

## FLASH NOTE:

## TOWARDS A RESILIENT

## FX MARKET

OVER THE LAST FOUR YEARS, EGYPT HAS FELT THE EFFECTS OF THE SHORTAGE OF FOREIGN CURRENCY, ON THE BACK OF DETERIORATING TOURISM REVENUES AND FOREIGN DIRECT INVESTMENTS (FDIs) IN THE AFTERMATH OF JANUARY'S REVOLUTION IN 2011. BOTH GOVERNMENT AND THE PRIVATE SECTOR HAVE BEEN NEGATIVELY IMPACTED BY THIS SHORTAGE AS FOLLOWS:

### ON THE GOVERNMENTAL SIDE:

- Net International Reserves (NIR) have witnessed a notable decrease, reaching \$ 15.3 billion in January 2015 compared to \$ 35 billion in January 2011.
- This has weakened the government's ability to import fuel and pay dues owed to foreign oil companies operating in Egypt, which has led to consecutive energy crises.

### ON THE PRIVATE SECTOR SIDE:

#### LESS AVAILABILITY OF US DOLLARS IN THE BANKING SECTOR HAS LED TO:

- The advent of the black market that has steadily grown as an alternative source for foreign currencies, where US Dollar and Euro traded at a premium to the regulated rate.
- Increasing cost of production due to the increasing prices of imported raw materials, machinery and spare parts.
- Higher prices of imported consumer goods like food & beverages, vehicles, clothes and home appliances.
- Less attractive investment climate for physical and financial investments in Egypt because of foreign investors' concerns on exchange rate risk and difficulty to repatriate their funds.

In response, the Central Bank of Egypt (CBE) has periodically held FX auctions since December 2012 to provide banks with foreign currency to help them provide their clients' needs. Since starting the auction mechanism, the CBE has worked to hold the Egyptian Pound relatively steady in the official market. However, it traded at 7.80 per US Dollar, 9% higher than the official rate, in the black market, assuring that the monetary policy has kept it artificially strong, as its exchange rate hasn't reflected the real supply and demand dynamics in the market.

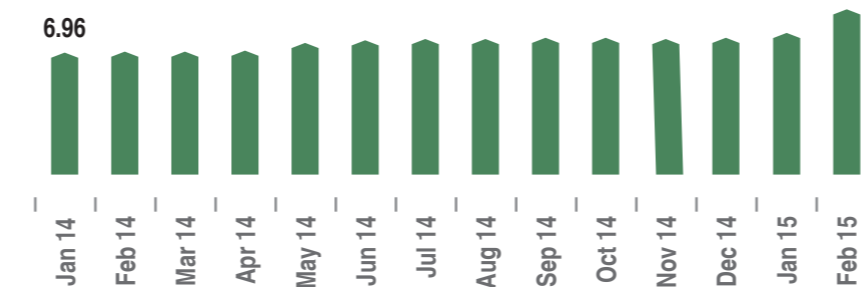
(1) Lowest price the CBE accepts from banks in FX auctions. The CBE uses these auctions to determine Egyptian Pound's exchange rate against foreign currencies, allowing trading them in banks within a fixed band.

## 2015...THE START OF DEVALUATION

On the 18<sup>th</sup> of January 2015, the CBE has allowed the Egyptian Pound to weaken against the US Dollar through raising the cut-off price <sup>(1)</sup> it accepted in its FX auction from EGP 7.14 to EGP 7.19, starting a gradual devaluation for ten consecutive auctions till 26<sup>th</sup> of February 2015 when the cut off price reached EGP 7.53.

The CBE has also imposed a \$ 10,000 daily ceiling for cash deposits in foreign currency for both individuals and companies, with a total monthly limit of \$ 50,000, besides preventing banks from buying foreign currencies from unknown sources. Further, the CBE widened the trading margin for banks to reach 10 piasters above or below the official rate, up from 3 piasters.

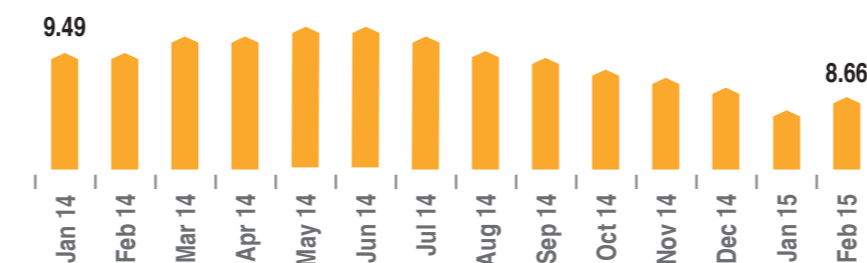
### EGP VS. USD



### THE MONETARY POLICY TURNAROUND AIMS TO:

- Reduce foreign investors concerns over exchange rate risk before Egypt's Economic Development Conference held on the 13<sup>th</sup>-15<sup>th</sup> of March 2015.
- Curb the rapid exhaustion of NIR that has already reached the red line, covering just 2.8 months of imports, limiting the CBE's ability to inject more dollars into the market.
- Offer a flexible exchange rate, reflecting supply and demand in the market to help eliminate the existence of two exchange rates for the US Dollar and attract the \$ 30 billion traded in the black market to the official market.
- Enhance exporters' competitiveness especially with main trade partners in the EU, as the Euro has depreciated against the Egyptian Pound by about 7% during 2014.
- Attract more tourists to benefit from the higher purchasing power of US Dollar versus the Egyptian Pound.

### EGP VS. EUR



### THESE MEASURES MAY ALSO HAVE NEGATIVE IMPACTS:

- Inflationary pressures could potentially decrease citizens' purchasing power.
- Widening of the budget deficit due to the expected rise in public external debt obligations, in addition to the increasing cost of strategic imports such as food, medicine, machines and raw materials.
- Lessening of 'non-essential' imports with a lower priority as the CBE obliges banks to give importers of strategic goods a priority in attaining their Dollar needs.

THE PREVIOUS MEASURES HAVE LED TO THE STABILITY OF THE EGYPTIAN POUND'S EXCHANGE RATE AGAINST MAJOR FOREIGN CURRENCIES AND AN ALMOST DISAPPEARANCE OF THE FX BLACK MARKET BECAUSE OF THE FOLLOWING FACTORS:

- The governmental success in attracting new investment deals worth about \$ 60 billion and \$ 12.5 billion grants and deposits in the CBE, pledged by Gulf countries through the economic conference.
- US Dollar liquidity increase in banks (According to the CBE Governor, Hisham Ramez, this liquidity has increased in banks operating in Egypt by 6-10 times after implementing the mentioned measures).
- Decreasing gap between official and black markets' rates. This gap reached around 7 piasters in March 2015, compared to 60 or 70 Piasters prior to January 2015.

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