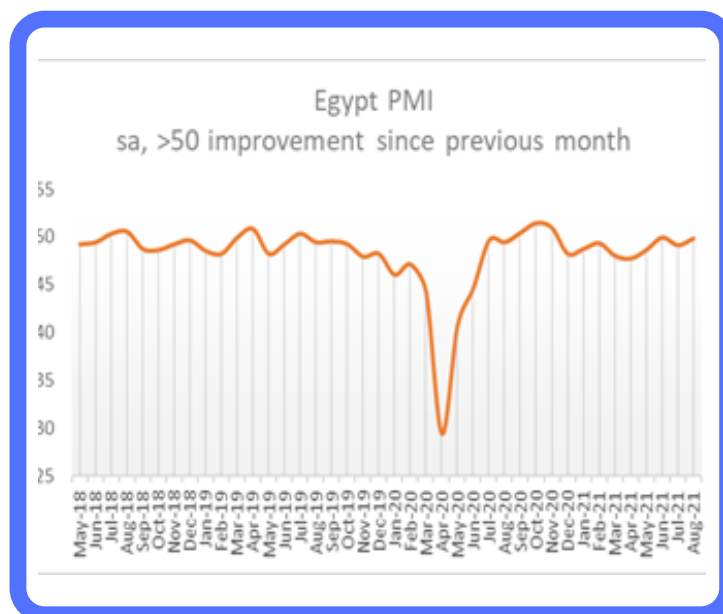
REAL SECTOR: PMI

- IHS Markit Egypt headline Purchasing Managers' Index (PMI) posted 49.8 in August 2021, compared to 49.1 a month earlier. Rising demand and inflationary pressures drive record increase in purchasing activity in August.
- While still in contraction territory, the PMI masked renewed upticks in output and new orders in August to suggest that businesses had taken further steps to recover from the COVID-19 pandemic. Panelists widely pointed to a rebound in market activity and an increase in tourism numbers as travel reopened. As a result, employment levels rose for the second month running. All three indices remained close to the 50.0 neutral threshold in August, suggesting that growth rates were only marginal.
- Input prices registered an increase to the highest level in exactly two years, the marked rise in input prices was passed on to consumers to a much greater extent than in July, as firms reported efforts to improve their profit margins. Notably, output charge inflation accelerated to the fastest since August 2018. As well as increasing commodity prices, firms noted that rises in transport costs and customs fees led them to mark up their charges
- Going forward, with a second phase of economic recovery taking shape, over half of all surveyed firms projected output to grow over the next 12 months, linked to expected improvements in demand and capacity.



49.1
points
July 2021

49.8 points
August 2021



Source: IHS Markit

MONETARY SECTOR: INFLATION

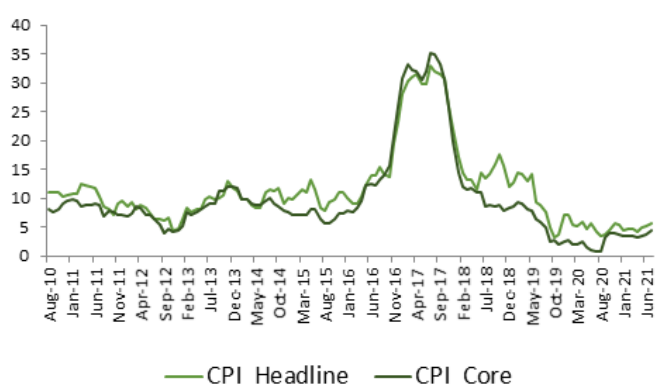
- Monthly headline urban inflation (Y-o-Y) inched up to 5.4% in July 2021, from 4.9% a month earlier. The acceleration is driven primarily from the monthly developments accounted for 0.9% in July 2021, compared to 0.4% in the same month of the previous year. Meanwhile, core inflation accelerated in July to record 4.6% (Y-o-Y) compared to 3.8% in June. This came on the back of higher m-o-m rate of 0.6% in July 2021, compared to negative 0.1% during the same month of the previous year.
- Coming to sources of core inflation, during July 2021, the decomposed series shows that the main source which fuels monthly core inflation is mainly attributed to irregular factors accounting for 0.38 percentage points out of 0.6%, which can be backed by the first round of supply shock related to energy price hikes. This is followed by the cyclical effect accounting for 0.20 percentage points which can be attributed to higher economic activity during this period. This can be supported by the positive money gaps that prevail during 11 consecutive months. This implies the likely existence of underlying inflationary pressure in the near future, consistent with global expectations of rising price levels post COVID. As such, these dynamics would put upside risks for the Central Bank and would induce it to hike interest rate in the upcoming one or two MPC meetings.



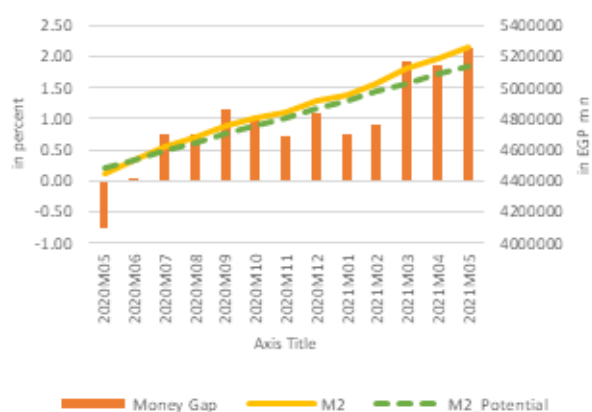
5.4%
Headline
Inflation

4.6%
Core
Inflation

Monthly Headline and Core Inflation (Y-o-Y)
(in percent)



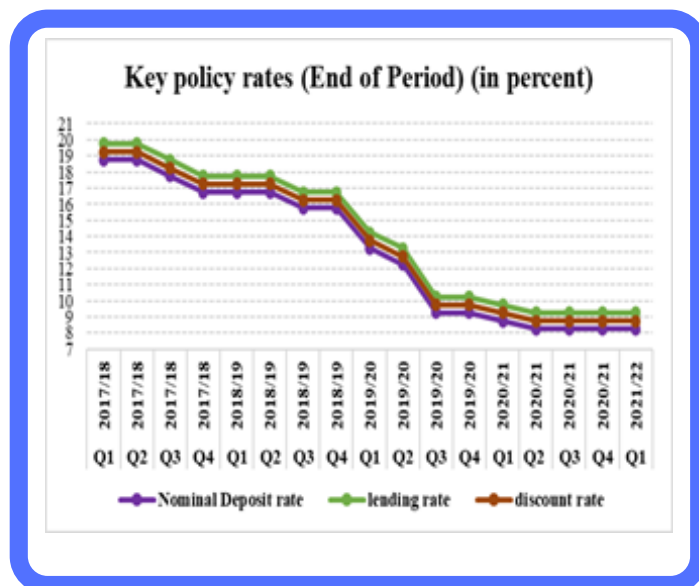
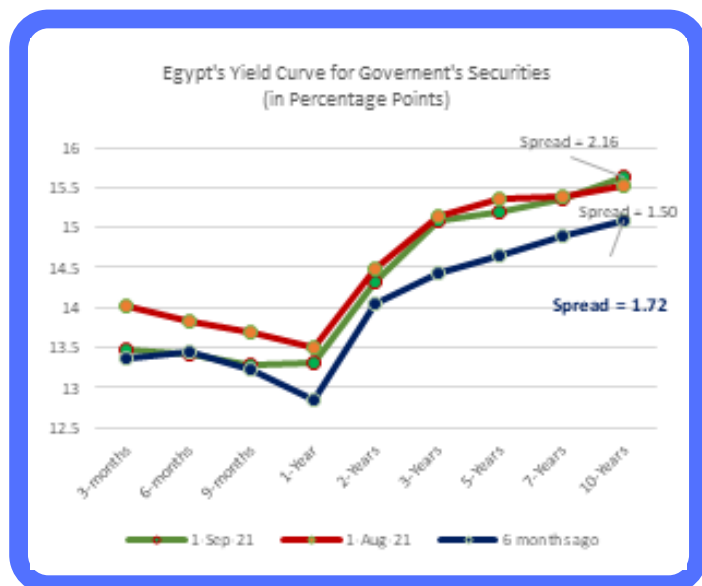
Domestic Liquidity Gap and Inflationary
Pressures



Source: MAP's Estimate, Ministry of Planning and Economic Development, CAPMAS and CBE.

MONETARY SECTOR: YIELD CURVE

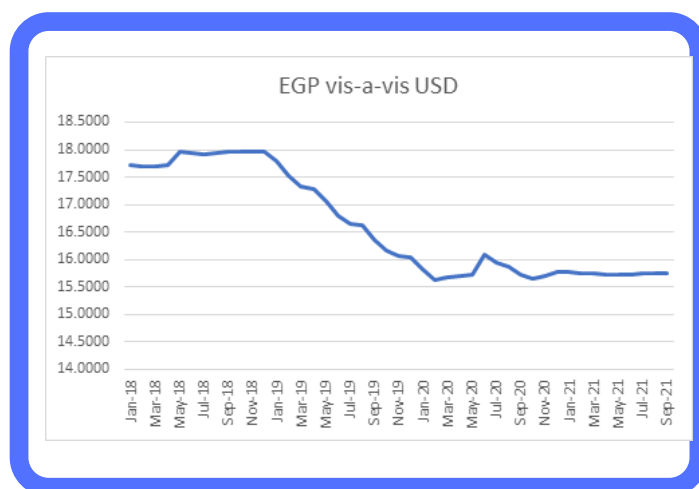
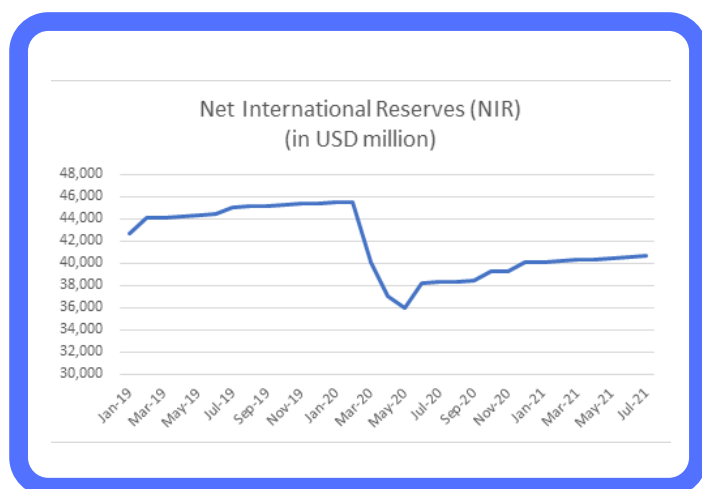
- Yield curve Implications for the Monetary policy...the short tail of graph below highlights that, September 2021 curve becomes clearly upward sloping and it is obviously lower than one month ago curve. This implies that the market anticipates remarkable decline in the interest rates in the short- to medium- terms.
- It is worth to mention, for the long tail, that the same projections as the previous month still prevail, since there is a coincidence between the August and September curves especially for the long tail. such dynamics have some implications for the monetary policy, CBE is expected to ease its policy sooner. Moreover, higher interest rates mirror the existence of market expectations of higher inflation in the short term accompanied by higher growth rates.



Source: World Government Bonds, accessed on September 01st, 2021 and CBE.

EXTERNAL SECTOR: NET INTERNATIONAL RESERVES

- The CBE (Central Bank of Egypt) announced that Egypt's net foreign reserves have risen marginally in July 2021 to reach USD 40.61 bn versus USD 40.58 bn in June 2021. The slight rise was due to an increase in the value of the gold component of the reserves. Foreign reserves have been rising since June 2020, after the initial shock phase at the onset of the Covid pandemic had passed.



Source: CBE.

FISCAL SECTOR: EFFICIENCY AND EFFECTIVENESS

- In analyzing the impact of the fiscal policy on the economic activity, it is important to mention the fiscal multiplier as a good measure for the effect of the additional government spending on the levels of income in a particular economy.
- In order to estimate the fiscal multiplier, it is not considered a bi-variate relationship, however, the relationship entails some economic interrelations by addressing a set of macroeconomic variables that can draw the Egyptian economy.
- The utilized model includes the real GDP as the variable of interest being a function in real government consumption, nominal exchange rate, treasury bill rate and the degree of economic openness (measured as summation of exports and imports to GDP).
- The methodology adopted a multiple regression to come up with the long-run estimated coefficients, afterwards Structural Vector Autoregression (SVAR) and impulse response functions are applied to get more insights about short-run dynamics and the time horizon of the multiplier effect of a fiscal shock on the real output.
- The fiscal multiplier captures the long-term impact on GDP, generated by changes in fiscal aggregates proxied by the total government spending. As shown, it is estimated to be approximately 0.91 which reflects that with every 1 EGP that the government spends, it will affect the GDP by 0.91. All the variables used in the model are significant, except the treasury bills rate and exchange rate.
- It is worth to note, that previous estimates for the fiscal multiplier has shown that it was just 0.66. The estimation time spanned from 2001:Q3 till 2018: Q2. However, the new dataset spans from 2001:Q3 through 2020:Q4. Such finding suggests that over the last two years, public spending reflects more efficiency, in which the fiscal multiplier jumped from 0.66 to 0.91.

Sample: 9/01/2001 12/01/2020

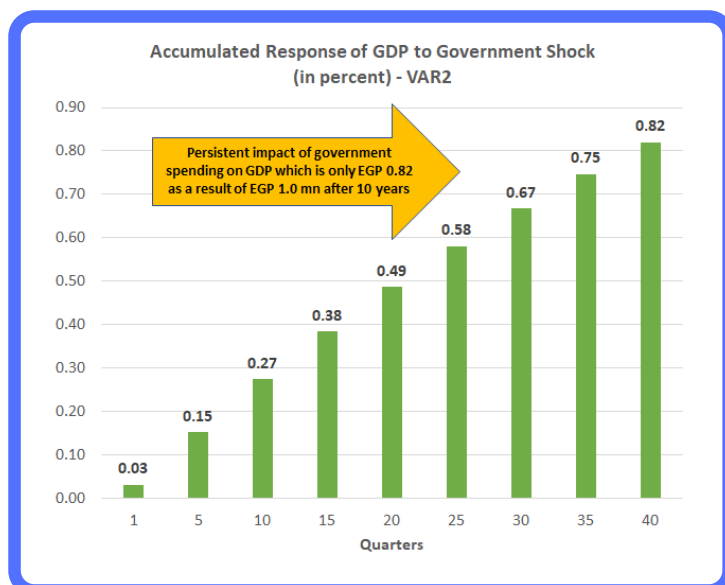
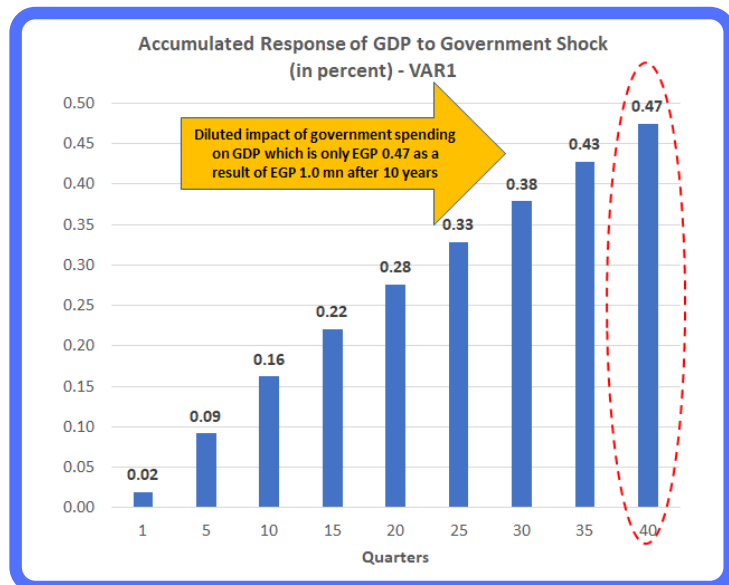
Included observations: 78

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LEX	0.00	0.04	0.03	0.98
LOPENNESS	0.13	0.04	3.60	0.00
LPC	0.91	0.07	12.31	0.00
LTBILLS	0.04	0.06	0.64	0.53
C	2.40	0.14	16.79	0.00
R-squared	0.90	Mean dependent var		4.96
Adjusted R-squared	0.89	S.D. dependent var		0.24
S.E. of regression	0.08	Akaike info criterion		-2.15
Sum squared resid	0.47	Schwarz criterion		-2.00
Log likelihood	88.78	Hannan-Quinn criter.		-2.09

Source: MAP's Estimations.

FISCAL SECTOR: EFFICIENCY AND EFFECTIVENESS

- The level of trade openness has a positive effect on real GDP as expected. However, the trade impact on real GDP is only 0.13 as it mirrors the rigidity of exported and imported volumes in Egypt over the studied period and their inelasticity to exchange rate's variations. This finding is supported by the statistical insignificant nominal exchange rate.



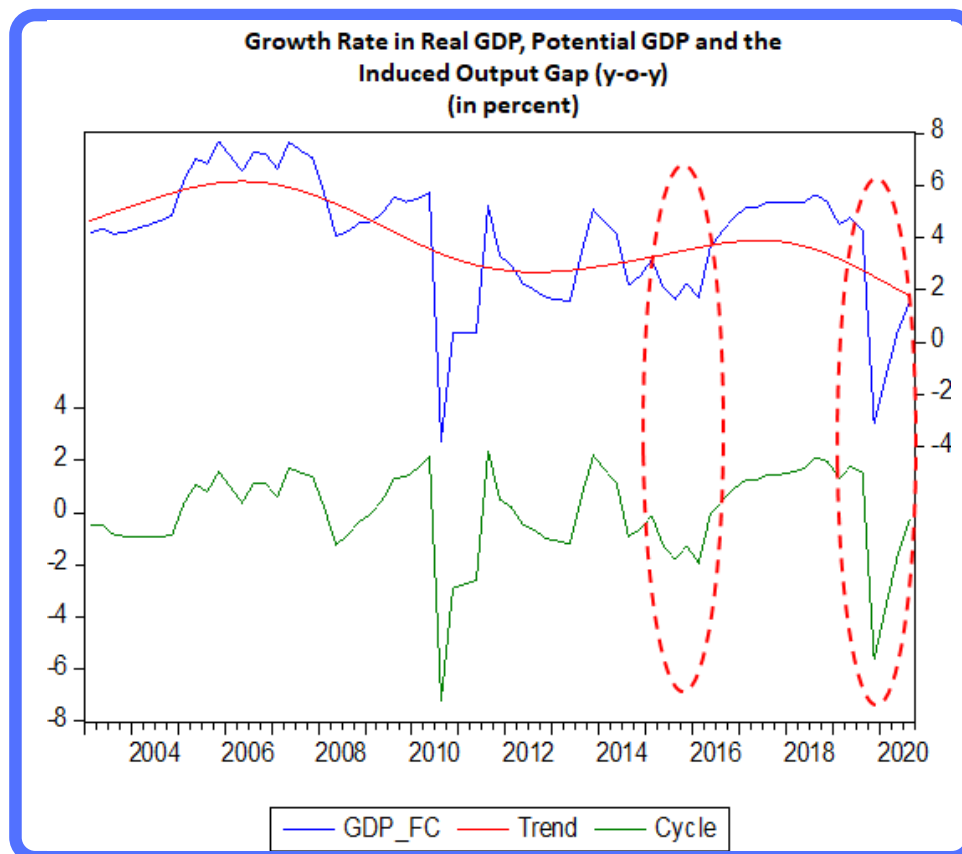
Source: MAP's Estimations.

- Generally, fiscal multiplier is defined as the ratio of a change in output (ΔY) to a discretionary change in government spending (ΔG). The fiscal multiplier basically measures the short-run effect.
- In an attempt to have more understanding about the time horizon of the fiscal multiplier in Egypt, empirical evidence indicates that the short-run impact multiplier, which is usually defined as the multiplier in the first quarter following the change in spending is very low. However, the impact of a 1% shock in government spending materializes in the medium- to long-terms and increases gradually over time to register about 0.30 after 5 years. Moreover, the long-run multiplier reaches its full impact of 0.47 after 10 years of the policy change.
- Another VAR model specification has been implemented because the impact of the public spending on GDP was diluted by including more macro-variables. Thus, a Bi-variate VAR was estimated, and the following has been concluded:
 - The **short-run impact multiplier**, which is usually defined as the multiplier in the first quarter following the change in spending is very low.
 - However, the impact of a 1% shock in government spending materializes in the medium- to long-terms and increases gradually over time to register 0.50 after 5 years.
 - Moreover, the **long-run multiplier** reaches its full impact of 0.82 after 10 years of the policy change.
- The second VAR model gives more reasonable result, because according to the multiple regression, it has been estimated that the long-run impact of public spending on GDP is 0.91, which has been underestimated by the first VAR model.
- However, the long run impact of the second VAR (after 40 quarters or equivalently after 10 years), the magnitude is estimated to be 0.82, which is close to 0.91 estimated coefficient.

FISCAL SECTOR: EFFICIENCY AND EFFECTIVENESS

IMPLICATIONS: MULTIPLIER AND BUSINESS CYCLE

- According to the literature, the impact of government spending on real GDP is highly sensitive to the phase of the economic cycle; the multiplier is relatively larger during an economic downturn and the recession period as the economy witnessed a negative output gap.



Source: MAP's Estimations.

- It is crucial to highlight that the time scope used to study this empirical relationship has witnessed serious economic shocks and policy fluctuations. The economic downturn resulted from the spillovers of COVID-19, has put the economic growth on the downward trajectory especially during 2020. In addition, the adoption of the reform program supported by the IMF in 2016 till 2018 accompanied by important economic decisions such as the exchange rate liberalization.
- During these episodes of economic recessions and prudent measures, the government's role is to intervene economically to boost growth, through stimulus packages and higher government expenditures, in order to increase GDP which is reflected in higher magnitude of fiscal multiplier, especially in the long-run. Therefore, this coefficient estimated at a range of 0.82 - 0.91 reflecting the government's impact on GDP during economic recessions.



The remarkable interest had the greatest impact in achieving qualitative leaps and developments in the Egyptian industrial sector.

The most important decisions related to the industrial sector were as follows:

- Issuing a law facilitating the procedures for granting industrial licenses and issuing its executive regulations.
- Issuing the executive regulations of the Law of Preferring Egyptian Industrial Products in Government Contracts no. 5 for 2015, which obliges the concerned authorities to contract on local products, prepare a guideline on the law and its executive regulations, distribute it to producers and manufacturers and make it available on electronic means to introduce their provisions.
- Issuance of the Industrial Development Authority Law no. 95 for 2018 and its Executive Regulations, which made the Industrial Development Authority a public economic authority with an independent legal personality affiliated with the Ministry of Industry, which allows it to regulate industrial activity and grants it the sole authority to issue licenses and allocate and annex industrial lands in Egypt.
- Issuing a decision to amend some provisions of the executive regulations of Law No. 24 of 1977 concerning the industrial registry, including canceling the temporary industrial registry, and allowing the issuance of a conditional industrial registry to ensure the seriousness of the project in accordance with the new industrial licensing law and contribute to confronting the phenomenon of manufacturers importing production requirements for the purpose of trade.

The "Industrial Establishments" Law defines the controls for the work of accreditation offices and their role regarding licenses

The Law to Facilitate Licensing Procedures for Industrial Establishments included controls for the work of accreditation offices and licensing service companies, as follows:

- 1- The license applicant may entrust the examination of the documents related to the establishment, management or operation of the industrial facility and determining their compliance with the necessary requirements and other procedures stipulated in the provisions of this law to the licensed accreditation offices.
- 2- The accreditation offices that have the necessary expertise to practice this activity shall be licensed in accordance with the conditions, rules and procedures issued by a decision of the competent minister, including the cases in which an annual insurance policy must be concluded to cover the risks and damages resulting from the activities carried out by these offices and the basis for determining a consideration the services you provide.





The law of preference for local products in government contracts is one of the government's means through which it seeks to increase reliance on the national industry in the face of import.

- It is Law No. 5 of 2015 regarding the preference of Egyptian products in government contracts. The law sets a clear definition of the product that meets the percentage of the Egyptian industrial component, as every industrial product in which the percentage of the local component exceeds 40% of the cost of the product, and the percentage of the industrial component is calculated by deducting the value of the imported components from the cost of the product.
- The certificate indicating that the percentage of the Egyptian industrial component has been satisfied is issued by the Federation of Egyptian Industries, after being approved by the Industrial Development Authority, or the Information Technology Industry Development Authority for software products and related applications, and that in accordance with the rules and procedures set forth in the executive regulations.
- ***Egyptian Product Preference Committee*** is a committee in the Federation of Industries with these shares and it communicates with manufacturers, and it is a committee affiliated to the Council of Ministers. A decision was issued to establish it in 2021 with complaints of non-compliance with the application of the law.



FUTURE PROSPECTS

- The Egyptian economy is one of the few emerging market countries that experienced a positive growth rate in 2020 and beyond. This came on the back of the government's prudent and prompt policy response, coupled with the IMF support. The Egyptian economy showed resilience in the face of the pandemic.
- The pandemic resulted in a sudden stop in tourism as well as significant capital outflows, with more than \$15 billion of portfolio outflows during March-April 2020 as investors pulled out of emerging markets in a flight to safety. The authorities' proactive and comprehensive measures in response to the crisis helped mitigate the health and social impact while ensuring macroeconomic stabilization, safeguarding debt sustainability, and preserving investor confidence.
- In this context, Egypt entered the COVID-19 crisis with sizable buffers, thanks to the reforms implemented since 2016 to restore macroeconomic imbalances. As a result, the GoE was able to quickly respond with a comprehensive support package while preserving economic stability. In this context, government efficiency has inched up during the previous two years in which fiscal multiplier has jumped from 0.66 to 0.91.
- Moreover, Egypt's medium-term outlook remains strong despite the temporary interruption to the growth momentum and potential scarring from the pandemic. The authorities' medium-term objective remains focused on achieving not only high but also inclusive growth to create jobs and ensure decent living standards for Egypt's young and rapidly growing population. Post-COVID-19 realities also highlight the need to strengthen healthcare and social safety nets and ensure a resilient economy. However, this will require diversifying from the current private-consumption-led growth and increasing contributions from other sources such as private investment and exports.
- External market conditions have also remained favorable in 2021. In February, the authorities accessed international bond markets for the third time since March 2020, with a \$3.75 billion Eurobonds at 5-, 10-, and 40-year maturities, while nonresident holdings of local currency debt reached a new peak of \$29 billion in April.
- Tourism receipts are expected to remain subdued as travel restrictions in many key tourist markets remain in place, although the expected resumption of direct flights from Russia in the summer to resorts in the Red Sea for the first time since 2015 provides possible upside to the outlook. According to the IMF, the FY2021/22 current account balance is projected at -3.6 percent of GDP (in house projections are estimated at -3.7%), lower than the projection at the first review, reflecting less import compression as the economy recovers.
- Structural and legislative measures are taken to improve business environment and enhance the role of the private Sector. These measures come in the context of the NSRP, which target a comprehensive package of policies to create a supportive and enabling environment for competition, to facilitate and develop the movement of trade and remove barriers, to upgrade the logistics and transport sectors and enable private sector partnerships, to further ease investment procedures, and to support the transition to a green economy and the sustainable use of natural resources. In addition, providing more opportunities for private participation in infrastructure through PPPs and stakeholders engagement in local communities to ensure support for PPP projects.

SUMMARY AND FUTURE PROSPECTS

FUTURE PROSPECTS

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. 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 and boost the real sector, creating more resilient and diversified economy.