The Egyptian Center for Economic Studies

Views on News

Date: 7 March 2024 **Issue no: 700** **Source: Central Bank of Egypt**

Extraordinary Meeting of the CBE's Monetary Policy Committee

The domestic economy has recently been affected by a shortage of foreign currency resources, leading to emergence of a parallel market for the exchange rate and slowdown in economic growth. The spillovers from global inflationary pressures continued to accumulate as the global economy was hit by successive shocks, leading to a rise in uncertainty and inflation expectations, which increased inflationary pressures.

Link

This issue of “Views on News” comments on the statement of the CBE’s Monetary Policy Committee, as well as the announcement by the IMF and Prime Minister Dr. Mostafa Madbouly signing a new financing agreement.

In this context, ECES has the following comments:

1. First, ECES welcomes the adoption of a flexible exchange rate, as it is a necessary measure and was inevitable. In fact, it was long overdue, as a flexible exchange rate is the norm. In fact, the economic system reached complete paralysis, and confidence was lost in the Egyptian economy as a result of the foreign currency shortage, which almost eliminated domestic and foreign investment and exports in light of the huge gap between supply and demand for the US dollar, resulting in the emergence of a parallel market that was twice the official exchange rate of the US dollar, not to mention its impact on citizens.

2. The exchange rate is expected to fluctuate significantly over the coming period before stabilizing at a rate that achieves equilibrium in the market, driving the parallel market into oblivion. It is a rate much lower than the rates the parallel market had reached previously, because a large part of the increase was linked to expectations of an increase in the exchange rate in a market that is very sensitive to such expectations. While unifying the exchange rate is certainly a step in the right direction, it will not be sufficient to solve Egypt’s real economic problem, as pointed out below.

3. Coupled with the announcement of the move to a unified exchange rate, the statement of the Monetary Policy Committee announced a new and

significant increase in the interest rate, stressing that this measure aims to control inflation. This raises a question about the timing of this measure in conjunction with the flotation, and the extent of the advantages and disadvantages involved, especially in light of its limited impact on inflation as the latter is not linked to demand pressure for goods but rather to an increase in cost, and also in light of the existence of other means to adopt a contractionary monetary policy, as required by the IMF, away from raising the interest rate, such as revisiting the statutory bank reserves.

4. Inflation essentially being linked to higher costs means that adopting a policy of continuous increases in interest rate worsens the problem instead of solving it, as it increases the nominal cost of borrowing, and translates practically into an increase in prices, in addition to growing debt servicing burdens on the Ministry of Finance, in addition to its negative impact on any productive investment, as it is impossible to achieve a return of up to 27%! The unification of the exchange rate will affect inflation gradually, but since the two measures have already been taken together, it is hoped that this simultaneity will not have a significant negative impact on the economic and social systems.

5. The signing of the new agreement with the IMF and the large investment project that Egypt signed along with the flotation procedures will certainly revive the economic system, despite the suffering of citizens—especially those with limited income— from inflation. However, it is important to note that restoring confidence in the Egyptian economy will not be fully realized except after fulfilling the domestic and foreign private sector backlog.

6. This new confidence, from both society and the private sector in particular, is only limited confidence as a result of resolving the foreign currency crisis.

But the foreign currency crisis is only a symptom of a larger problem, which is the approach followed in managing the state's resources and setting priorities and roles in the economic system, issues that were addressed in previous issues of "Views in News" and ECES research papers.

7. Addressing the roots of the problem requires major institutional reform that extricates Egypt from the vicious cycle of debt, poverty, and constant resort to the IMF, toward achieving the economic progress that befits Egypt's considerable resources, and shifting it to the path of developed countries in all fields; hence eliminating the symptoms of the problem, such as the foreign currency crisis, inflation, unemployment, poverty, and limited exports.

8. In the press release, Dr. Madbouly referred to rationalization and governance of spending, a greater role for the private sector, attracting investment and creating job opportunities, as well as increasing social protection packages—certainly sound goals and sincere promises, but the question is: To what extent will policies be adopted that differ from previous government policies in trying to achieve the same goals without achieving tangible results?

9. What is urgently needed is serious implementation of the IMF program while adopting a rapid plan for complete institutional reform so that Egypt moves from social protection packages to real opportunities in all fields as a result of significant economic activity, and attracting local and foreign investment in the real economy. Also required is significant promotion of education and health to capitalize on Egypt's human resources. This way we can achieve

robust economic and social systems that encourage social mobility and increase the incomes of both individuals and the state.