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Behind exacerbation of Egyptian economic crisis

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At the outset, it must be emphasized that the repercussions that hit the Egyptian economy resulting from the covid-19 crisis or the Russian invasion of Ukraine are not the main causes of the Egyptian economy's problems¹, although they have contributed to accelerating the exacerbation of these problems, which accordingly required acceleration of the government's steps in facing them. Following are some of the key repercussions of war the Egyptian economy:

1- Hot money exodus

The exodus of funds invested in Egyptian domestic debt instruments is perhaps one of the most important and at the same time the most dangerous repercussions on the Egyptian economy in the wake of the Russian war on Ukraine.

Foreign investments in debt instruments (bills and bonds) have recorded about \$34 billion since September of last year, according to the Fitch credit rating report issued on 20 October last year². According to Bloomberg, amounts of this balance up to 15 billion dollars were withdrawn from the local debt market in the first three weeks after the outbreak of the war, where these amounts are likely to increase during the coming period.

It is noteworthy that this mass exodus of hot money from the Egyptian debt instruments market was not the first of its kind - as in a few days of the massive spread of covid-19, there was an unprecedented exodus of these tools, with a total of 20 billion dollars out within several weeks.

It is also known that investors in hot money prefer safe havens in the United States and major Western countries, especially in times of crises that push global markets to uncertainty. Accordingly, experts worldwide expected this money exodus from Egypt and other emerging economies, even before the recent crisis in Ukraine, following end of the quantitative easing -related to the covid-19

¹ This study is a continuation of a previous study published early this year under the title "An outlook of Egyptian economy over next 3 years (2022-2025)", by Dr. Ahmed Zikrallah, [link](#)

² After hot money exodus, devaluation of the Egyptian pound is likely, [link](#)

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crisis- in the United States and Western countries, and thus the beginning of raising interest rates, especially by the US Federal Reserve to confront a wave Global inflation that has escalated recently.

This confirms what Fitch Ratings reported in early March that emerging markets face a variety of additional credit risks stemming from the conflict between Russia and Ukraine, citing the price pressures and the declining investor appetite³.

Perhaps this prompted the Egyptian Finance Minister to stress that the mass exodus of foreign funds from Egypt's sovereign debt instruments was expected, which raises an important question: Why did the Egyptian government not hedge against the rising US interest rates, a decision that everyone had expected several months before.

It is strange that the Egyptian government waited about a month from the beginning of the Russian-Ukrainian war to start its first steps to raise the interest rate and reduce the value of the Egyptian pound, which has been managed for years through the Central Bank of Egypt (CBE), especially that the acceleration of raising the interest rate and decreasing the local currency might have worked, even in part, to slow down the exodus of hot funds. The slowdown in hedging this matter has led to huge losses for the Egyptian people. A simple calculation indicates that if 15 billion dollars came out, according to Bloomberg estimates, (may be much more at putting the decision into force) at an exchange rate of EGP 18.5 to the dollar instead of the EGP 15.5 rate at the exodus of the \$15 billion, the Egyptian economy would have saved about EGP 45 billion (equivalent to \$ 2 billion), which is considered a fine for the slowdown in making the appropriate decision and putting it into force.

In general, it must be emphasized that the hot money was certainly on its way to exit from the Egyptian market anyway, but on a gradual basis in coincidence with each raise of the US interest rate, whether the war in Ukraine occurred or not, as the US Federal Reserve expected that raising the interest rate may be six times to come. This indicates the possibility of recurrence of exodus of money with the successive raises in the US interest rate, and thus the continuation of the Egyptian government's approach to raising the interest rate and devaluing the local currency. It is easy to

³ What do you know about "hot money" and its impact on the devaluation of the Egyptian pound?, [link](#)

expect that interest and debt installments will devour up to 100% of Egyptian public revenues, and perhaps more in the next public budget.

2- Oil and grain hiking prices

The Russian war on Ukraine was not the cause of the ignition of oil prices, which have started to rise on a continuous basis since the second half of 2020. With the intense global competition to compensate for the losses of the closure due to the covid-19 crisis, this rise was fueled, not only in the price of oil, but also in the prices of all minerals important for industry, at the global level.

This escalation in oil and metal prices paralleled a series of crises caused by covid-19, such as the supply chain crisis, the failure of the agreement with OPEC + countries to increase production, and the Sino-US trade war, which have supported the upward trends in oil and metal prices, all of which existed before the outbreak of the war on Ukraine.

Before the war on Ukraine, the prices of the main food grains also escalated, especially in light of the difficulties in shipping and supply, in addition to the huge financial surpluses resulting from the expansion of quantitative easing programs, which led the pent-up consumer spending to inflate during the Coronavirus closures, which caused a continuous rise in inflation rates worldwide, clearly fueled by oil prices as well as the global prices of grains and cooking oil.

When the Russian war on Ukraine broke out, the oil price was around \$100 a barrel, and the wheat price exceeded \$350 per ton. In the midst of all this, the Egyptian Ministry of Finance had set the price of a barrel at only \$60, and wheat at \$255 per ton in the Egyptian budget. According to these prices, the budget deficit submitted to the International Monetary Fund is numerically set, within the framework of previous loan pledges, as well as the new loan talks that started more than a year ago, but officially announced a few days ago.

It can be said that the war on Ukraine contributed no more than 20% of the rise in oil prices. And because Egypt is a gas and oil exporter as well, it is likely that a significant increase in Egypt's natural gas exports may compensate for part of the repercussions of the hiking oil prices on the Egyptian budget, although this part is relatively small, as it is not possible to exceed the maximum liquefaction capacity at the Damietta and Edku stations. This raises a question about delay of the Egyptian Ministry

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of Finance in measures of insurance against the high oil price risks, which has repeatedly been announced by the ministry.

With respect to the rise in wheat prices, despite its upward trend during the pre-war period, the significance of cheap Russian and Ukrainian wheat to Egypt, the largest wheat importer globally, cannot be overlooked. However, at the same time, the decline of wheat cultivation in Egypt is a logical result of the Egyptian government policies towards the agricultural sector.

Perhaps it suffices to demonstrate this through pointing out that the total support provided to the agricultural sector in the current year's budget amounts to only EGP 365 million (compared to about EGP 3 billion in support of exports), and it is surprising that EGP 300 million of them are directed to the Agricultural Bank of Egypt to support it in the face of farmers' failure to pay loans due to the spread of covid-19, and therefore the total support directed to Egyptian farms amounts to only EGP 65 million.

In general, it should be noted that according to the government estimates, the Egyptian treasury is expected to bear an additional EGP 17 billion (about \$1 billion) due to the rise in prices of imported wheat and grains. Accordingly, it is possible to estimate the additional dollar gap as a result of the rise in prices of oil, wheat and other grains above the estimates of the general budget by about \$ 5 billion, in addition to other factors that fuel the rise in the deficit in dollar availability, which puts significant pressure on foreign exchange reserves.

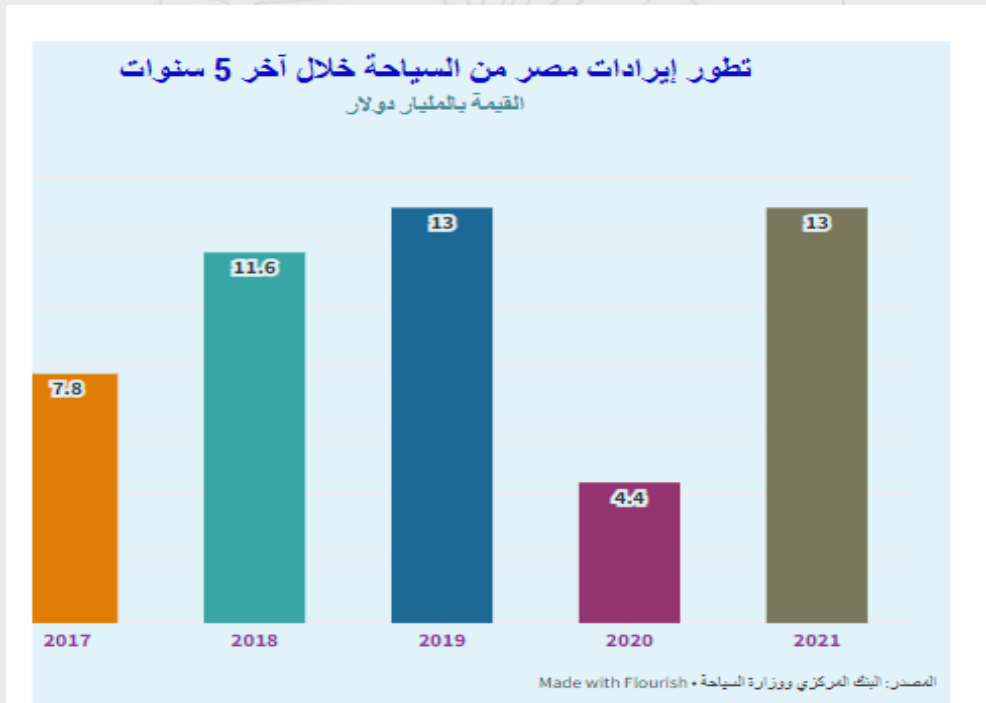
It is natural that the rise in the prices of oil, gas, minerals and major agricultural commodities would fuel the domestic inflation rate as it is the case in all countries across the world, but it should be noted that inflation rates in Egypt had previously flared up in conjunction with the first International Monetary Fund program. At the time, the purchasing power of the vast majority of Egyptians incurred losses that have not been compensated so far. Most likely, the current wave of inflation means that the majority of Egyptians are likely to forcibly abandon one or more meals per day.

3- Negative impact on tourism sector

Data included in the following figure indicate that Egypt received approximately 13 million foreign tourists in 2019, achieving an estimated income of about \$13 billion, while the CBE data indicate that \$3 billion is incurred in a nearly stable annual cost for tourism and reverse travel⁴.

Of course, the tourism sector was severely affected by the restrictions on travel due to the Coronavirus crisis, where tourism revenues decreased to about \$ 4.4 billion only in 2020, before rising to \$ 13 billion again by the end of 2021.

According to figures of the Ministry of Tourism and the Egyptian Chamber of Tourism Establishments, Russian and Ukrainian tourists represent about 40 % of the volume of beach tourism that comes to Egypt on an annual basis, where Ukraine ranked second in the incoming tourism movement to Egypt during 2019 before the covid-19 pandemic, as Egyptian tourist cities received about 1.6 million Ukrainian tourists, by an increase of 32%⁵ compared to about 727 thousand Ukrainians who visited Egypt in 2020, which constitutes 21% of the total foreign tourists who flocked during the year.



⁴ Zikrallah Ahmed. An outlook of Egyptian economy over next 3 years (2022-2025), [link](#)

⁵ How is Egyptian tourism affected by the Russia-Ukraine war?, [link](#)

With respect to Russian tourists coming to Egypt, Russia resumed trips in mid-2021 only, after a halt of more than five years, specifically since October 2015, due to the bombing of a Russian passenger plane over the Sinai Peninsula, where about 3.2 million Russian tourists visited Egypt in the same year, about 33% of the total inbound tourism to Egypt.

Since the resumption of tourism between Egypt and Russia in June 2021 until the end of the year, the number of Russian tourists has reached about 700,000, according to the Executive Director of the Federation of Executive Tourism Companies, and thus Egypt has become the second tourist destination for Russian tourists after Turkey.

Analysis of the figures related to Russian and Ukrainian tourism indicates a loss of about \$ 1.6 billion annually due to the cessation of Ukrainian tourism, and perhaps a loss of \$ billion from Russian tourism that had been suspended.

It is noteworthy that Egypt has failed to diversify its tourism markets and is still dependent on traditional markets, which clearly indicates a limited Egyptian tourism ambition compared to the huge potential available there. In general, it can be said that these losses can be offset by focus on new tourist markets, which is not actually happening.

In conclusion, the above analysis indicates a loss of about \$ 3 billion in Egypt this year due to the damage to the tourism sector resulting from the war on Ukraine, an additional \$ 1 billion on the grain import bill, in addition to an expected increase in the oil import bill by no less than \$ 4 billion. After the recent rise in the Suez Canal traffic fees, it is expected that there will be a good increase in the SC revenues, but will not unfortunately be included in the general budget in light of the fact that only one-third of the revenues is included in the budget, with secrecy surrounding the remaining two-thirds.

Based on the above, the dollar resources from the migrating hot money constitute the largest burden on the Egyptian economy during the remainder of this year and perhaps next year as well. The above analysis also confirms that the war on Ukraine only accelerated emergence of the consequences of the accumulated policies eight years ago.

Egypt's total loss of dollar resources as a result of the exodus of hot money and the rise in oil and grain prices, as well as the drop in tourism revenues, is estimated at approximately \$25 billion⁶.

⁶ The views expressed in this article are entirely those of the author's and do not necessarily reflect the views of the Egyptian Institute for Studies