



An economy's real exchange rate plays an important role in resource allocation as it determines the relative price of tradable and non-tradable goods. It also guides the consumption and investment decisions of economic agents. Exchange rate misalignment occurs when the real exchange rate becomes disassociated from its equilibrium value and this may arise due to an economic shock with a significantly destabilizing effect, frictions in the foreign exchange market that prohibit efficient price discovery, or a policy intervention such as supporting a currency peg. Regardless of its cause, the misalignment results in misallocation of resources between the tradable and non-tradable sectors and tends to create an unsustainable balance of payments position, possibly leading to a currency emergency.



1) Was devaluing the pound inevitable and what the future holds for our EGP?

In a bold move, the Central Bank of Egypt went for a surprise interest rate hike and allowed the EGP slip against the USD. The CBE raised rates by 100 bps, its first hike in five years, after calling a special monetary policy meeting on 21 March. The bank acted to stave off inflationary pressure and support economic activity. A number of factors prompted the CBE to act impatiently quickly, including (a) the imperative to tamp-down inflation, (b) the need to keep Egypt attractive to the global carry trade, and (c) wiping away the perception that had emerged in some quarters that the EGP was overvalued against the greenback.

The central bank's moves are the latest in a series of on-point policy measures by the Sisi administration as Egypt faces fallout from Russia's war with Ukraine. The two countries together account for a bit more than 30% of all tourist arrivals in Egypt and sell us just over 85% of our total wheat imports. The war is also driving a global risk-off, has sent the price of oil far above the figure penciled into Egypt's 2021-2022 national budget, and comes at the same time as the US Federal Reserve hiked interest rates for the first time since 2018, providing more generous returns to risk-averse investors.

So, in brief, the answer is YES!! The free float was inevitable and couldn't have been done in a better way due to the speed of the taken adjustment which's could be a balancing act by itself. It is expected that the real exchange rate after applying the free float regime in any country will try to stabilize and to buffer against external shocks allowing the economy to absorb them without generating the large inflationary or deflationary pressures that tended to result under the previous fixed exchange rate regimes. A move to fair value in the short term implies that the currency would not be as overvalued in the future, resulting in a slower pace of depreciation in the long run which the timeframe which many foreign investors are actually interested in. This could be positive for portfolio inflows as well as the economy's competitiveness in the long term.

The unknown is uncertain. Uncertainty can intensify how threatening a situation feels. We could not confirm by how much the EGP will devalue over 2022. There are a lot of uncertain external global factors controlling and affecting the local and regional situation. Not only for Egypt but precisely for the emerging markets and the EU due to the Russian Ukrainian war. Therefore, exchange rates now come down to economic factors, political conditions and market psychology. We would likely wish if the CBE could create a band for the EGP currency identifying the minimum and the maximum value the EGP could reach, as investors do look forward to more transparency and clearer long-term plans. This would help introduce the idea of a perfect competition where (a) everyone has perfect information about what is being bought and sold, (b) everyone sells an identical product, (c) no one person can control the market price, (d) everyone has a relatively small market share, and (e) there are no barriers to entry or exit. Under perfect competition, no one can develop into a monopoly because there are many buyers and sellers and prices reflect supply and demand. Everyone earns enough profit to survive, and no more, because any excess profits are competed away as other businesses enter the market and drive profits down.





2) How Egypt real estate market is being affected by the commodity price shock and the EGP devaluation?

Real estate is one of the most critical sectors to the Egyptian economy, constituting more than 16% of the country's GDP, according to Central Bank of Egypt. With a significant portion of Egyptian households' wealth stored in real estate investments, a debate has been created about the expected increase in real estate prices in 2022 due to the expected increase in inflation. The Russian-Ukrainian war and its accompanying inflation has led to a rise in the cost of building materials, with the annual inflation rate in Egypt recording 10% for February 2022, compared to 4.9% a year earlier.

The jump in global energy costs is pushing up cement prices, accounting for some 50% of the increase in cement prices. Coal, the primary source of fuel used for cement production, has been rising since the beginning of the year, but began to really soar at the end of February, when the war started. One ton of coal was trading at around 240 USD on 25 February, jumping to 400 USD per ton on 2 March and peaking at 423 USD per ton on 9 March, according to market data. Prices have since chilled, with a ton of coal currently priced at **324 USD**.

Faced with these increasing energy costs, some local manufacturers decided to temporarily suspend production and rely on selling stockpiles in hopes of waiting out the price volatility. But some producers who chose for this route depleted their cement stocks and are now faced with even higher input costs than when they had decided to suspend production. So, it's natural that this will be reflected on their final product at a higher cost. And even manufacturers who still have stocks to sell are likely going to be selling their cement at current market prices, to be able to ensure enough of a margin to cover the costs of their next coal purchase and manufacture more cement.

The prices of cement now vary between producers, depending on when they sourced their energy. The Head of the Cairo Chamber of Commerce's building materials division Ahmed El Zeiny told Enterprise that cement is now selling at **1.6k EGP** per ton. Local cement manufacturers want to increase their reliance on natural gas, and are looking to set their natural gas consumption at 10% of their fuel mix. While relying on natural gas as a local energy source would be beneficial for manufacturers, particularly if the government supplies it at lower costs, this scenario seems far-fetched, since the energy shortage in Europe is the perfect window for Egypt to export more natural gas and increase its revenues.

Steel prices are also going up. The war's inflationary wave is also touching steel, the price of which jumped to 21k EGP from 15.5k EGP over the course of two weeks. This rapid jump is primarily caused by a significant rise in imported scrap metal prices (to 650 USD per ton, from 514 EGP per ton), which accounts for around 60% of the cost of steel, according to the head of the FEI's metal industries division Mohamed Hanafy. Steel prices are also affected by higher shipping and freight costs, particularly in light of ongoing supply chain disruptions. This issue is compounded by the shortage of raw materials, which is pushing manufacturers to import their goods from China and India (as opposed to Europe), resulting in even higher shipping and freight expenses.

In brief, for all of the above reasons, it is expected an increase in the prices of real estate units ranging between 30-50% during the current year and it is possible that the inflationary wave in real estate prices will extend until the beginning of next year after the expected inflation. The developer needs to earn in the new and compensate for his losses in the old units sold, and this will be reflected in the price of the new proposals. Challenges are mounting for the government: the government is in a tough position, would you buy wheat and food staples to ensure food security, or buy steel and cement?