



March 17, 2016

Contact Information

Head of Research: Marwan Mikhael
marwan.mikhael@blominvestbank.com

Research Department
Tel: +961 1 991 784

The measures adopted by the Central Bank of Egypt (CBE) during the previous 3 years to curtail capital flows, were having negative impact on exports, new foreign investments, and even existing investments. Giant cement producer Italcementi said it is considering moving its regional operations from Egypt due to its prevention from transferring annual revenues outside the country. General Motors announced last month it would temporarily close its factory if the crisis surrounding dollar liquidity is not resolved. Air France and British Airways, stated that they are unable to transfer their earnings after the crash of the Russian plane in October due to the shortage of dollars, which has deepened as a result of the decline in tourists activity.

The issue of the foreign exchange market in Egypt went through a vicious circle. Political and security instability led to a decline in foreign investment and tourism, which led to the depreciation of the currency. The CBE then took the decisions to establish capital controls to try to reduce the pressure on its foreign reserves. However these capital controls deterred foreign direct and portfolio investment, and even had a negative impact on exports and other local industries that were unable to import their raw materials. The situation has given the black market more control over the available US dollars. The foreign exchange reserves of the CBE dropped from USD 36 billion in the aftermath of the January 2011 revolution to USD 16.5 billion by end February 2016.

Since the election of Mohamad Morsi in 2012, the Egyptian pound has continued to depreciate against the US dollar, moving from 6.07EGP to 7.83 EGP by the end of 2015. The intervention of the CBE in the market had always moved against the liberalization of capital movement, which had the impact of exacerbating the lack of dollar availability in banks to cover the customer needs, allowing the black market to flourish throughout 2015 and eventually causing the dollar value to skyrocket.

During the last two weeks, the newly appointed central bank Governor Mr. Tarek Amer, took many decisions to break the vicious circle that was entangling the Egyptian forex market. On March 2nd, the CBE removed the cap on dollar deposits and withdrawals for companies. Furthermore, the CBE lifted on March 8 the monthly cap on dollar deposits and withdrawals for individuals. Previously the CBE had imposed limits on deposits at USD 50,000 per month and USD 10,000 per day.

On another front, the CBE auctioned USD 500 million to the banks on March 6 as opposed to the usual auction of USD 40 million that takes place three times per week. The auction occurred at the official rate at the time of EGP 7.73 per USD (this is the auction rate to the banks that will resell the dollar for EGP 7.83) and followed a deterioration of the exchange rate in the black market. In fact the exchange rate in the parallel market reached EGP 9.75 on Sunday March 6 compared to EGP 9.25 the previous Thursday.

On March 14th, the CBE devalued the currency by 14.30% to a new strike price of EGP/\$ 8.95 and auctioned a further \$198M in foreign currencies to cover imports of basic commodities. This devaluation targets the correction of imbalances in currency valuation by the government and the black market.

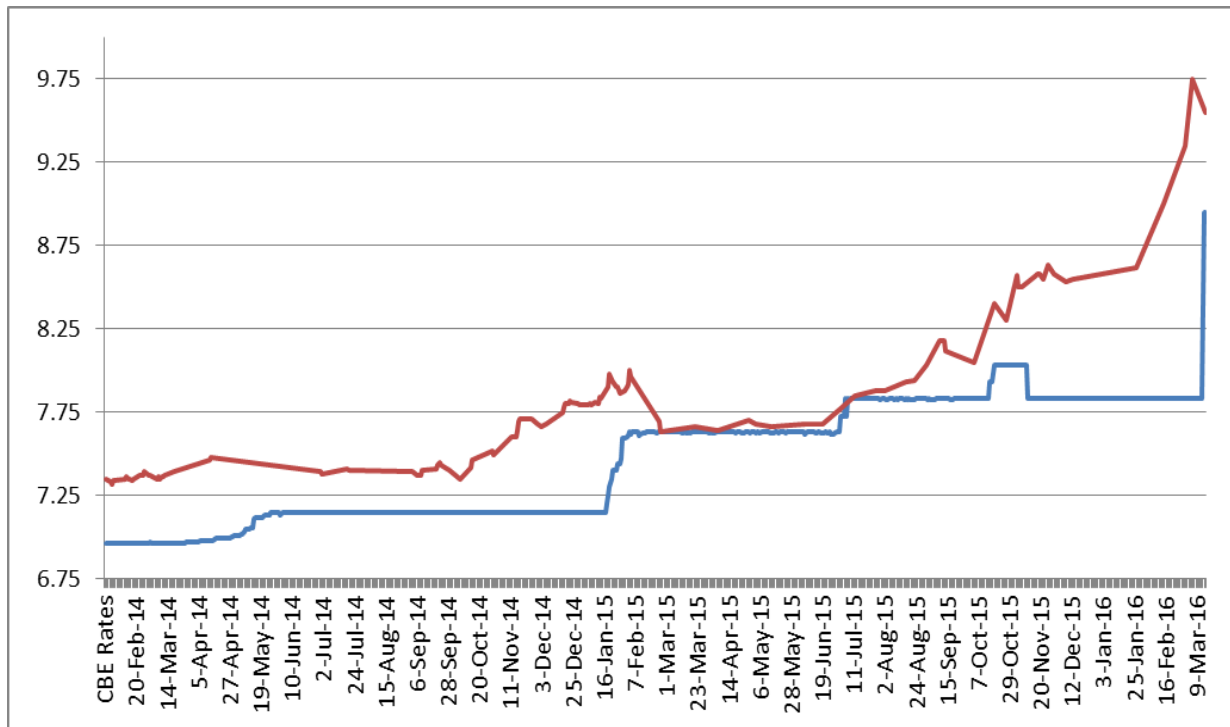
Impact of the devaluation on the forex market

The devaluation decision dealt a blow to the black market as transactions in this market ceased on Monday. This market suffered from a dollar deficiency after the devaluation and the large auctions by the CBE. According to exchange offices, the black market rate converged towards the official rate on Monday March 14 compared to EGP 9.20 the previous Saturday and Sunday.

Moreover, two of the government owned banks, namely the National Bank of Egypt and Banque Misr issued EGP savings certificates carrying a yield of 15 percent for those who give back their dollars to the bank. This of course will entice many individuals and will help in fighting the informal market.

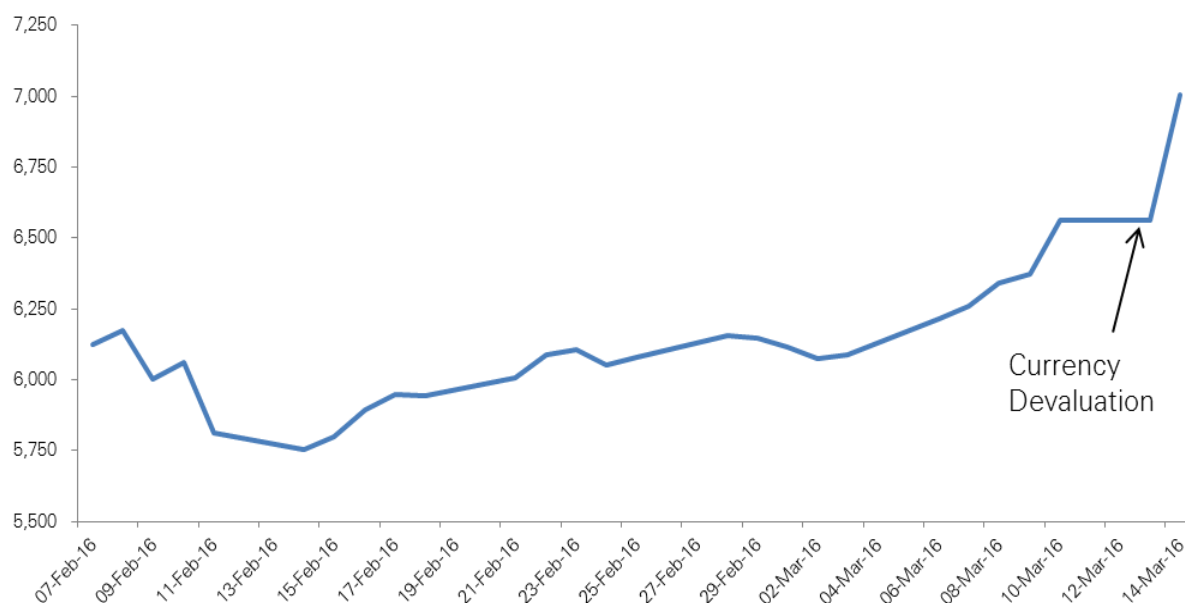
The central bank also offered USD 1.5 billion in a special auction on Wednesday March 16 to crush the black market and stabilize the forex market. During the last 10 days, the central bank offered more than USD 2.4 billion or around 15 percent of its reserves in order to provide the market with the needed liquidity in foreign currencies. The market should move into equilibrium for some time. However unless capital controls are completely lifted, the black market may reappear in the future once the impact of these measures fades with time.

Forex market: Official versus black market



Impact of the devaluation on the stock market

These policy decisions reflected positively on the Egyptian Stock Exchange, as witnessed by the 1.25% daily increase in the level of the EGX 30 following the removal of caps on dollar deposits and withdrawals on March 8th, and a 6.70% daily increase of the index to 7,003.85 points on Monday March 14th following the currency's devaluation. The level of foreign portfolio investment on the stock exchange was similarly bolstered. Upon the announcement of the currency's devaluation on March 14th, foreign investors contribution as a percentage of total value traded improved from a two-month average of 6.70% by February 2016 to 20.86% and have risen to above 32% on March 15 for the first time since end-November 2015. It is worth noting that following the CBE's decision to place caps on foreign currency deposits and withdrawals in early February, foreign portfolio investments' levels dropped to as low as 2.87% on February 7th, 2016.

EGX 30 performance since February 7th, 2016

Impact of the devaluation on the economy

It is too soon to study the impact of the devaluation on the economy, however if it succeeds in eliminating the black market, its positive implications will be unlimited. The economic growth could increase by 2 to 3 percentage points if the devaluation and the loosening of capital controls had their full impact on the economy, and this for many reasons. First the devaluation will render the Egyptian exports more competitive. Second, it will attract foreign direct investment as it was accompanied with the lifting of some capital controls measures. Third, it has facilitated the access of businesses to foreign exchange and therefore reduced their costs.

On another front, the devaluation may cause some inflationary pressures and reduce the purchasing power of the low income people. It is expected that inflation will jump by 4 to 5 percentage points following the devaluation as imports constitute 30 percent of the Egyptian GDP, and the EGP has been devalued by 14.3 percent.

For your Queries:

BLOMINVEST BANK s.a.l.

Research Department
Bab Idriss, Weygand Str.
POBOX 11-1540 Riad El Soloh
Beirut 1107 2080 Lebanon

Marwan Mikhael, Head of Research
marwan.mikhael@blominvestbank.com
+961 1 991 782

Disclaimer

This report is published for information purposes only. The information herein has been compiled from, or based upon sources we believe to be reliable, but we do not guarantee or accept responsibility for its completeness or accuracy. This document should not be construed as a solicitation to take part in any investment, or as constituting any representation or warranty on our part. The consequences of any action taken on the basis of information contained herein are solely the responsibility of the recipient.