

FLASH NOTE:

CBE FLOATS THE EGYPTIAN POUND

THE CENTRAL BANK OF EGYPT (CBE) HAS ANNOUNCED THE ADOPTION OF A FREE FLOAT EXCHANGE RATE REGIME ON THE 3RD OF NOVEMBER 2016. THIS MOVE CAME AFTER YEARS OF FOREIGN CURRENCY SHORTAGE IN THE AFTERMATH OF JANUARY'S REVOLUTION IN 2011, WITH INTERNATIONAL RESERVES DROPPING BY ABOUT 45% TO USD19.6 BILLION IN SEPTEMBER 2016 AGAINST USD35.5 BILLION IN SEPTEMBER 2010. THE PETROLEUM MINISTRY ALSO RAISED FUEL PRICES AMID GOVERNMENTAL EFFORTS TO CONTAIN THE WIDENING BUDGET DEFICIT. THESE DECISIONS ARE EXPECTED TO ALLOW FOR THE DEEPENING OF FOREIGN CURRENCY LIQUIDITY WHILE STREAMLINING ACTIVITY INTO THE FORMAL CHANNELS. THEY ARE ALSO EXPECTED TO RAISE PRIVATE TRANSFERS, TRADE COMPETITIVENESS, FOREIGN INVESTMENTS, AND TOURISM REVENUES. ON THE OTHER HAND, THE INFLATION RATE IS EXPECTED TO SIGNIFICANTLY INCREASE, FURTHERING THE RISE IN PRICES OF MOST GOODS AND SERVICES.

EGP FLOATING AND RISING FUEL PRICES

The CBE decided to adopt a free-float exchange rate regime, with the US Dollar to be traded at EGP13 as a starting point and a +/-10% band placed on banks FX pricing. This band was discarded after the CBE's FX auction held on the 3rd of November.

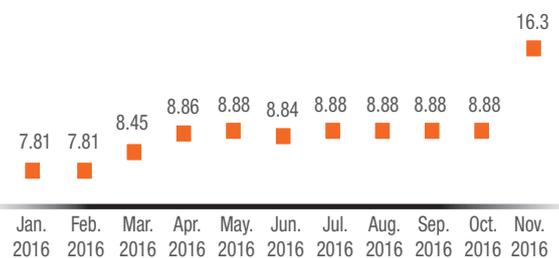
The decision was also accompanied with the following steps:

- ⬢ Raising core interest rates by 3% to 14.75%, 15.75% and 15.25% for overnight deposit and lending rates and discount rates respectively, to contain the expected inflationary pressures. Accordingly, State-owned banks "National Bank of Egypt", "Banque Misr" and "Banque Du Caire" are going to offer 18-months and 3-year investment certificates at 20% and 16% interest rate respectively.
- ⬢ Selling USD100 million to local banks in an exceptional foreign exchange auction at a cut-off price of EGP13, promising to hold multiple price auctions when deemed necessary.

Petroleum Ministry had to raise fuel prices late on Thursday 3rd of November 2016, came into effect as of Friday, to adjust prices after the depreciation of the Egyptian Pound. The Egyptian government plans to reduce subsidies by 14% to reach EGP 130.1 billion in FY 2016/17 compared to the previous fiscal year. This includes trimming the petroleum subsidy bill by 43.5% to reach EGP35 billion and the electricity subsidy bill by 6.4% to EGP29 billion in FY 2016/17.

The CBE also agreed with the Ministry of Finance to gradually phase out the monetary financing of the budget deficit over the coming months. This indicates a declining rate of issuing new T-Bills and T-Bonds. The objective is being consistent with the government's commitment to prudent fiscal policies which will contribute to decreasing the budget deficit and public debt.

Monthly Average Exchange Rate (USD/EGP)



Source: Ministry of Finance, CBE

- ⬢ Allowing banks to operate until 9PM every day, including Friday and Saturday, for foreign exchange transactions and transfers only.
- ⬢ Applying no limits or conditions on foreign currency deposits in banks, in addition to keeping the USD50,000 per month cap previously imposed on foreign currency deposits by companies importing non-basic commodities.

New Prices For Petroleum Products

	Before	After	% Change
80-Octane Gasoline EGP Per Liter	1.60	2.35	46.9 ▲
92-Octane Gasoline EGP Per Liter	2.60	3.50	34.6 ▲
Diesel EGP Per Liter	1.80	2.35	30.6 ▲
Small Gas Cylinder EGP	12.50	15	20 ▲
Big Gas Cylinder EGP	25	30	20 ▲

Source: Ahram Online

POSITIVE IMPACTS

A FAIR VALUE FOR THE EGYPTIAN POUND

- ▶ The CBE move ended speculations about devaluing the Egyptian Pound that led to raising its exchange rate in the parallel market to EGP18 per US Dollar. The US Dollar was traded during the first week post devaluation at EGP16.3 inside banks, with expectations to witness severe fluctuations for the coming period till reaching its equilibrium point.

ELIMINATING PARALLEL MARKET

- ▶ One of the main targets for floating the Egyptian Pound was channeling FX activity into formal channels, which would help deepen foreign currency liquidity in banks and eliminating the parallel market that appeared as a result of the foreign currency shortage Egypt has been experiencing. Different banks operating in Egypt started to raise limits on purchases and cash withdrawal from their debit and credit cards outside Egypt after continuously decreasing these limits for the past 2 months.

SEALING IMF DEAL

- ▶ The previously mentioned decisions taken by Egyptian authorities are going to help Egypt seal the USD12 billion deal with the International Monetary Fund (IMF) after fulfilling one of its main conditions to offer these funds to Egypt.

ATTRACTING FDI

- ▶ Eradicating foreign exchange risk, the financial risk of an investment's value changing due to the changes in currency exchange rates, is expected to majorly improve investment climate in Egypt and attract more Foreign Direct Investments (FDIs). The Egyptian stock Market will also benefit from the previous decision, with expectations of being well positioned among emerging markets. EGX30, Egyptian Stock Market main index, rose notably by about 20% on the 8th of November 2016 compared to one week earlier.

IMPROVING EGYPT'S CREDIT RATING

- ▶ The outlook for Egypt's credit rating is expected to rise for most credit rating agencies, with positive potential effect on Egypt's Eurobonds yields traded internationally that have already declined dramatically to 4.91% from 5.13% on the 3rd of November 2016.

SUPPORTING EXPORTS, REAL ESTATE, AND TOURISM

- ▶ The depreciation of the Egyptian Pound is expected to improve the competitiveness of Egyptian exports in international markets. Moreover, real estate is going to be more attractive for international investors, especially those who come from the Gulf area, due to its relative affordable prices. Tourism sector is also expected to benefit from the depreciation of the Egyptian Pound as Egypt is going to be a more affordable destination for tourists from all over the world.

GDP

- ▶ Potential inflows of foreign investments are expected to offset the negative impacts of deteriorating economic situation during the first half of 2016. Hence, GDP growth rate is expected to slightly decline to 4% in FY 2016/17 compared to 4.3% in FY 2015/16, with further improvement in the coming years.

NEGATIVE IMPACTS

RISING INFLATION RATE

- ▶ Prices of most goods (vehicles, food items, building materials, medicine ...) and services (transportation, ...) are expected to augment on the short term, with expectations for annual Consumer Price Index (CPI) to rise sharply in the first half of 2017.

RISING SOCIAL PRESSURES

- ▶ The political aspect in similar decisions cannot be neglected, with rise in prices directly impacting social morale and applying further pressures to living conditions.

HIGH COST OF LOCAL BORROWING

- Both the government and private sector may suffer from the rising cost of borrowing locally after the hike in core interest rates, with interest rates on 182 and 357-day T-Bills rising to 19.5% and 20.5% respectively compared to 16.1% and 16.8% for 182 and 364-day T-Bills one week earlier. This hike is expected to ease on the short term especially with the tendency to decrease the rate of issuing new government securities.

TESTIMONIALS



- “Egypt did not have the luxury of postponing urgent economic reforms. These decisions are our fate, and we have to move forward and the Egyptian economy has to improve”

Sherief Ismail
Prime Minister



- “Banks and other market participants are at liberty to quote and trade at any exchange rate. Bid and ask exchange rates will be determined by forces of demand and supply. The CBE will use the prevailing market rate for any transactions it undertakes”

Central Bank of Egypt



- “This is a welcome move given the economic circumstances. The way in which it is handled is welcomed and it's a decision clearly that the Egyptian authorities have matured and deliberated and are putting in place for the Egyptian economy and for the Egyptian currency”

Christine Lagarde
Managing Director Of IMF

MOODY'S

- “Adopting a free float exchange rate regime in Egypt will have a positive impact on the credit rating of Egyptian banks, as it will help increase foreign currency inflows to the economy and boost banking activities accordingly”

Moody's



- “The depreciation of the Egyptian Pound improves the competitiveness of Egyptian exports and help boost GDP growth rates in the coming financial year”

European Bank for Reconstruction and Development



- “The World Bank welcomes Egypt's recent economic and social reform measures including the floatation of the currency, measures to boost investment especially in Upper Egypt, adjusting energy prices to reflect market conditions, and strengthening the social safety net”

The World Bank



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