وزارة التخطيط والتنمية الإقتصادية
Ministry of Planning and Economic Development

MACRO ANALYSIS
POLICY UNIT (MAP)

MONTHLY ECONOMIC REVIEW

2022 | JULY

MONTHLY ECONOMIC REVIEW

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.

JULY'S HIGHLIGHT

- Real GDP growth shows a strong momentum during Q3 FY2021/22 and during the first nine months of the same fiscal year. This growth has been generated from the positive contributions of five leading sectors.
- Both GOE and the IMF maintained their positive outlook for the GDP growth for the fiscal year 2021/22, hovering around 6.2% and 5.9%, respectively.
- Although urban headline inflation (Y-o-Y) softens in June to record 13.2% down from 13.5% a month earlier, yet, core inflation is still on the upward trajectory surging to 14.6% in June compared to 13.3% a month earlier. This reflects the demand-side inflation and the manifestation of the second-round effects of the supply-side shocks.
- This has been mirrored in the build-up of the implied inflation during recent months accounting for 12% annual rate along with the unfavorable pass-through effect which calls for the insistence on the prudent tight monetary policy.

REAL GDP GROWTH RATE DEVELOPMENTS

- Real GDP growth rate at constant prices grew by 5.4% during Q3 of the Fiscal year 2021/22 up from 2.9% during the corresponding quarter of the fiscal year 2020/21. This came despite the slow down in growth compared to the previous two quarters after the phasing out of the base effect.

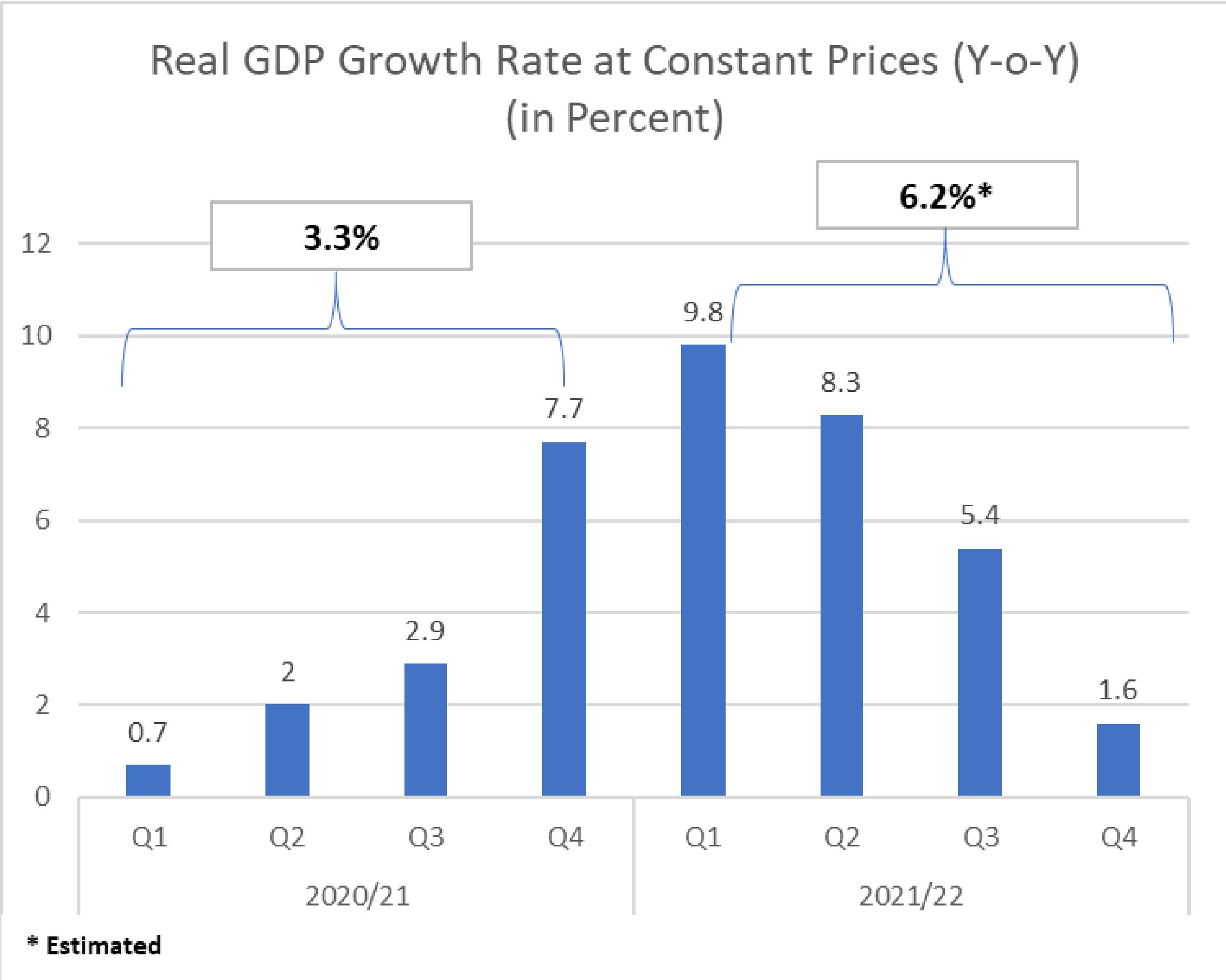
- Moreover, the Real GDP is expected to grow by only 1.6% in the coming quarter, dropping from 7.7% during the corresponding quarter backed by the projection of retreated purchasing power and consumption sentiment being the main contributor to GDP growth during the recent quarters. As such, the growth rate for the fiscal year 2021/22 is expected to record 6.2% up from 3.3% a year earlier.

- The real GDP growth during Q3 of the fiscal year 2021/22 emerged from five leading sectors: ICT, Suez Canal, manufacturing, construction, and Hotels & restaurants. All the five sectors registered positive and resilient growth rates recording, 16.3%, 9.8%, 8.5%, 6.3% and 5.5%, respectively during Q3 of FY 2021/22.

REAL GDP GROWTH RATE DEVELOPMENTS

- Real GDP growth rate registered 7.8% during the first nine months of the FY 2021/22, compared to only 1.9% during the same period of FY 2020/21.

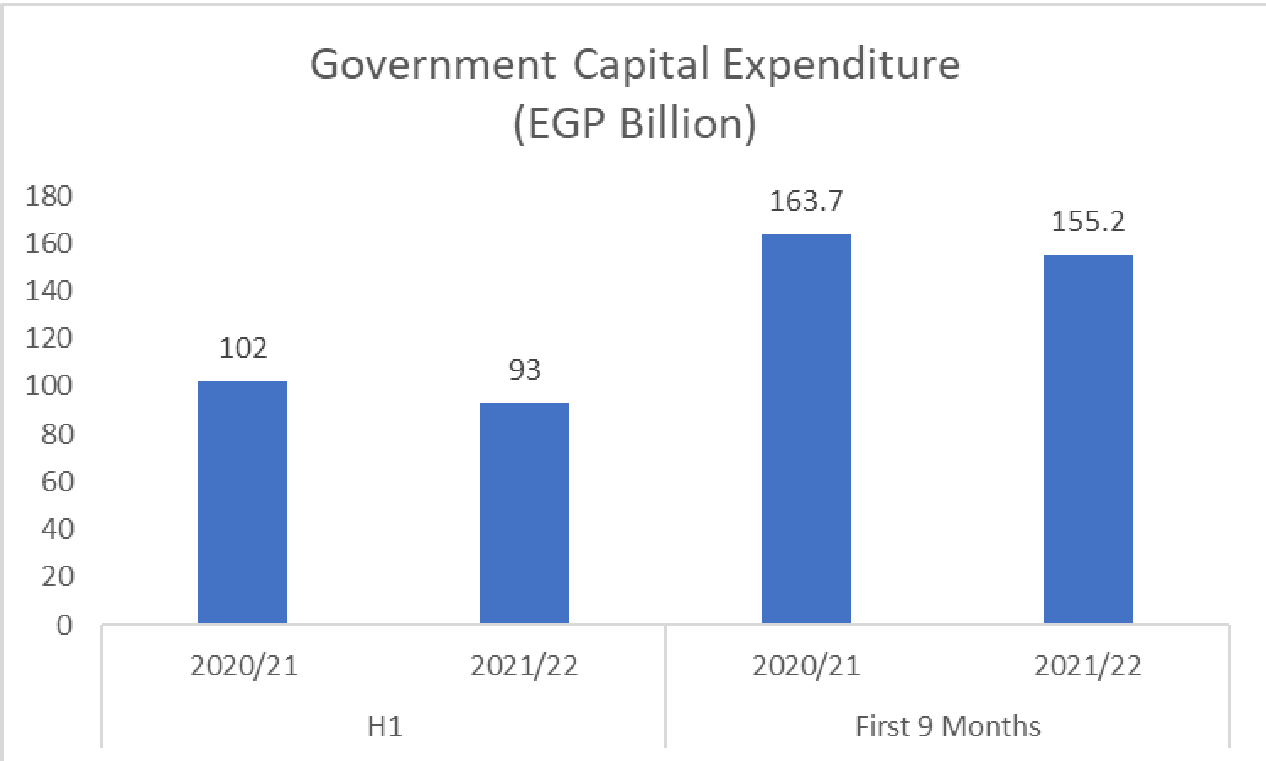
- In the meantime, the IMF has kept its projections for Egypt's GDP at 5.9% for the FY 2021/22, slightly below the national projected figure of 6.2%.



Source: Ministry of Planning and Economic Development.

CAPITAL EXPENDITURE DEVELOPMENTS

- Government capital expenditure witnessed some retreatment during H1 FY 2021/22 and the first nine months of the same year. This has been emerged from the high commodity prices which have put upward pressure on social spending and the subsidy bill, what urged the government to reduce its capital spending plans. Moreover, the government in its budget draft of FY2022/23 planned to raise capital spending by only 9.6% compared to an average of 25% over the last five years.



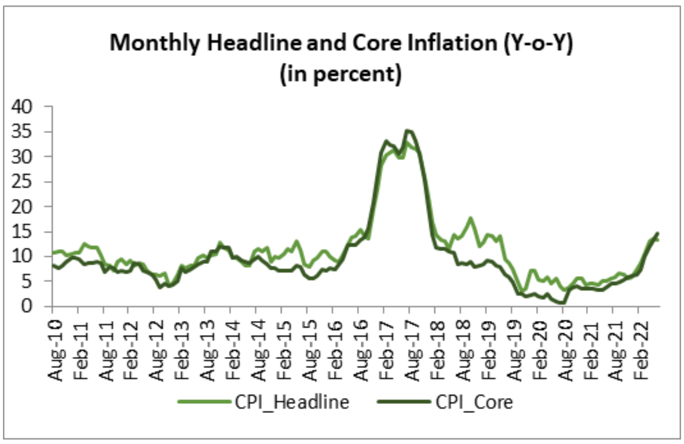
Source: Ministry of Planning and Economic Development.

INFLATION DYNAMICS

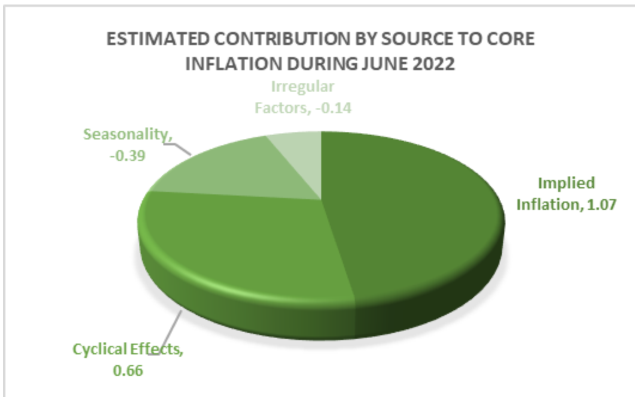
- Urban headline inflation (Y-o-Y) softens in June to record 13.2% down from 13.5% a month earlier. The monthly dynamics has been also significantly eased to show a deceleration of 0.1% in June compared to 1.1% and 3.3% during the previous two months.

- Meanwhile, core inflation is still on the upward trajectory surging to 14.6% in June compared to 13.3% a month earlier. This came despite the decrease of the monthly rate to 1.2% in June down from 1.6% in May 2022. It is worth to mention that, the monthly easing in core inflation has taken place for four months in a row.

- June dynamics indicate that monthly core inflation has been further eased to register 1.2% compared to 1.6% a month earlier. Nevertheless, implied inflation has increased to 1.07 percentage points compared to 0.95 percentage points during May, reflecting higher inflation expectations that represent the level of inflation that cannot be avoided by the Central Bank.



Source: CAPMAS and CBE



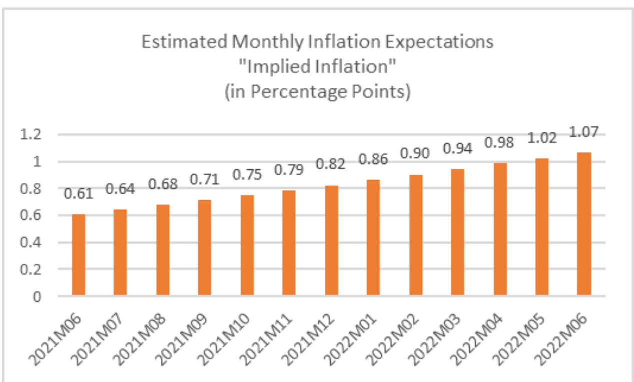
Source: CBE and MAP's Estimates, MPED.

INFLATION DYNAMICS

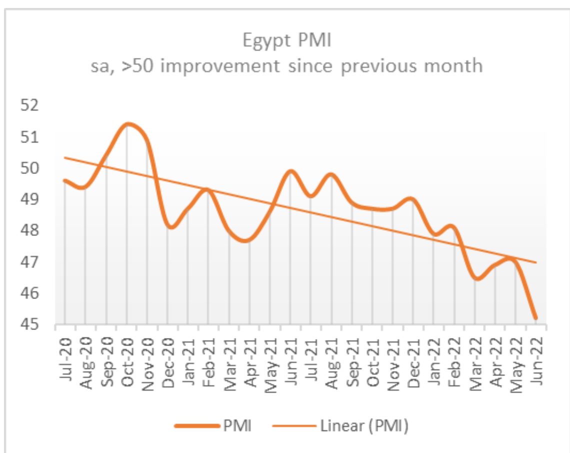
- Implied inflation started to build up since the beginning of the current fiscal year, which is considered as a red flag for the CBE to adjust its inflation target upwards with a higher band to mirror the uncertainty surrounding the inflation risks being 12%±3%. This can be induced from the fact that having a monthly average implied inflation of about 1.0% is equivalent to 12.0% annual rate.

- In the meantime, cyclical factors contribution has been slightly eased from 0.72 in May to 0.66 percentage points in June 2022, yet it is still positive and high, which can be related to both supply-push effects and demand-side effects. The former can be backed by imported inflation. As for the demand side effects, it can be attributed to the positive real money gaps reflecting the shortage of the produced goods and services relative to the money supplied in the economy.

- These developments are inconsistent with the non-oil private sector business conditions and dynamics that have been adversely hit in June. In this context, PMI has registered a low record of 45.2, the worst slump in two years.



Source: CBE and MAP's Estimates, MPED.

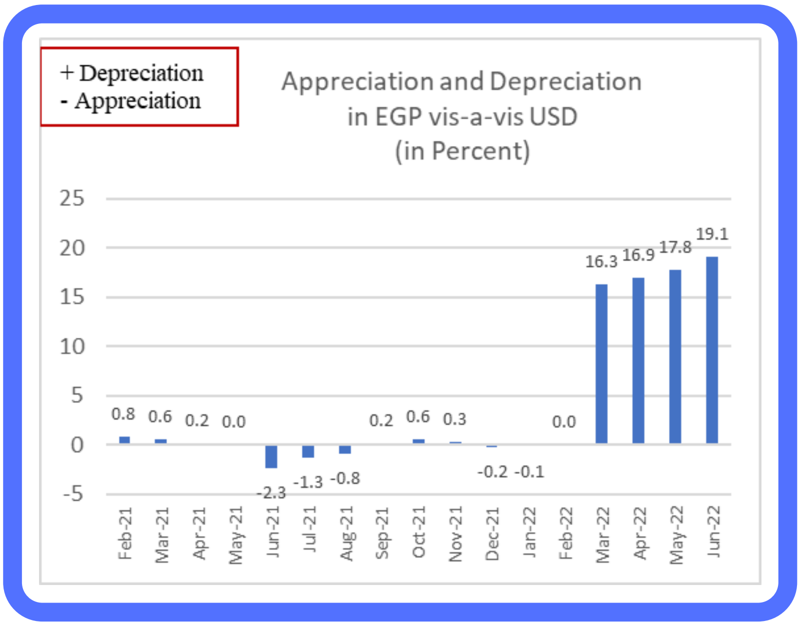


Source: IHS Markit.

EXCHANGE RATE DYNAMICS AND PASS-THROUGH EFFECT

- The recent Central Bank measures to devaluate the Egyptian Pound by 17% that reached 19.0% in June, has its anticipated repercussions on the domestic inflation due to unfavorable pass-through effect that starts to totally manifest during May figure. Rather, it is expected that it will be materialized more during the next couple of months with higher inflation rates.

- Knowing that the estimated pass-through effect of exchange rate is quantified as 0.3, estimated equation shows that all variables are statistically significant and with the expected right signs. The highest impact comes from interest rates with a magnitude of negative 7.2, followed by exchange rate (proxied by NEER) with an estimated coefficient of negative 3.5, demand-pull inflation that resulted from the real growth rate and improved purchasing power is quantified at 1.9 and finally the supply-push inflation that stemmed from the producers' pass-through effect is measured to be 1.1.

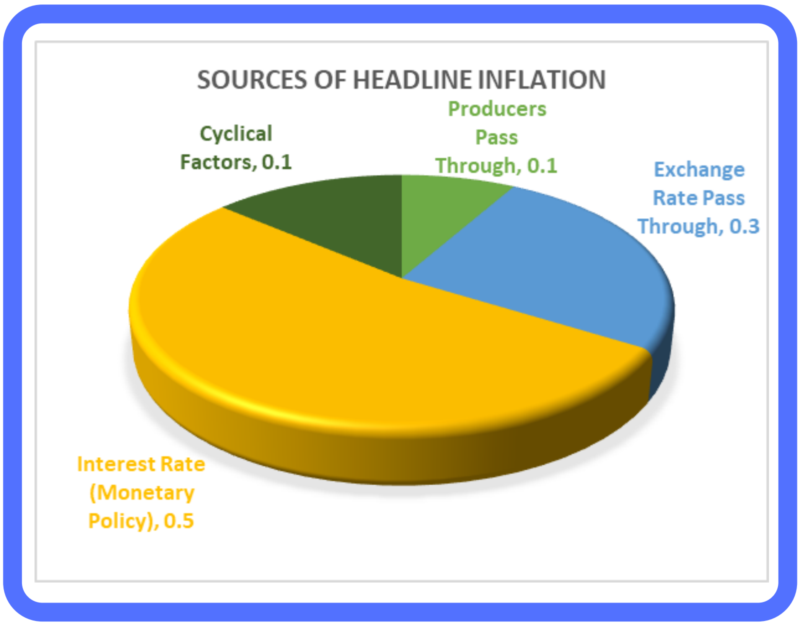


Source: MPED and CBE.

EXCHANGE RATE DYNAMICS AND PASS-THROUGH EFFECT

- The estimated coefficients are then transformed to contributions to headline inflation rate. It has been found that about 50% of the dynamics in the inflation rate comes from the monetary policy decisions, implying more effective role of the CBE in affecting the inflation rate during recent years. This is followed by the exchange rate pass-through effect quantified at 30% of the inflation rate dynamics. Finally comes both the producers' pass-through effect (supply-push) and cyclical factors (demand-pull) inflation, each contributes by 10% of the overall inflation dynamics.

- These findings motivate the belief that interest rate movements are essential at this juncture so that hiking policy rates now can curb inflationary pressures, yet it can worsen the private sector operational conditions in addition to discouraging the private consumption. This is highly recommended to support the Egyptian Pound and to achieve positive real interest rates that could improve the foreign investment sentiments in the future.



Source: MAP's Estimates, MPED.

SUMMARY AND FUTURE PROSPECTS

- Given the decline in the government capital expenditure during the last couple of quarters of the FY2021/22, and the belief that the private investment spending will also diminish, this can be aggravated by the fact that tight monetary conditions will push up the borrowing costs and encourage the risk averse economic participants to save rather than invest.

- Nevertheless, rising foreign investment -fueled by the government measures and incentives- can offset some of the impact of these negative dynamics on investment activity.

- In this context, in March 2022, Egypt and Saudi Arabia signed an investment agreement under which the Saudi public investment fund will invest USD 10 bn in the country in addition to Qatar and Emirates which have pledged another USD 15 bn.

- Moreover, having a tight monetary policy can anchor inflation expectations and pull back the inflation rate to one digit once again over the medium term, that could result in positive real interest rates rendering the Egyptian economy as a favorite investment destination that can invite the foreign investors in carry trade agreements and reinforcing the portfolio investment being one resilient pillar in the balance of payments performance.

SUMMARY AND FUTURE PROSPECTS

To mitigate these adverse repercussions on the Egyptian economy, the Government of Egypt embarked on the newly launched National Structural Reform Program (NSRP) (FY2021/2022–FY2023/2024) in order to undertake more structural "second wave" reforms, to enhance the pre-pandemic stabilization reforms. This program aims at improving the standards of living and service delivery to all Egyptians without discrimination. It seeks to implement a package of structural policies to address existing imbalances, strengthen and better target social safety nets and develop human capital.