



## Promoting Export competitiveness: Devaluation or Not?

10 April 2012

# Overview of the Presentation

- *Analysis of Egypt's trade structure, by area.*
- *Analysis of the impact of exchange rate development on trade competitiveness.*
- *Assessment of the impact of trade competitiveness on growth and inflation.*

# Structure

## Trade Competitiveness

### Aggregate Analysis

The Euro Area  
All Major Trading Partners

### Disaggregate Analysis

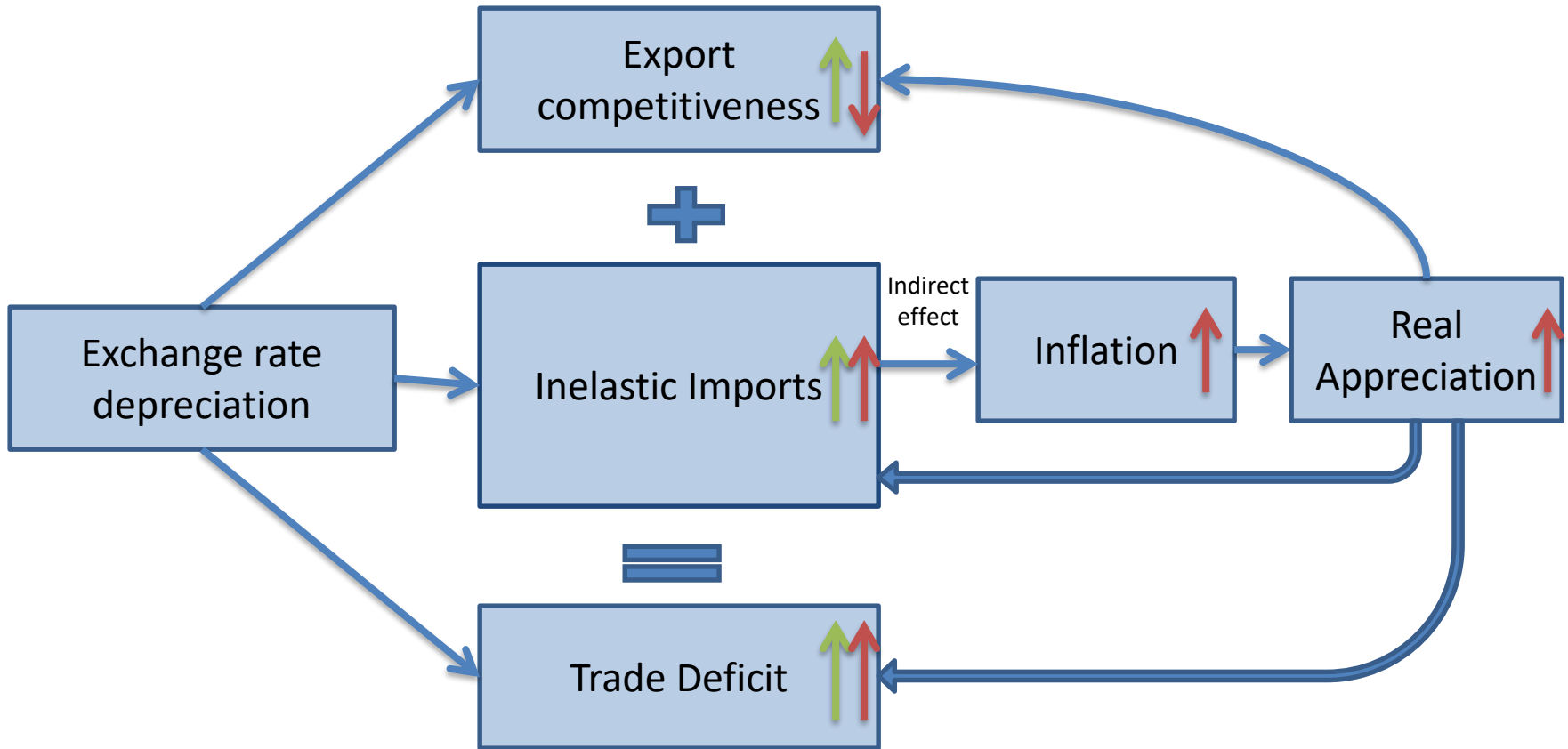
Processed Food Industry

## Implications on Growth and Inflation

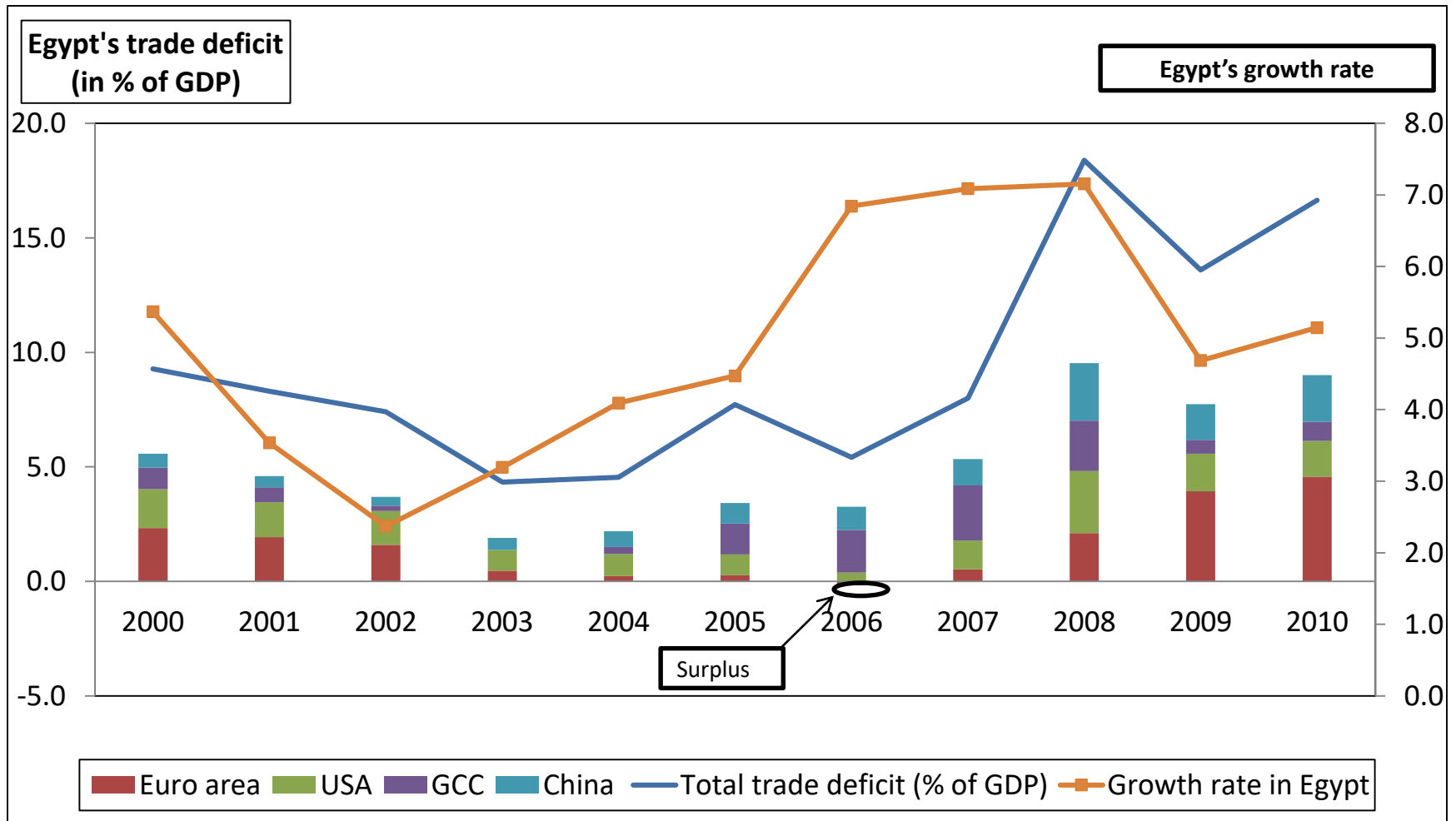
### Aggregate Analysis

Disaggregate Analysis  
Processed Food Industry

# The Plan Chart

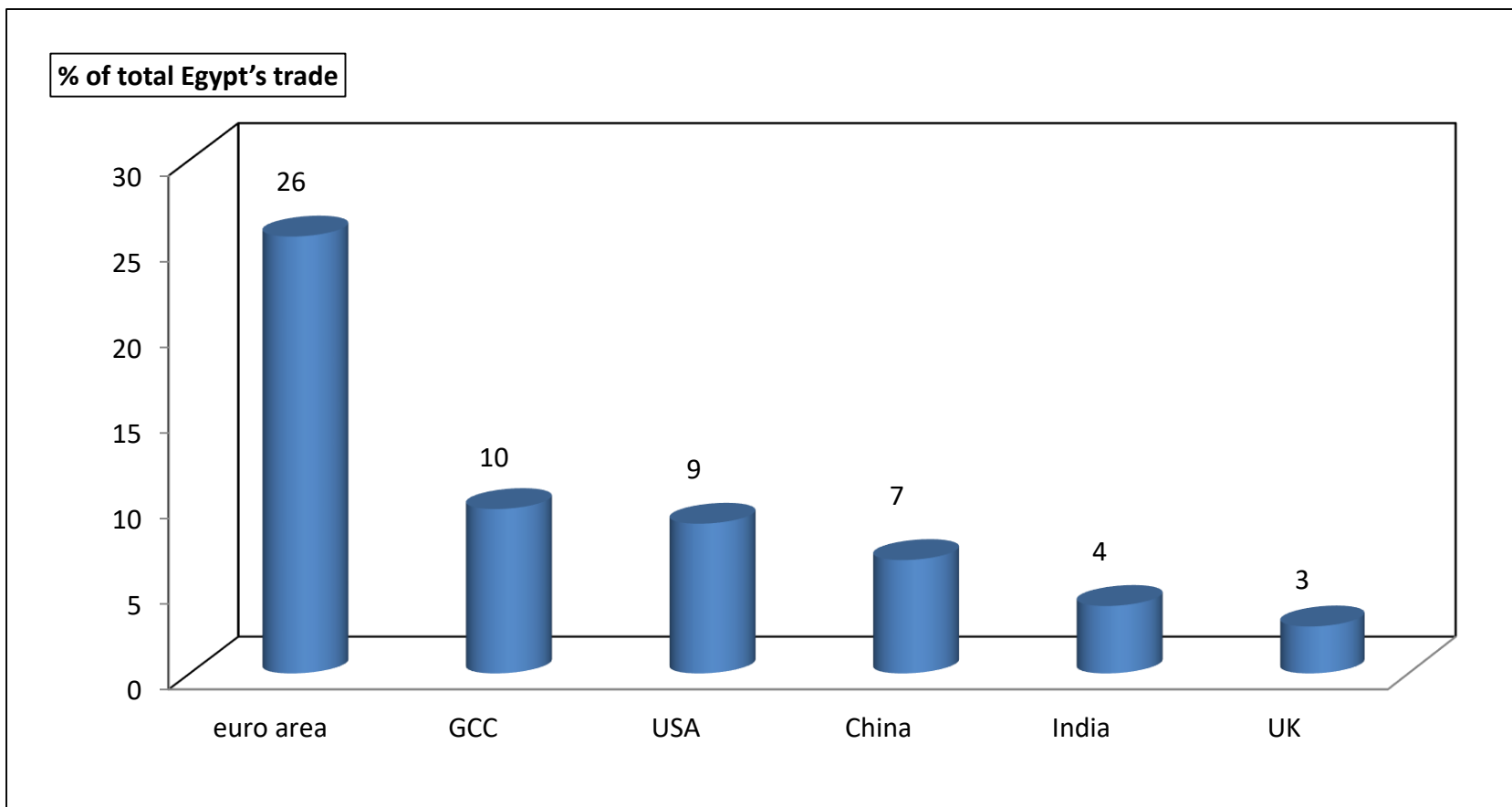


***Failure to mobilize export competitiveness has resulted in wider deficit with various partners, particularly when the economy was booming.***



### Composition of trade deficit with major partners

***The Euro Area is Egypt's largest trading partner, reflecting the importance of the exchange rate of the Egyptian pound, relative to the Euro.***



Based on average shares of trade (exports plus imports over the period (2008-2010)) with major trading partners .

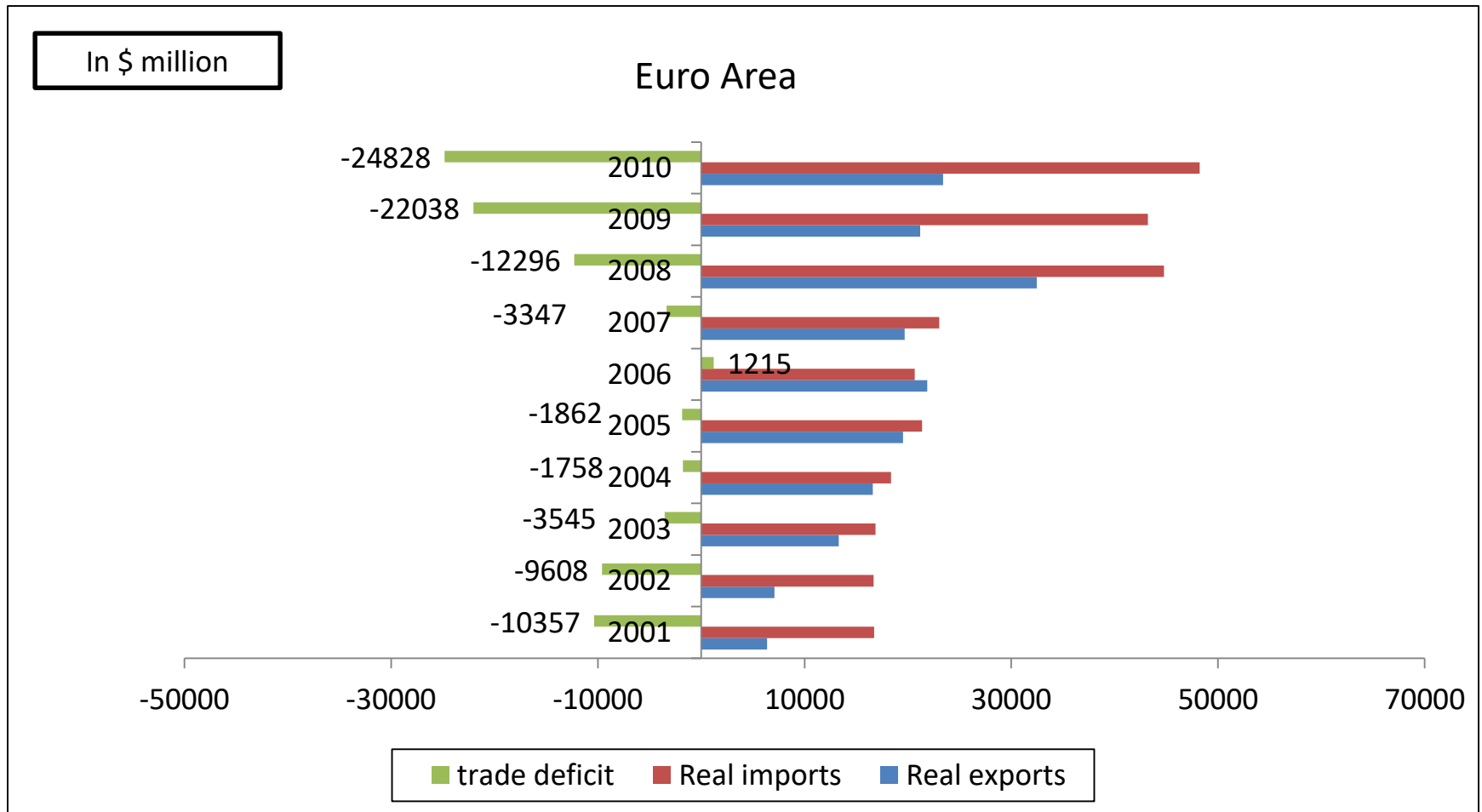
**The euro area currently consists of Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.**

# **Aggregate Analysis:**

## **Trade Competitiveness with the Euro Area**

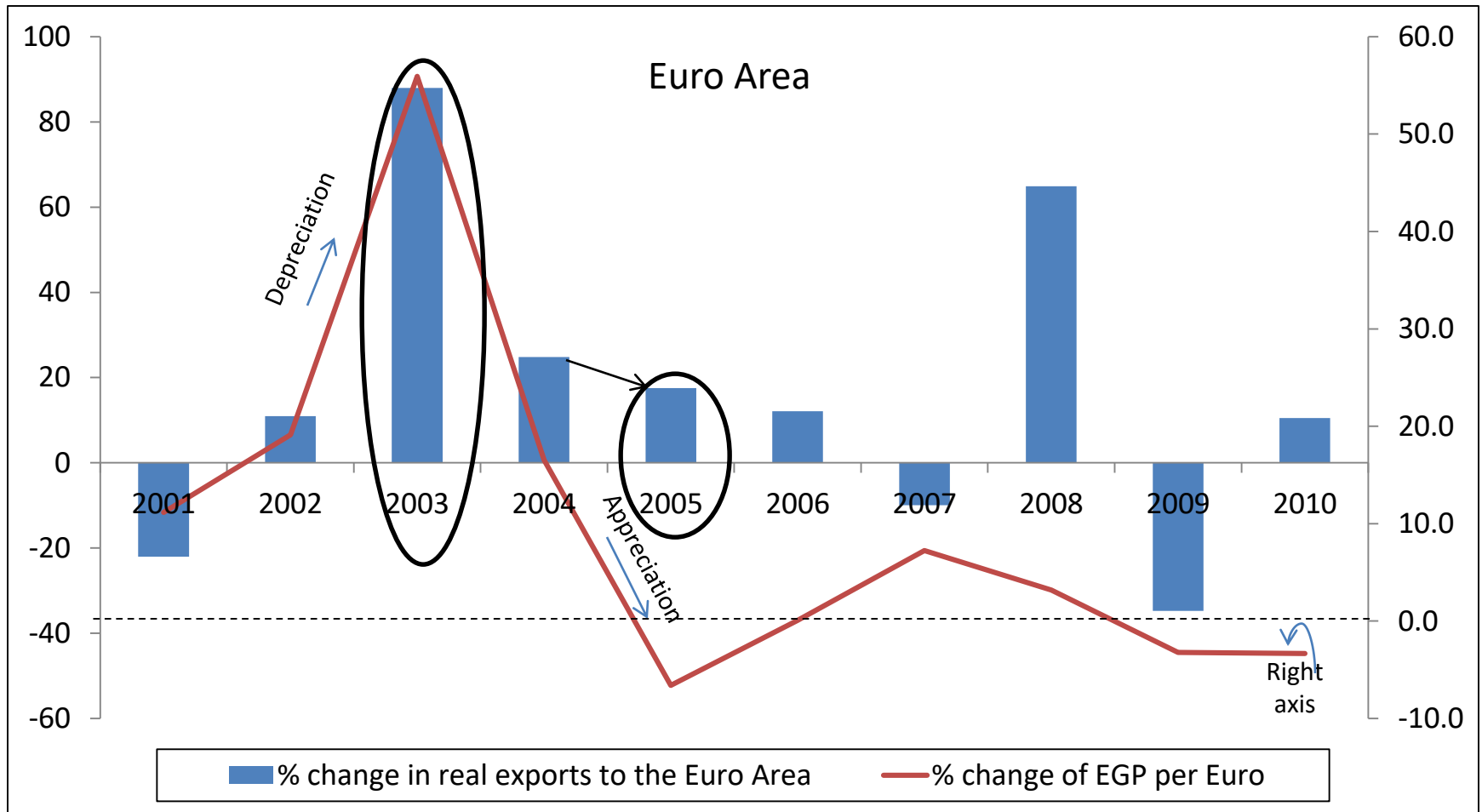
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***The deficit with the Euro Area has widened on account of faster growth in imports, relative to exports.***

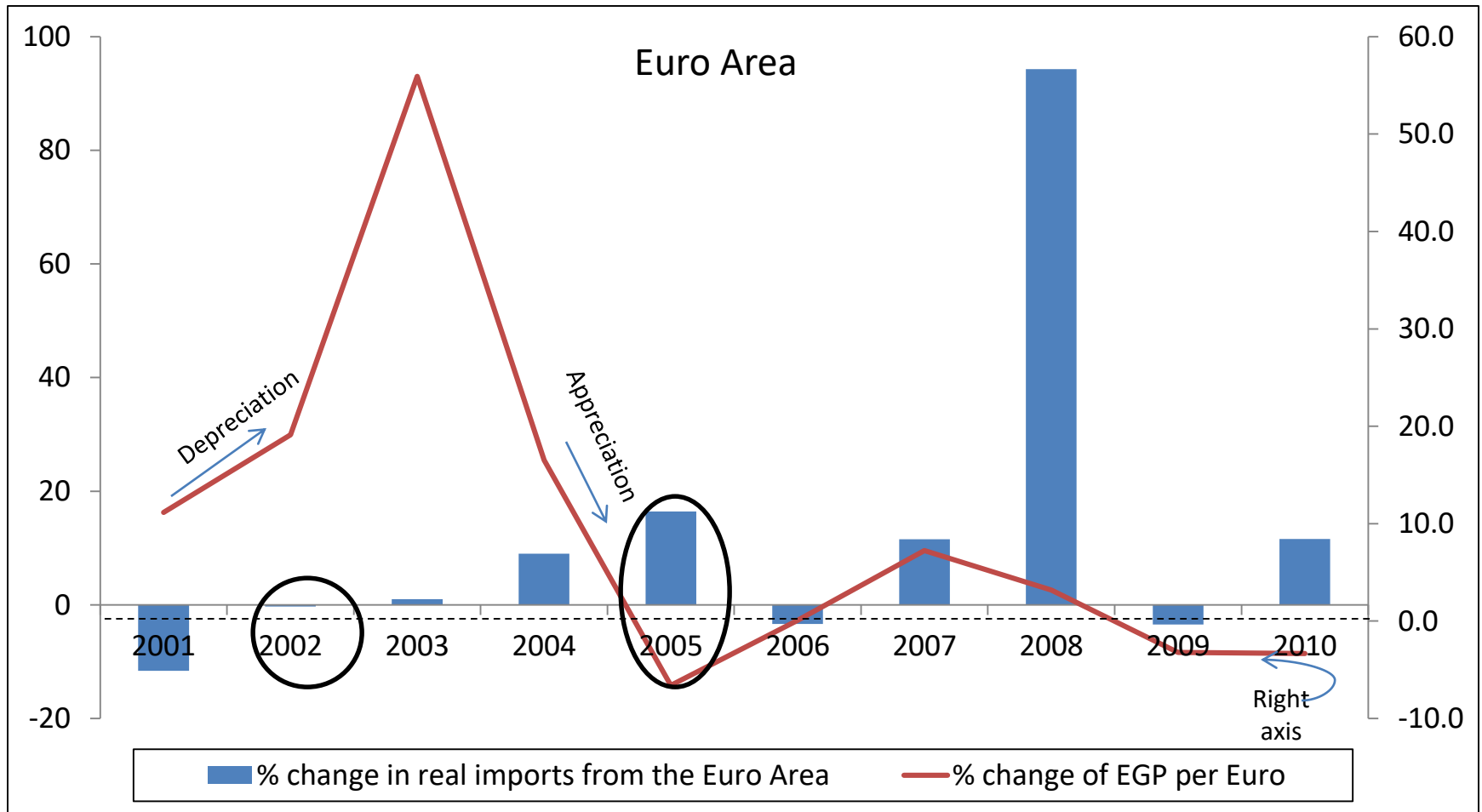




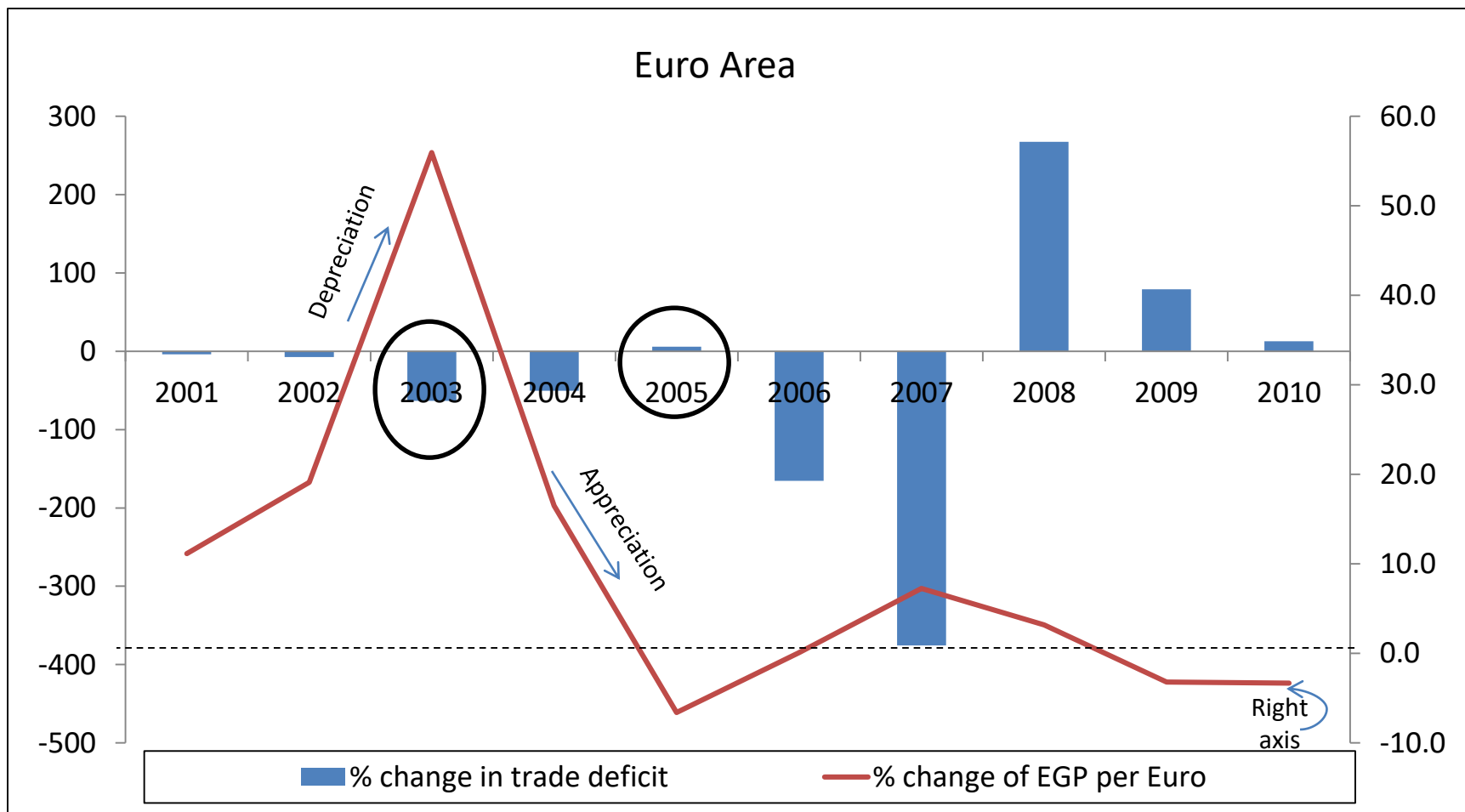
***Exports to the Euro Area have gained momentum on account of depreciation of the pound, while appreciation counters competitiveness.***



***In contrast, depreciation of the Pound curbed imports from the Euro Area, while appreciation helps promote imports.***



***The trade deficit with the Euro Area increased, reflecting appreciation of the pound relative to the Euro, while depreciation helped to narrow the deficit.***

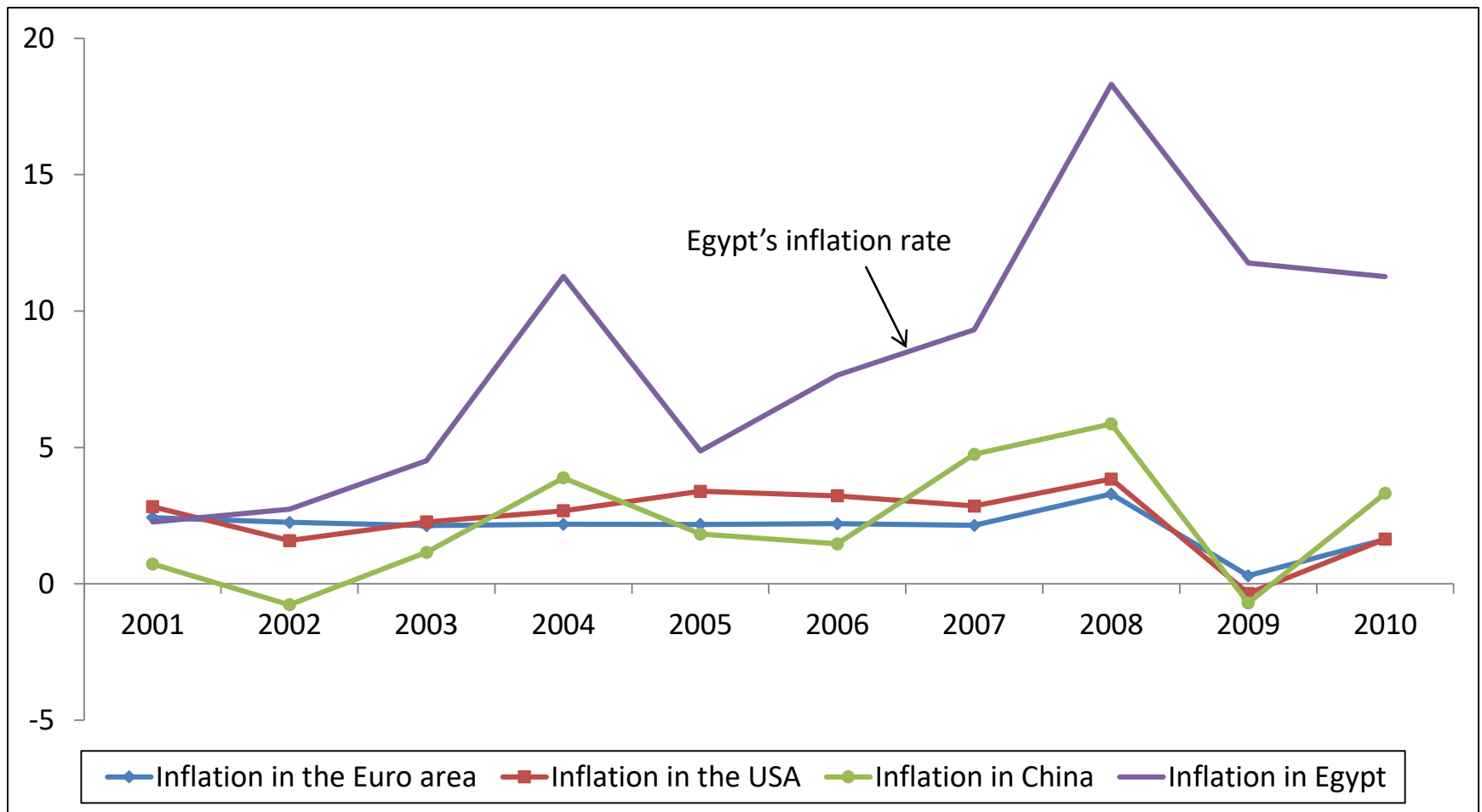


# **Aggregate Analysis:**

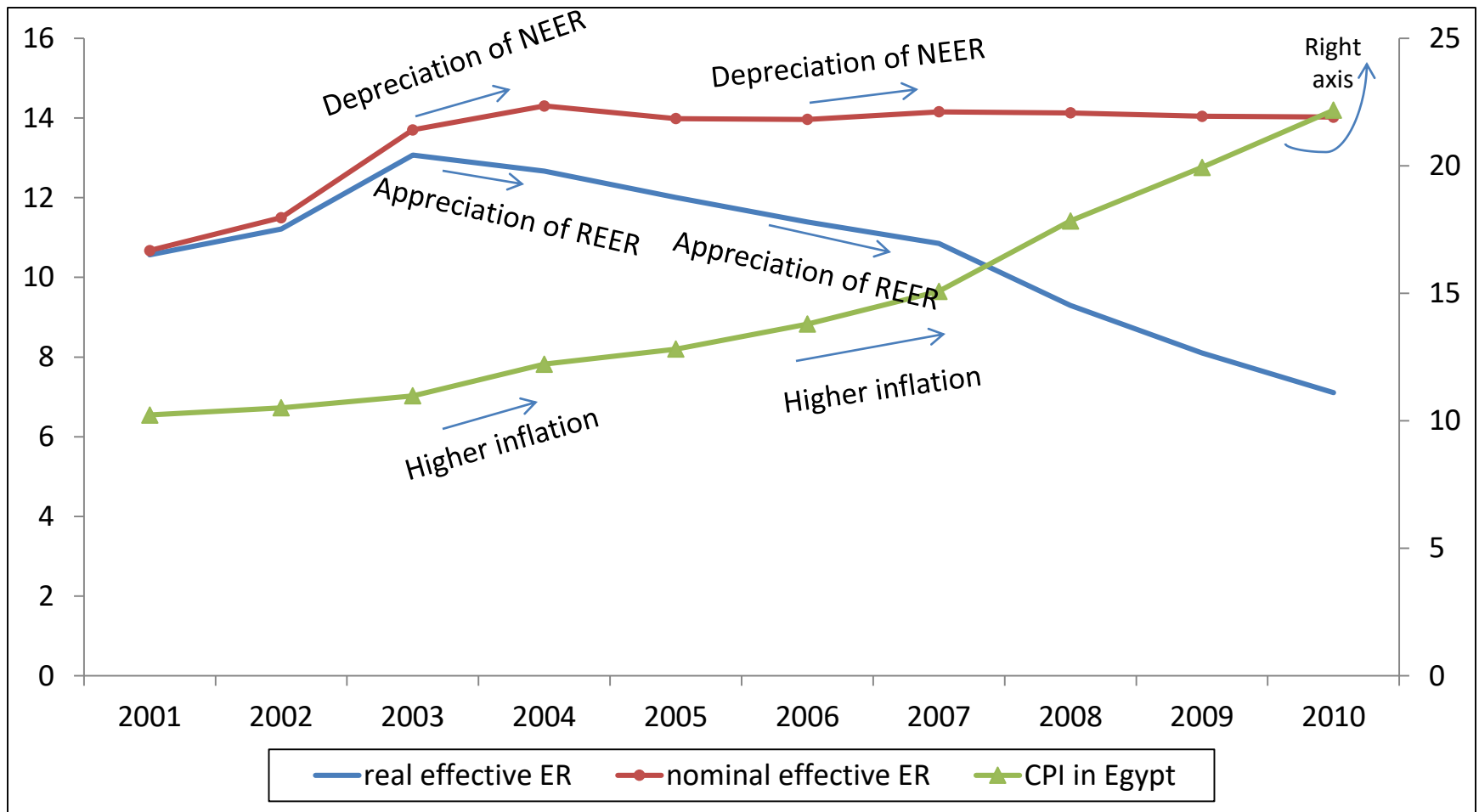
**Trade Competitiveness with all Major trading Partners**

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***Price inflation in Egypt exceeds inflation in major trading partners, which erodes competitiveness.***

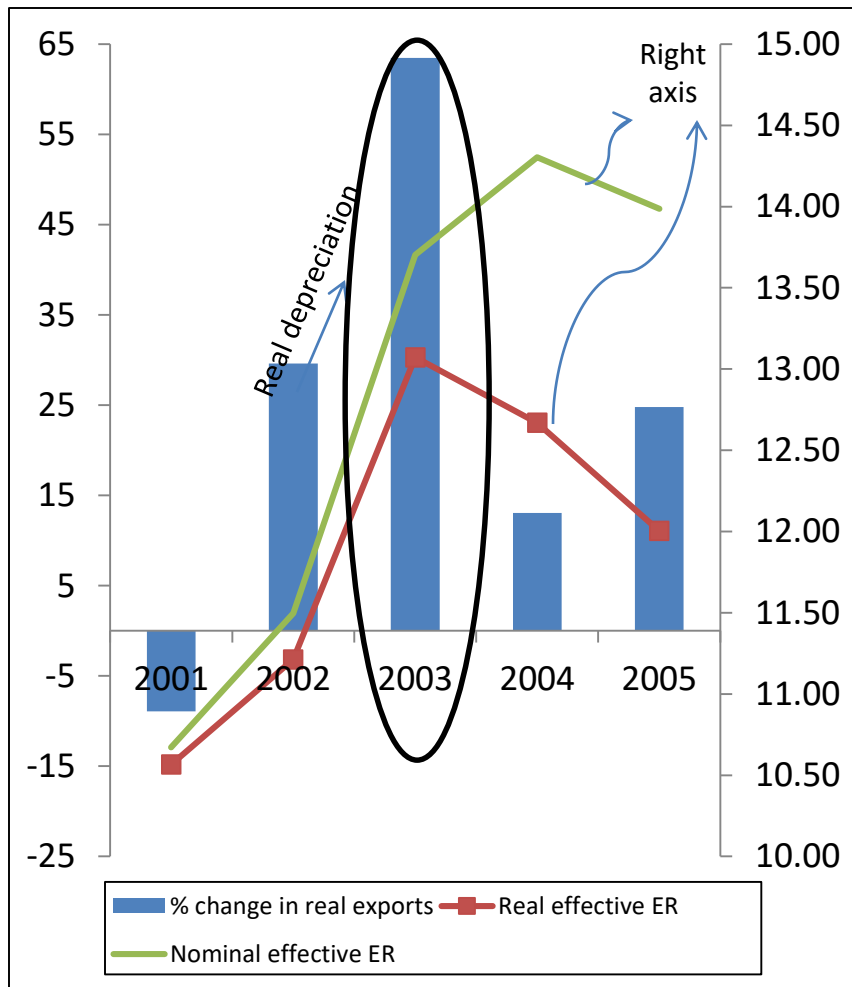


***The real effective exchange rate with respect to major trading partners has been appreciating since 2004 despite episodes of nominal depreciation, reflecting high inflation in Egypt .***



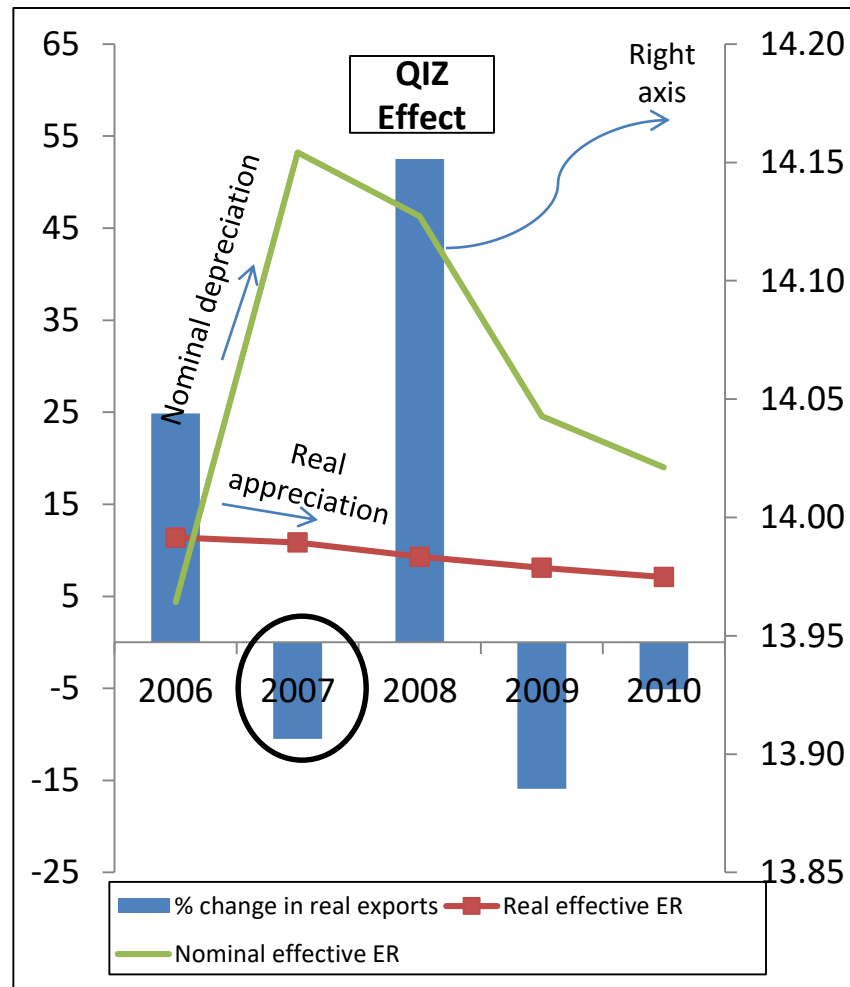
**Real depreciation helped boost export competitiveness.**

2001-2005



**However, Real appreciation has hindered the prospect of export competitiveness.**

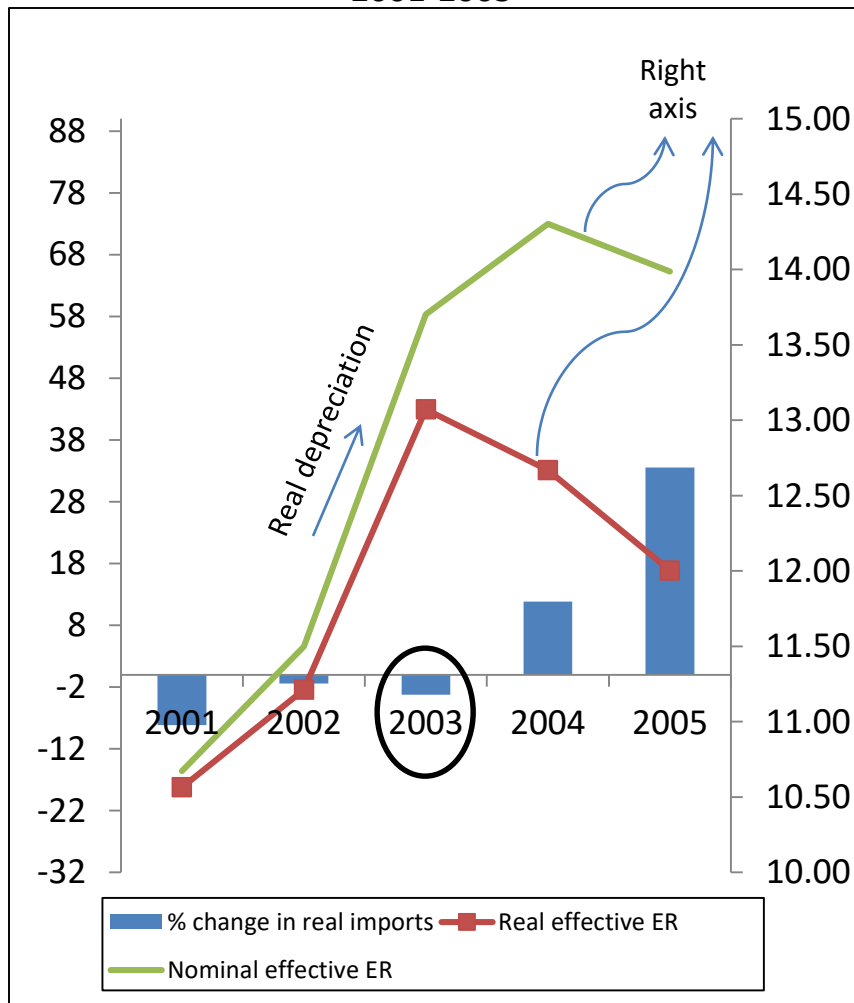
2006-2010



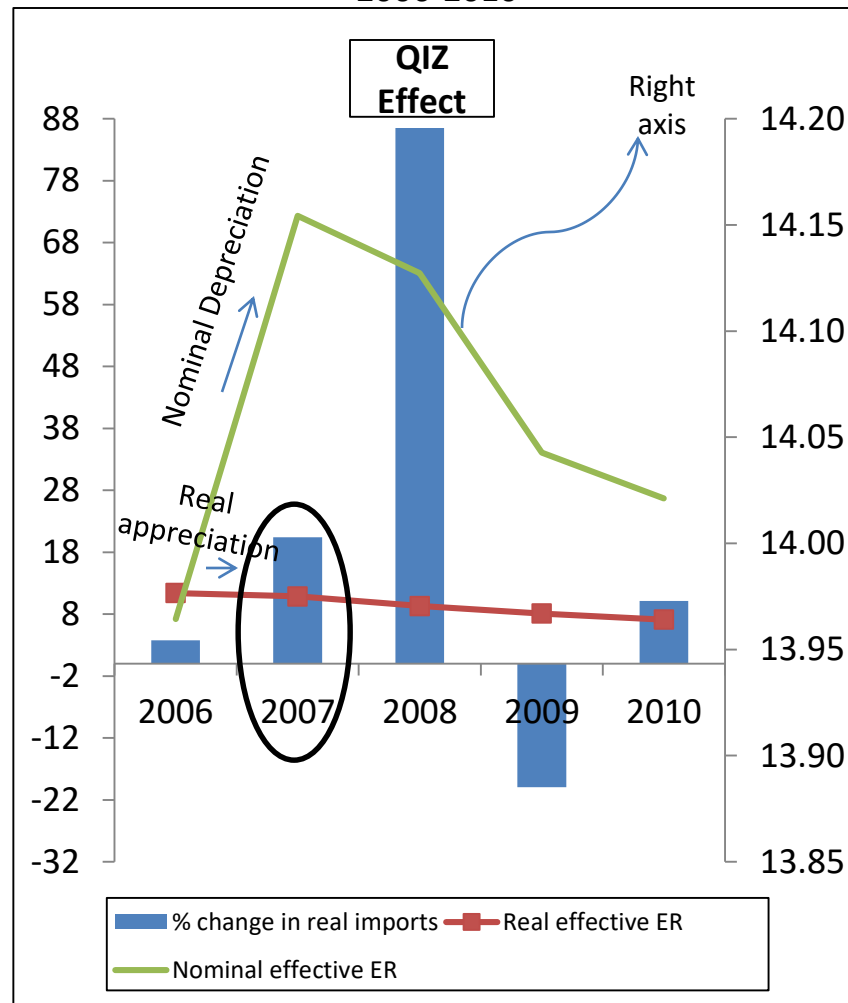
**Real depreciation helped curb imports.**

**In contrast, real appreciation has sustained high imports, despite episodes of nominal depreciation.**

2001-2005



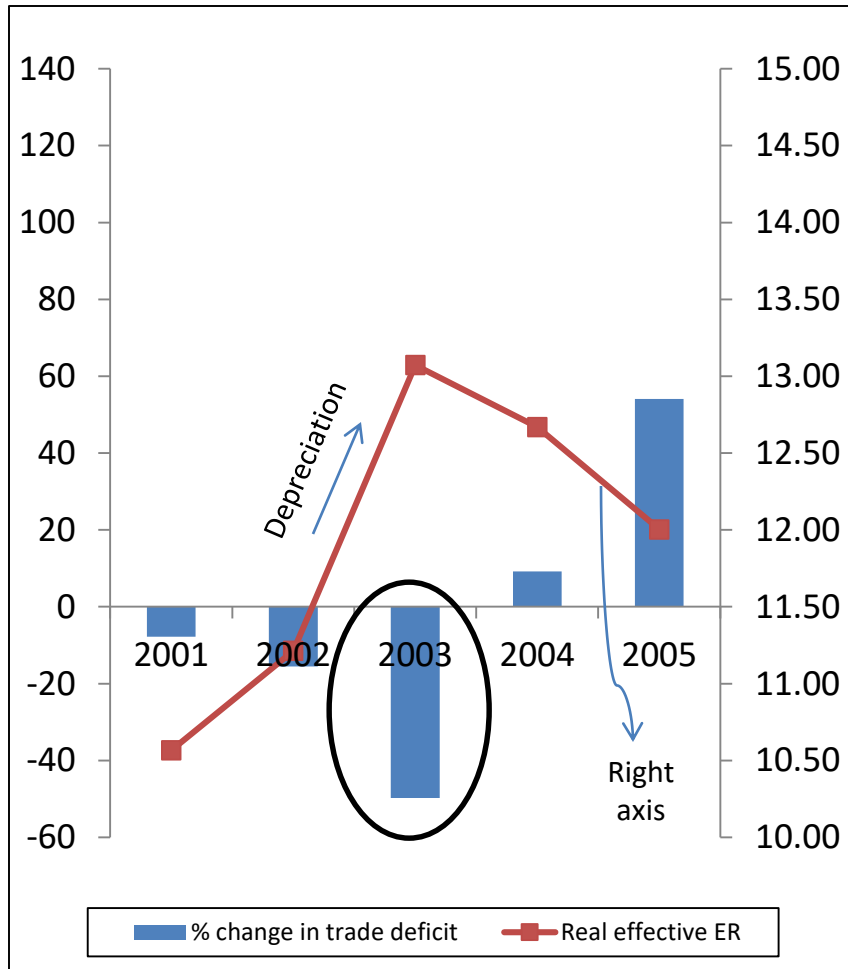
2006-2010





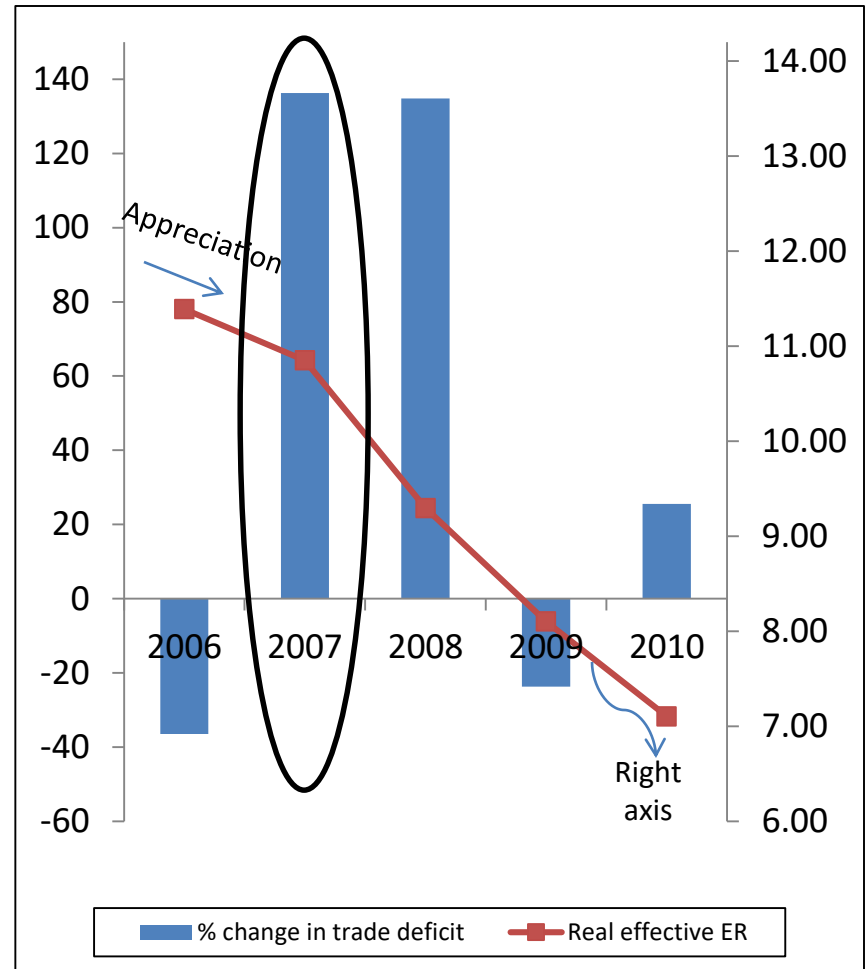
**As a result, real depreciation helped contain the trade deficit.**

2001-2005



**In contrast, the trade deficit has widened in response to sustained appreciation.**

2006-2010



# Implications

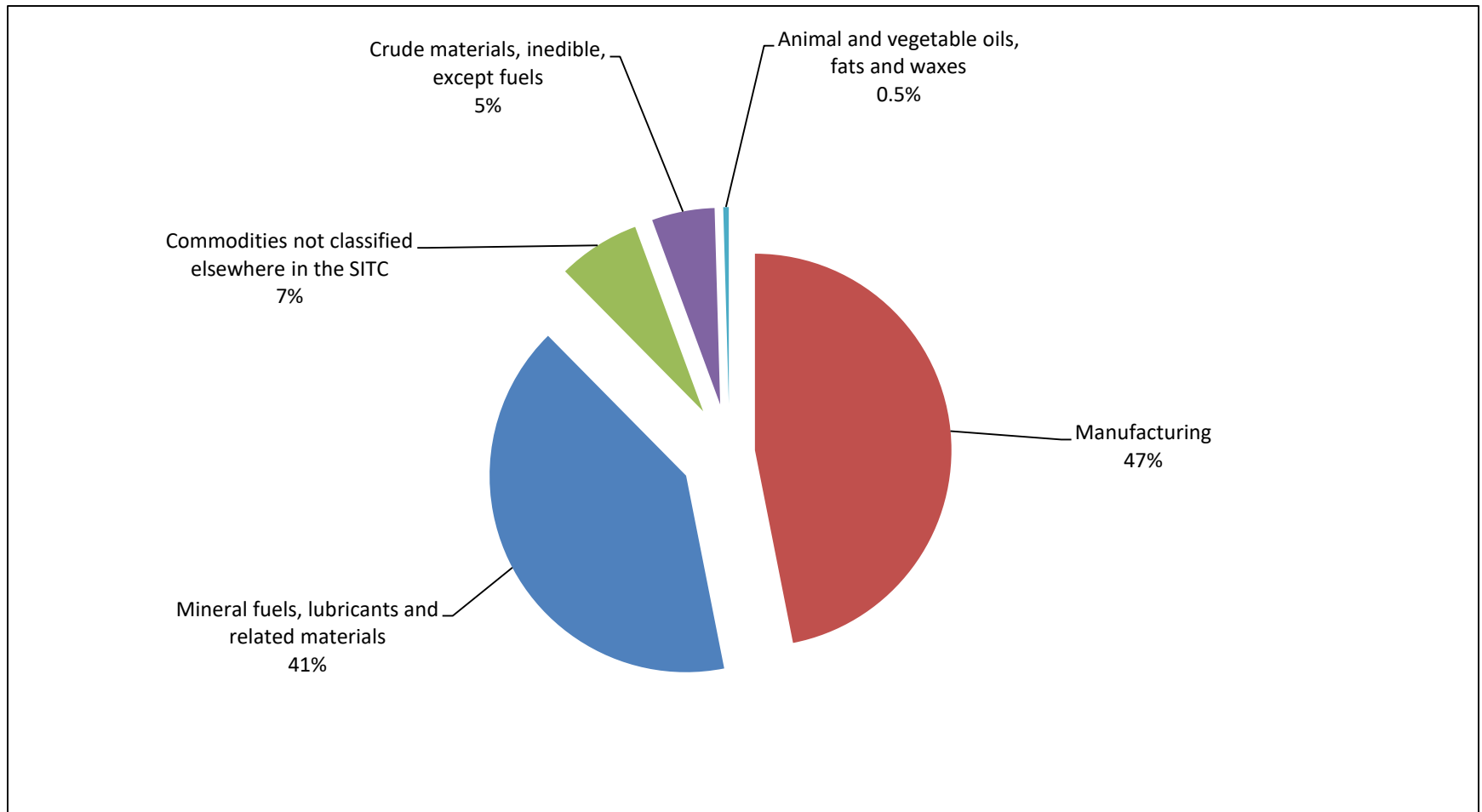
- *Failure to mobilize export growth demands policies that include market access, product upgrading and more distinguished export structure.*
- *Further, high dependency on imported intermediate goods increases the cost of production and appreciates the real exchange rate.*
- *Eliminating distortions and rigidities in product pricing and diversifying away from imported intermediate goods will increase the scope to enhance export competitiveness.*

# **Disaggregate Analysis**

**Trade Competitiveness:**

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***Manufactured goods are Egypt's main exports to the world, accounting for almost half of total exports over the period (2000-2010).***



**\*Manufactured goods include : manufactured goods classified chiefly by material, food & live animals, chemicals, miscellaneous manufactured articles, and machinery & transport equipment**

# ***The QIZ Protocol affected trade with the US.***

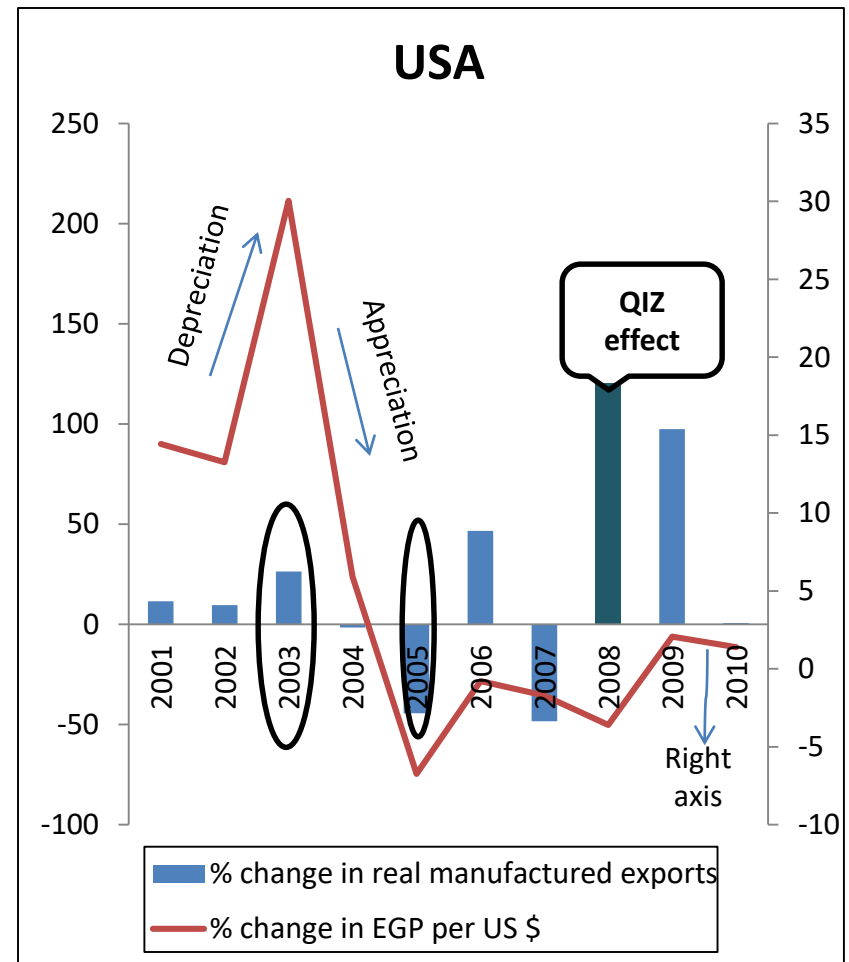
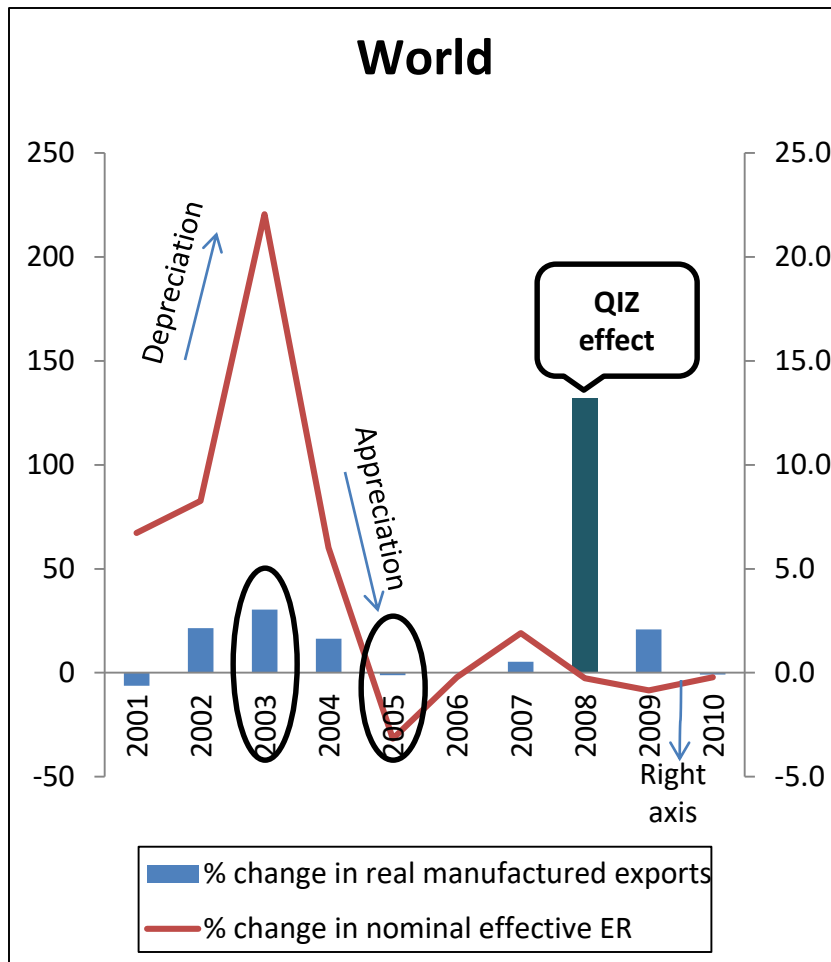
## **Main Features**

- In 2004, the Egyptian government signed the Qualifying Industrial Zones Protocol with the US and Israel, permitting duty-free entry into the US for products manufactured by qualified companies operating within designated geographic locations in Egypt with an agreed upon Israeli content of 11.7%.
- In early 2005, the QIZ started operating in 7 designated industrial locations in Egypt, with an initial 397 qualified companies.

## **In 2008**

- On 24/2/2008, the required QIZ Israeli component was reduced from 11.7% to 10.5%, effective the 1<sup>st</sup> quarter of 2008.
- On 05/6/2008, the qualified companies increased and reached a total of 717, maximizing the effect on exports and imports.
- On 23-6-2008, a technical team was formed to ensure the compliance of QIZ exporters with the United States documentation requirements.

***There is some evidence that exchange rate movements determine competitiveness of manufactured goods. However, total real manufactured exports have picked up recently and appear to be less responsive to movements in the exchange rate.***



**\*Egypt's manufactured exports to the USA accounts for 10% of total Egypt's manufactured exports over the period (2000-2010).**

Source: UN comtrade, SITC (Rev. 3)

IMF. International Financial Statistics

World Bank

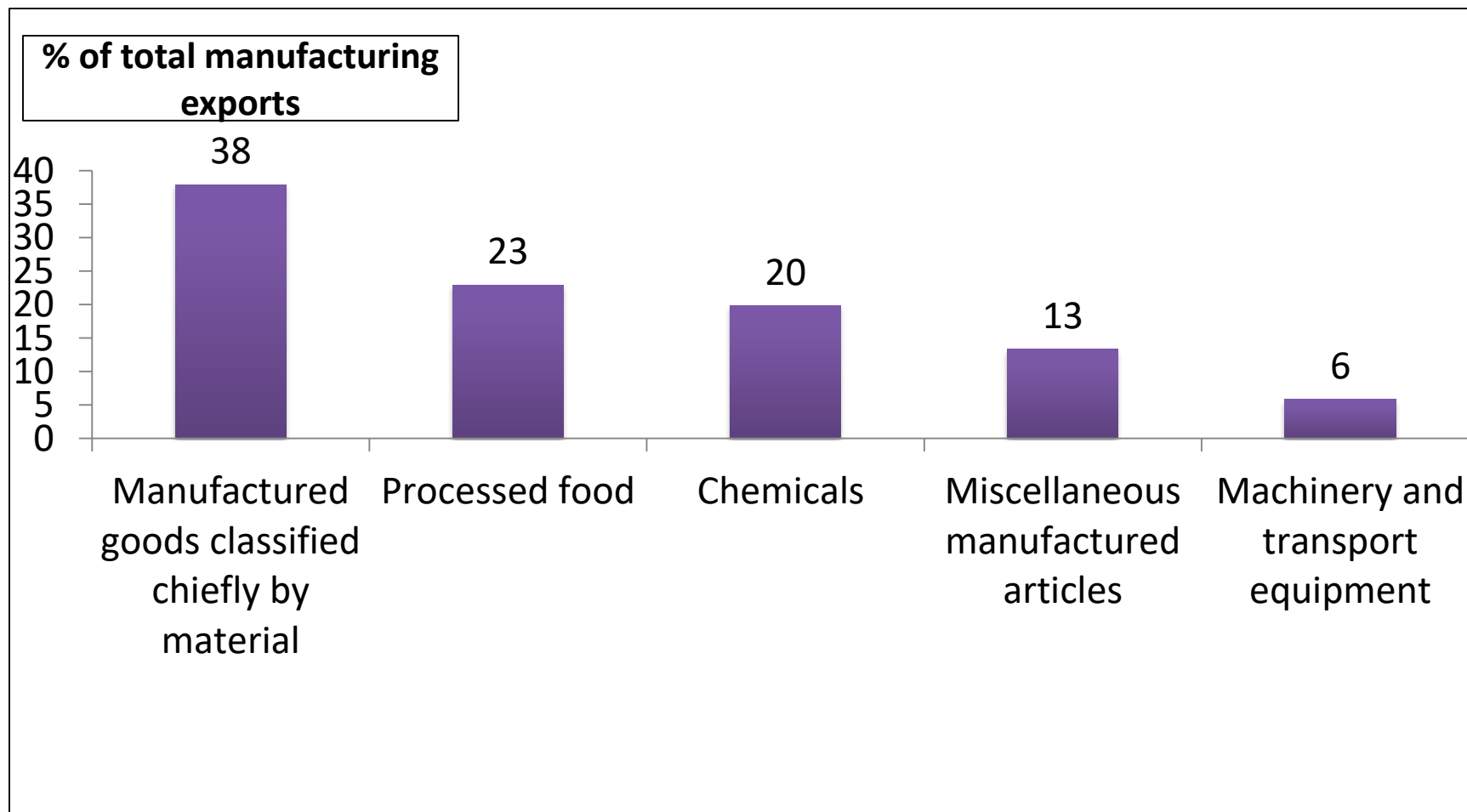
# Disaggregate Analysis:

## Trade Competitiveness: Processed Food Industry

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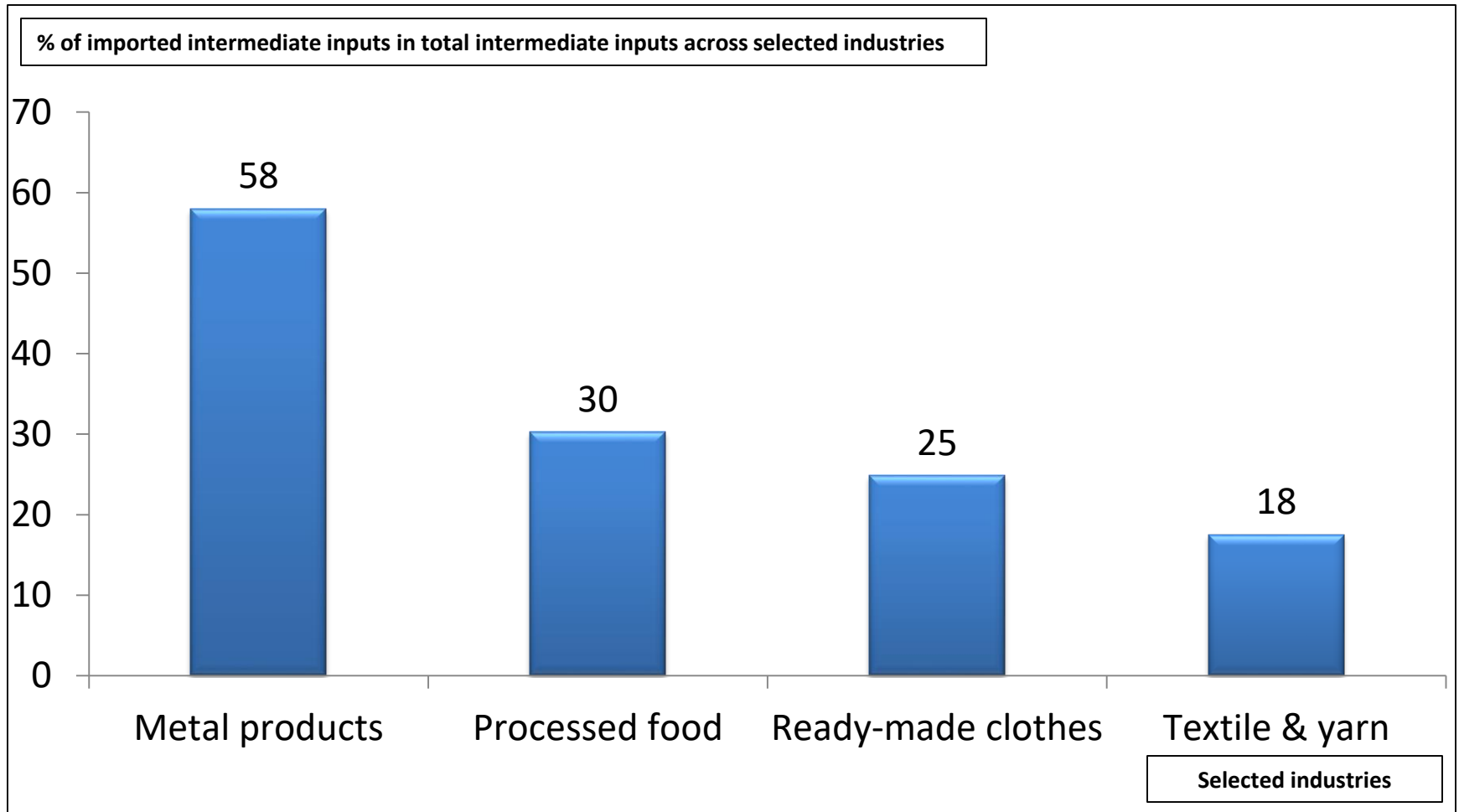


***Exports of Processed food represents 23% of total manufacturing exports.***



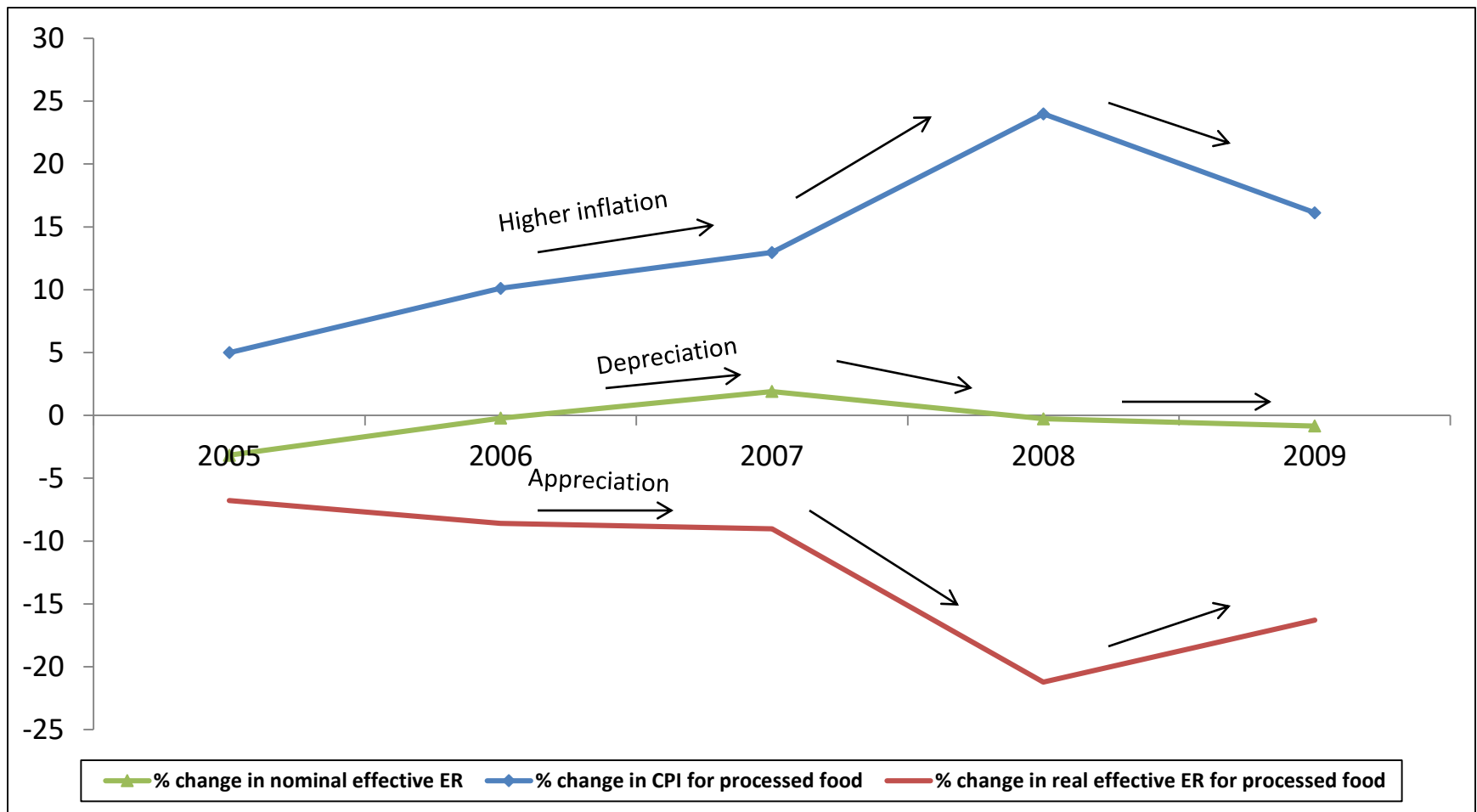


***At the same time, there is evidence that processed food industry has a high import content.***

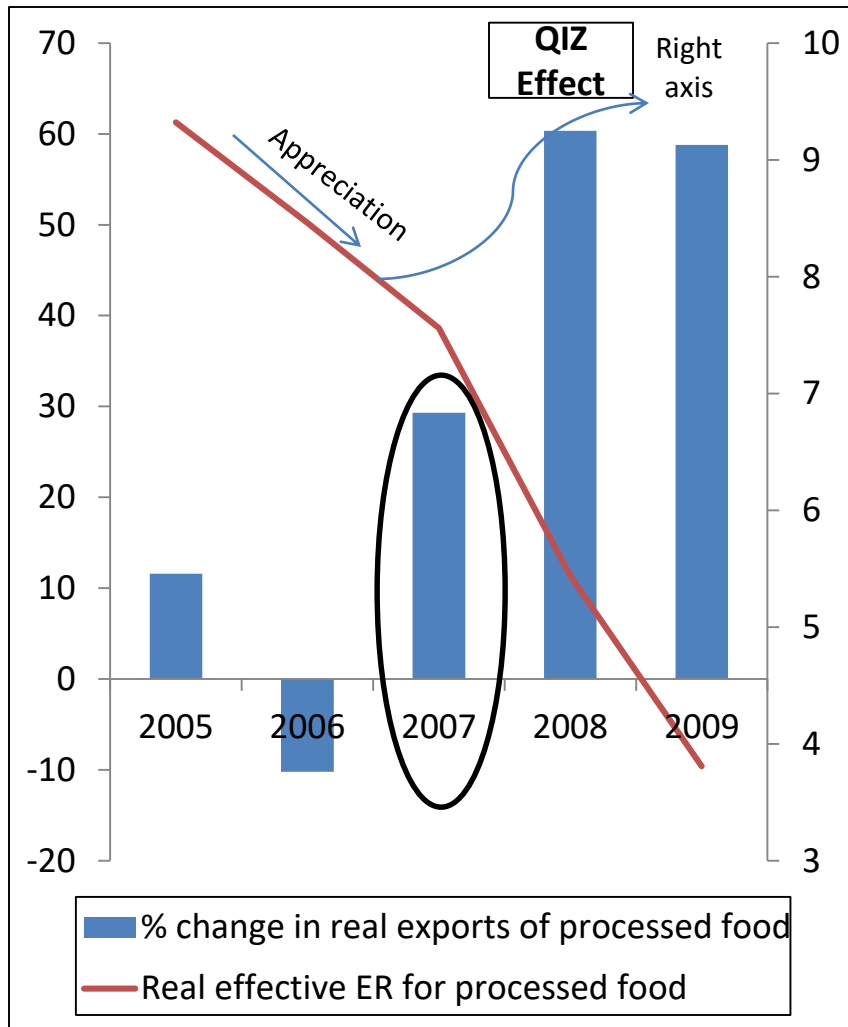


\*Based on input-output table for the year 1998/1999

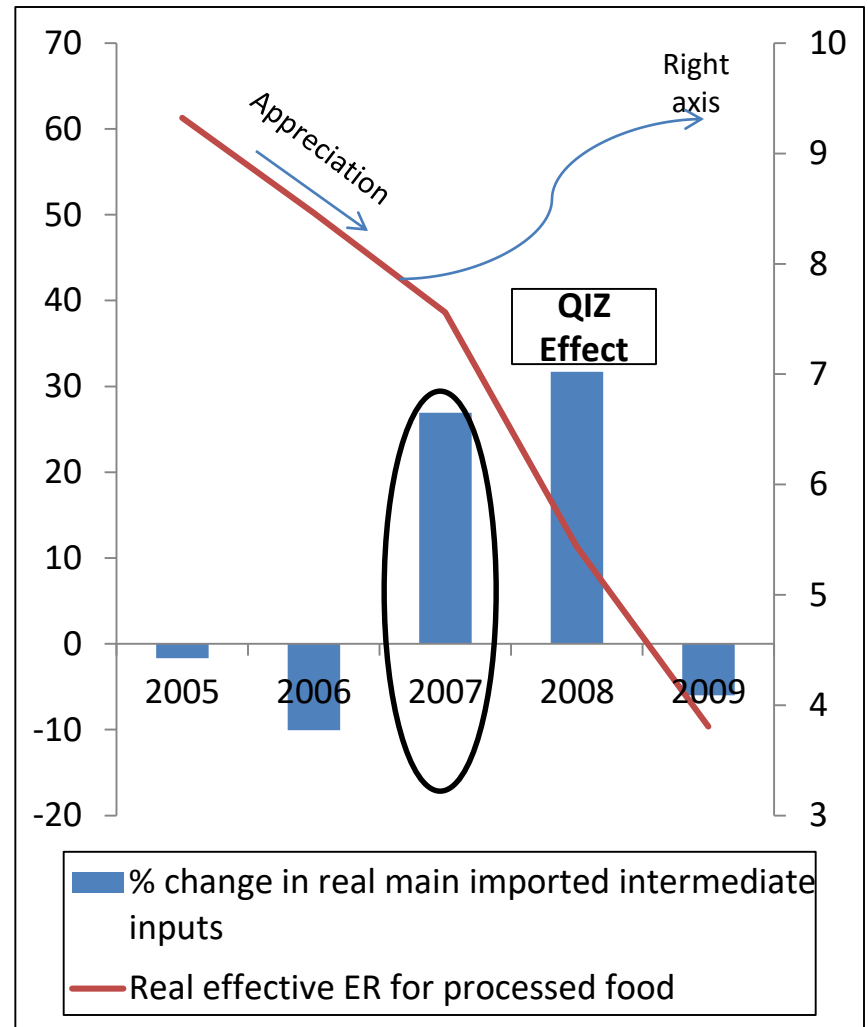
***For processed food, the real effective exchange rate has been appreciating despite nominal depreciation in 2007, reflecting high product price inflation in the industry.***



**For processed food, exports have increased despite real appreciation**



**Further, real appreciation has sustained higher imported intermediate inputs.**

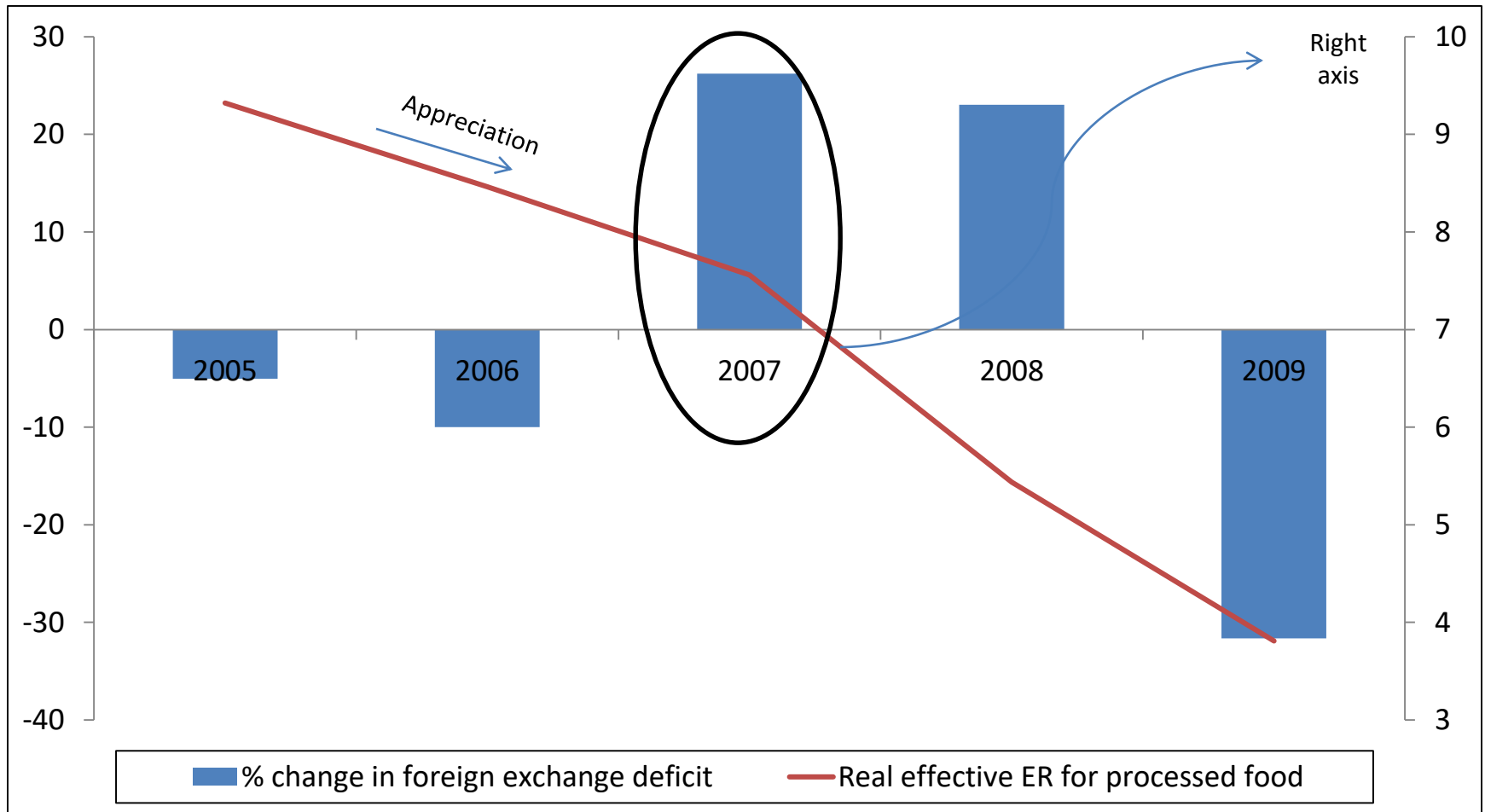


*\*It is noted that the food industry has started accessing the QIZ custom-free advantage from the fourth quarter of 2005. Also the number of food manufacturers participating in QIZ have increased since that time. There is evidence that food exports to the US have increased by 228% in the period (2006-2010) compared with the period (2000-2005).*

Source: UN comtrade, SITC (Rev. 3)

IMF. International Financial Statistics

***As a result, the foreign exchange deficit has widened in response to sustained appreciation of the real effective exchange rate, reflecting higher imports, compared to exports.***



\*The foreign exchange deficit is defined as the difference between real main imported intermediate inputs and real exports for the industry of processed food.

# Implications

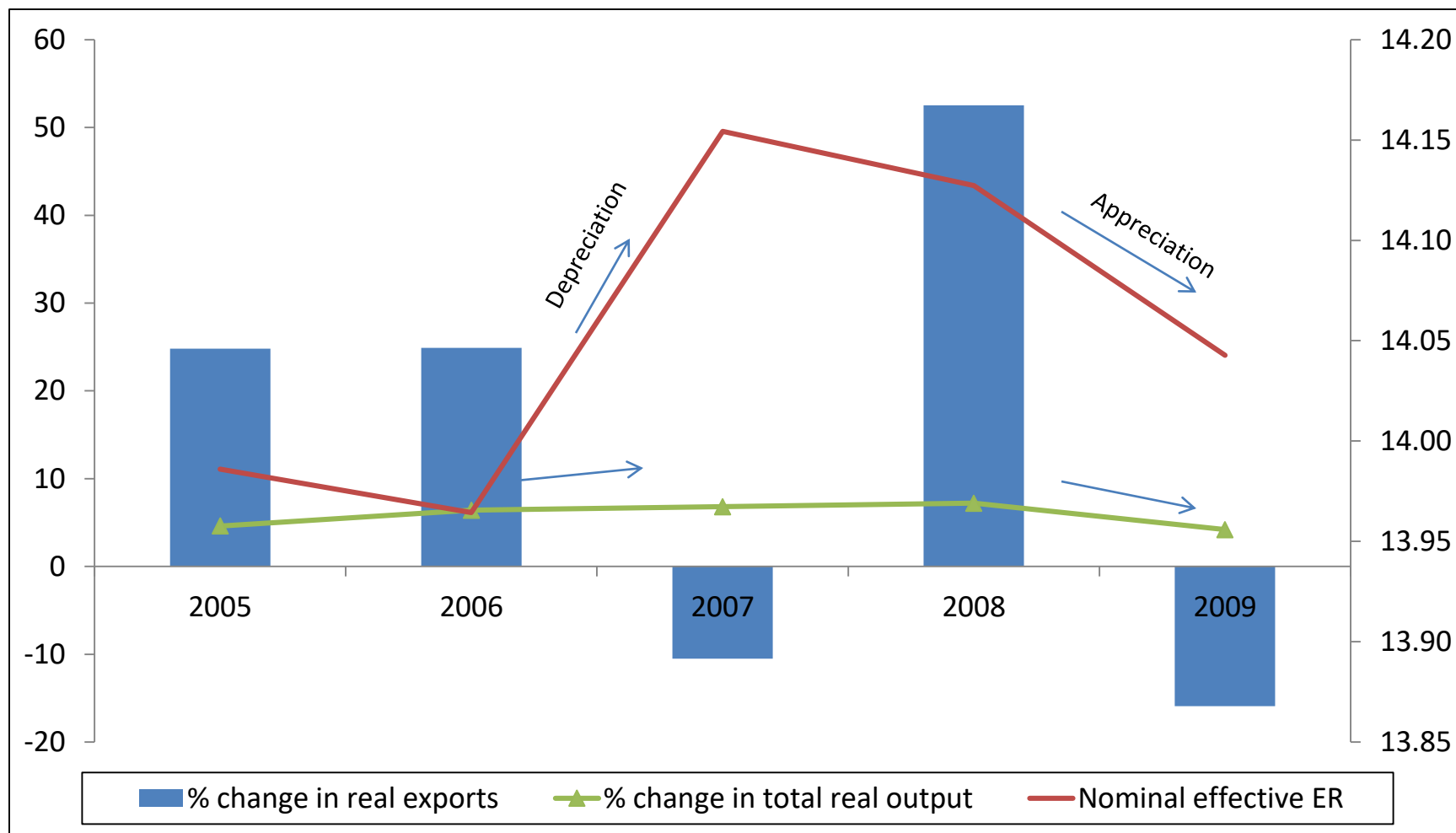
- *Real appreciation has sustained high intermediate imports for the processed food industry, despite nominal depreciation. As a result, the foreign exchange deficit has widened in response to sustained appreciation of the real effective exchange rate.*
- *Depreciation may lead to higher cost of imported intermediate inputs, given inelastic demand in the food industry.*
- *Hence, there is scope to further boost export competitiveness and reduce dependency on imports towards maximizing the full potential of exchange rate competitiveness.*

# **Aggregate Analysis:**

## **Implications on Growth and Inflation :**

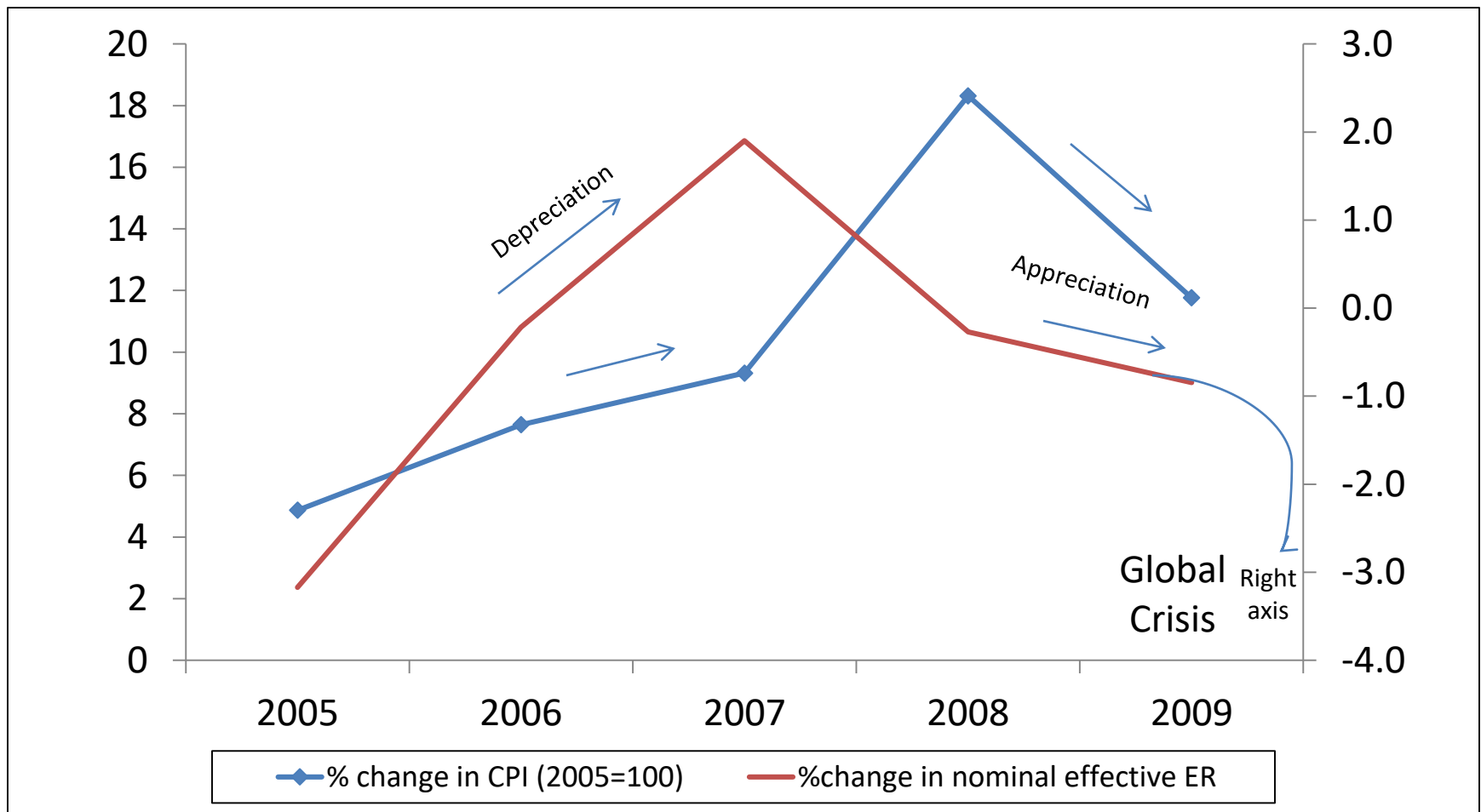
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***Depreciation of the Egyptian pound helped stimulate output growth, while appreciation, coupled with the global financial crisis, slowed down real growth.***



Source: UN comtrade, SITC (Rev. 3)  
 IMF. International Financial Statistics  
 Central Agency for Public Mobilization and Statistics

***Depreciation of the Egyptian Pound, relative to major trading partners, increased price inflation, while appreciation, coupled with the global financial crisis, reduced inflationary pressures.***



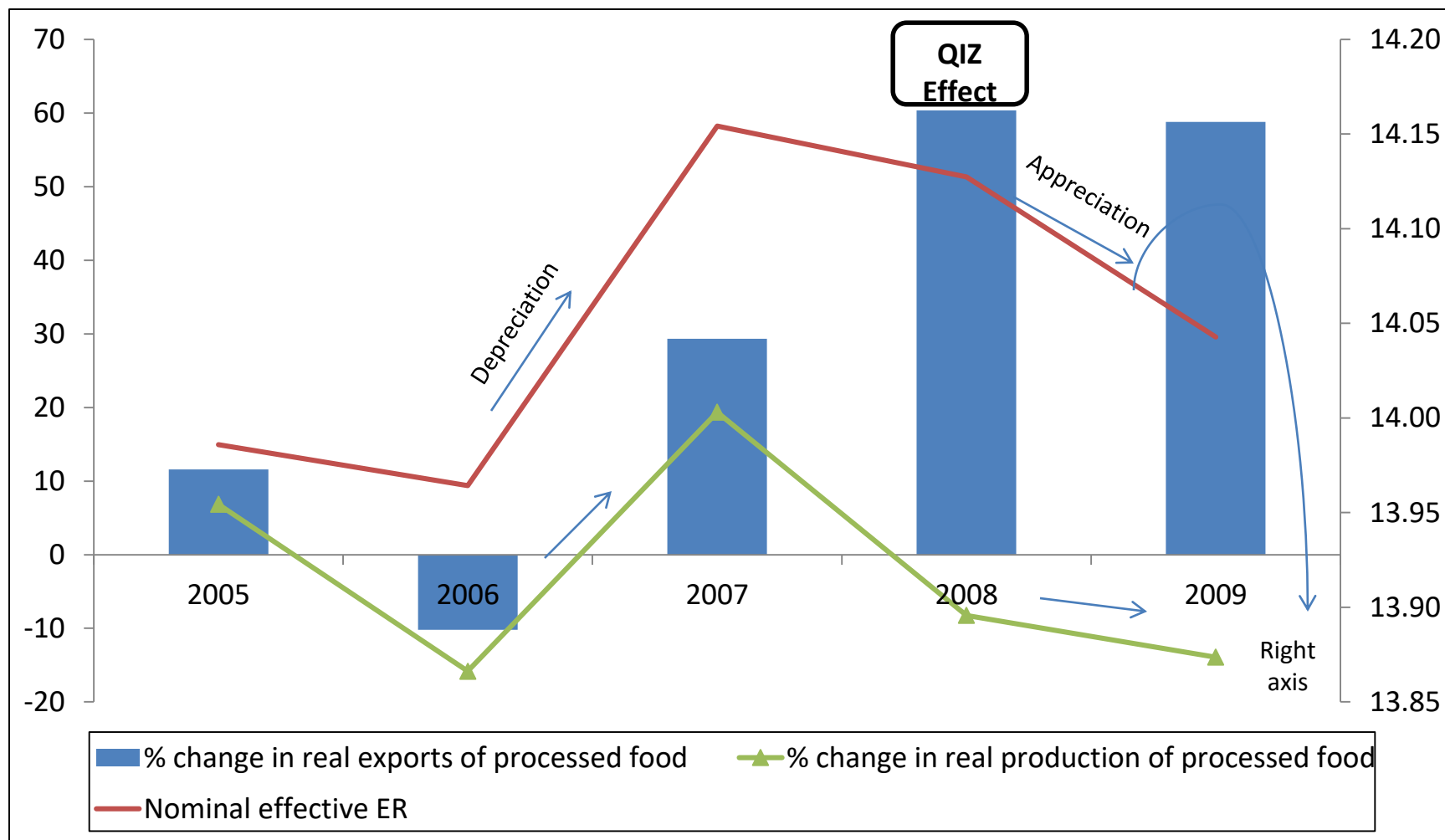


# **Disaggregate Analysis:**

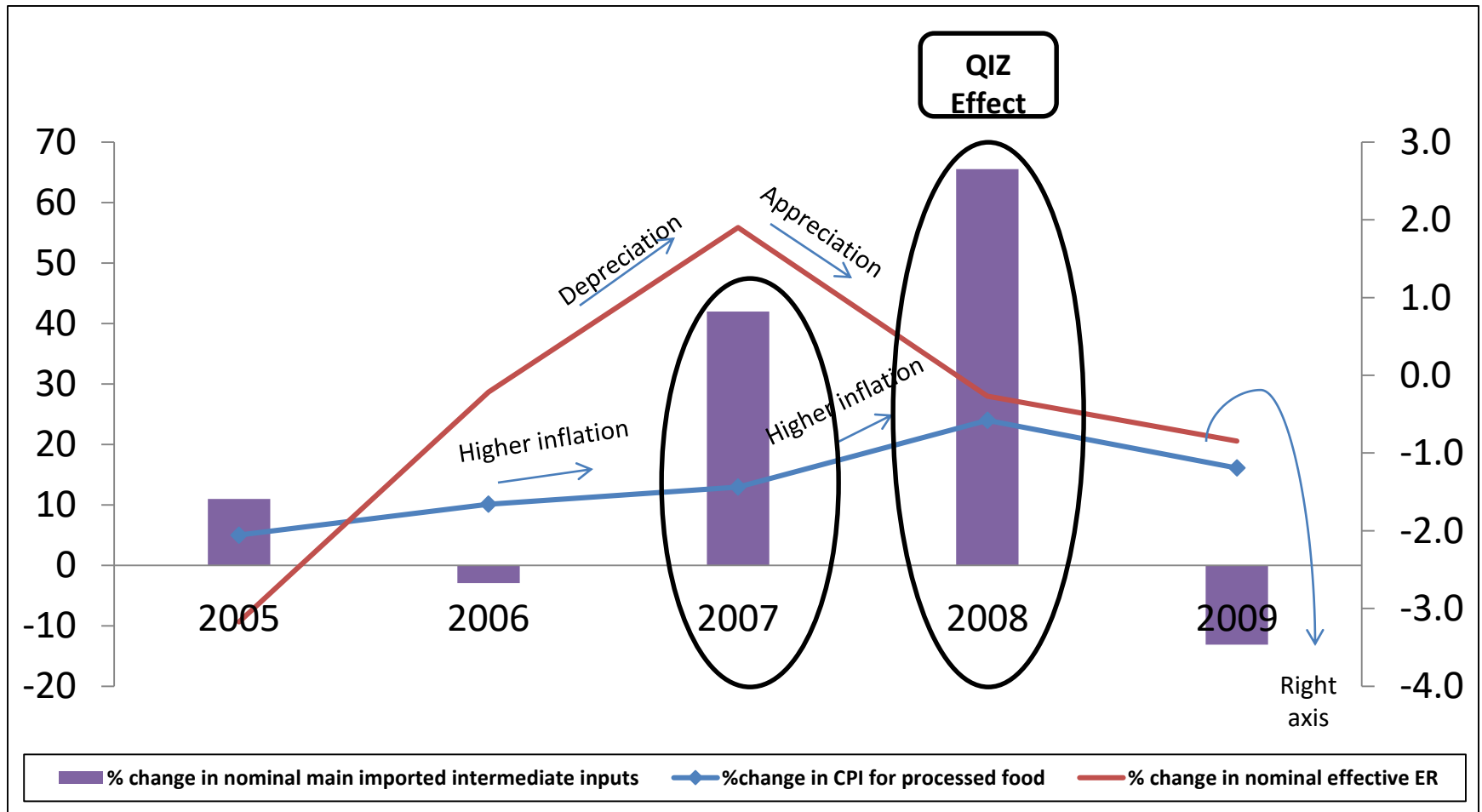
**Implications on Growth and Inflation :Processed Food Industry**

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***For processed food industry, depreciation of the Egyptian pound helps stimulate output growth, while appreciation, in the context of a decline in global growth, adversely affected output, despite robust export growth.***



**Price inflation reflects higher cost of imports, following depreciation. In contrast, inelastic imports limit the scope to reduce inflation following exchange rate appreciation, increasing the cost of production.**



Source: UN comtrade, SITC (Rev. 3)  
 IMF. International Financial Statistics  
 Central Agency for Public Mobilization and Statistics

# Implications

- *Exchange rate competitiveness has not been a major determinant of growth, at the aggregate level, despite some benefits for specific industries.*
- *However, the pass-through of exchange rate fluctuations to price inflation is more pronounced, both at the aggregate and industrial levels.*
- *Competitiveness requires striking a balance between growth and inflationary concerns.*

# Conclusion

- ❑ *Nominal depreciation may not be effective due to:*
  - *High dependency on imports that increase the cost of production and output price inflation.*
  - *Real exchange rate appreciation counters competitiveness of exports, resulting in higher trade deficit.*

# Conclusion

- To boost competitiveness and reap the full benefits of competitiveness, other measures are necessary to boost exports, including upgrading quality, market access and efficient production.*
- In parallel, policies should aim at countering the pass-through of exchange rate depreciation to higher inflation towards maintaining competitive real exchange rate, and stimulating real growth.*
- Further, creating domestic alternatives towards reducing high dependency on intermediate imports would solidify export competitiveness and curb inflationary pressures.*