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## AN EXPLORATORY ECONOMIC STUDY OF THE IMPACT OF THE EGYPTIAN POUND FLOTATION ON ASPECTS OF THE EGYPTIAN ECONOMY

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### ABSTRACT :

**T**he problem of this study is to represent the negative impacts of pound flotation on the Egyptian economy and on other different aspects of the economy. Also, it aimed at identify the positive and negative impacts of floating the pound on aspects of the recuperating Egyptian economy with all of its suffering in the last period. Among these sufferings are; the recession in tourism, increasing the amount of imports, declining the amount of exports, increasing the prices for the majority of food commodities and lack of wage increases, in an attempt to reach the recommendations that can help to encounter those challenges. In an attempt to achieve this objective, the study tackled the effects of the flotation decision on the foreign exchange earnings, indicators of the Egyptian exports and imports and the living situation of the Egyptian citizen. Finally, the study concluded that the increase of the foreign exchange reserves to about 16.564 billion dollars by the end of August 2016 compared to 15.536 billion dollars by the end of July of the same year. Also, the performance of the Egyptian stock exchange was

improved as well as the positive reaction in the market. However, the black market returned to be more active than before, making everyone speculate that the government will decide further actions (the partial removal of subsidies on many strategic goods) as part of the agreement with the International Monetary Fund (IMF). Besides, the Egyptian pound still continuing to decline against its counterpart, the dollar, since the dollar price in banks reached to about 18.75 as the price to buy and about 19 pounds as the rate of sale. As for the Egyptian living reality, the flotation decision had a negative impact which was clearly evident in the sharp rise of the prices of all food commodities and production requirements, as well as a severe shortages of many commodities, at the top was the sugar and many medicines, especially after the cessation of the medicine companies form importing, resulting from higher customs dollar as a means to impose pressure on the government to raise prices. Also, the decision to reduce support form gasoline, diesel fuel and supplied goods had a great impact of the rise of all prices of goods and services; such as education, transportation, prices of electricity, water, health care and all aspects of the Egyptian economy. Additionally, this study recommended increasing exports through increasing the domestic product and giving attention to its quality so that it can compete in the global markets, as well as working on the establishment of large-scale projects (Food industry) to accommodate a great number of labors in order to gradually eliminate unemployment.

**KEYWORDS :** Economic study, Egyptian economy, Pound Flotation.

### INTRODUCTION

The first real flotation of the pound was carried by President Al-Sadat, when he allowed the return of the importing cards to the private sector. Hence, he started the era of borrowing from the West, which later became the so-called "Debts of the Paris Club". Yet, Al-Sadat's disability to unpeg the general budget of 1977 and the lack of the continuous flow of the Gulf investments along with the general economic weakness in the eighties led to the

occurrence of the dollar crises again. Consequently, the dollar rose officially from 1.25 pounds to about 2.5, which led to the bankruptcy of many people. Moreover, the Egyptian private sector borrowed dollars and worked in pounds. Therefore, Egypt encountered with an "economic setback" that started with the beginning of the financial crisis, that hit the entire world in 2008, and reached its peak in the wake of the 2011 Revolution accompanied by the subsequent unrests that led to the reluctance of foreign tourists and investors, who are the two main sources of the hard currency, along with the decline of the revenues of the Suez Canal and the remittances of the Egyptians working abroad.

Recently, the Central Bank of Egypt began the first steps to float the pound against the dollar which was a decision talked about by economists and officials during the last period, but the conditions of inflation and the reduction of the country's foreign exchange prevented that during the last period. Additionally, the investment bank, "Belton Financial", considered the month of October 2016 as a final political support for the flotation decision. Besides, the Committee of the Monetary Policy in the Central Bank of Egypt has approved flotation. Also, Belton Financial has predicted in a research note that the dollar price after the flotation will reach to 11.5 or 12.5 pounds. Thus, Egypt was obliged to commit to the economic reform program as a condition to get a loan of the International Monetary Fund. This loan was estimated by 12 billion \$ during three years. Its most important items were to reduce the local currency to reflect its true value. In addition, the Central Bank encountered intense pressure to reduce the value of the pound and waged strong controlling campaigns on the money exchange traders to control the price of the dollar in the black market. Thus, in the recent days, the dollar jumped above the level of 18 pounds, compared to 8.88 pounds in the banks before flotation. There are two scenarios for the flotation. The first is the full flotation of the pound, and the second reducing it through an exceptional giving to sell the dollar. Therefore, Egypt was turned to an exchange rate system that was more flexible on one condition, to move to the entire flotation before the beginning of 2017.

### PROBLEM OF THE STUDY

The problem of the study is embodied in the negative effects resulted from the flotation of the pound on the Egyptian economy and on various aspects of the economy.

### OBJECTIVE OF THE STUDY

The study aims at identifying the positive and negative effects of the flotation of the pound on aspects of the recuperating Egyptian economy with all of its suffering in the last period and the recession in tourism, increasing the imports amount, decreasing the exports amounts, increasing the prices of the majority of food commodities and lack of wage increases, in order to reach recommendations that can help to encounter these challenges.

### METHOD OF APPROACH AND DATA SOURCES

The study depended on the statistical descriptive analysis style to describe data. Moreover, it has been relying on data from a field study in the markets where 150 forms were assembling were collected by 50 Form from the vegetables and fruit markets, 50 from the butcher shops and consumer associations, 50 from supermarkets and grocery stores. Also, this study used many of the Web sites and studies that are relevant to the topic of the research.

### FINDINGS OUT OF THE STUDY

#### Meaning of the pound flotation and its types:

It is a method in the management of the monetary policy. Also, it means that the Central Bank leaves the exchange rate of the currency and equating it with other currencies, determined by the forces of supply and demand in the cash market. Besides, the governments' policies differ to float their currencies depending on the standard of unpeg its national economy and the adequacy of its performance and flexibility of its production system. Moreover, the flotation policy includes two types, the first is "free-floating" that means that the Central Bank leaves the currency exchange rate to change and determine freely with time, according to market supply and demand. However, the intervention of central banks will be only in this situation to affect the speed of change

in the exchange rate, and not to reduce this it change.

Additionally, it is relying on this type of flotation in the advanced, industrialized and capitalist countries, such as the American dollar, the British pound and the Swiss franc. However, it cannot be useful or reliable in the case of Egypt since its economy is suffering from many crises. Also, Egypt has not yet turned to be a producing country whose exports rise from its imports. The second type of flotation is the "managed flotation", which means to let the exchange rate to be determined according to supply and demand with intervention from the Central Bank whenever it is necessary to modify this price compared to other currencies. This happened as a response to a set of indicators such as the size of the gap between supply and demand in the exchange market, the rates of cash and delayed exchange prices, and the new developments in the exchange rate markets. Moreover, it is important to mention in this context that flotation is reversed to connectivity. Currencies pegged against the main currency or the basket of currencies is floated through the "unpeg" of the currency either partially or wholly. As for the decrease in the currency value, its opposite is the increase of the currency value, as it happens for the major currencies in free open markets; such as the US dollar or the euro or others. As the value of those currencies rise or decrease in the market according to supply and demand, the strength of the fundamentals of economies they represent, and the actions of speculators in the currency markets. For example, China has basically linked its national currency, the Yuan to the basket of currencies and the US dollar. Besides, China is under pressure from the West to unpeg this link and let its currency's value to rise or decline according to the market factors, which means "to float the Yuan," and that is the first kind. Indeed, China has recently resorted to float its currency against the dollar, in response to criticism during the American presidential campaign of the policies of China's cash and its impact on trade with America.

### **The Impact of the Pound Flotation on the Foreign Exchange:**

Egypt's reserve of the foreign exchange is expected to increase as soon as it receives the first slice of the International Monetary Fund (IMF) loan. Also, the Central Bank noted that it is possible to float the pound when foreign exchange reserves will reach to 25 billion dollar. Besides, the Central Bank coordinated with the National Bank, Bank Misr and Cairo Bank to raise the interests' rates on the three years investing certificates (16.5%) yearly, as well as the category of 1.5 years (20%) to launch an attack on the black market. The Central Bank of Egypt has announced that the foreign exchange reserves rose to 16.564 billion dollars by the end of August 2016 compared to 15.536 billion dollars by the end of July of the same year, with an increase valued by about one billion dollar. In addition, it is worth to mention that Egypt's economy is suffering from great difficulties. So, it is essential to make rooted economic reforms to encounter these difficulties. The Egyptian government pegs its currency (the pound) to the dollar with a fixed rate which is the official price in banks, but the shortage of foreign currency makes the dollar price much higher on the black market.

However, the Central Bank of Egypt surprised the market through decreasing the price of the pound 14.5% against the dollar (1) in the first official reduction. Thus, the announcement of the devaluation of the pound against the dollar came in an attempt to ease the shortage of foreign currency and to eliminate the black market and also to face the imports of basic strategic goods. Consequently, the Central Bank sold 198.3 million dollars in an exceptional giving by a price that reached 8.85 pounds. This has happened as a part of reforming the distortions in the system of exchange rates. As a result, the foreign exchange was restored into the banking system on a regular basis. Thus, the government proved the power of its national currency through pegging, and reduces the black currency market by raising the dollar price in order to meet the investors' demand for dollar that was not available to them through the official market. Also, it aimed at encountering the increase of the dollar's trade on the black market. Therefore, the Central Bank of Egypt, entrusted with the government's monetary policy, decided the activation of flotation as a tool and partially unpegs the Egyptian pound to the dollar. In spite of the improvement of the Egyptian stock Exchange and the positive reaction in the market, yet the black market returned to be more active than before, making everyone speculate that the government will decide further action (the removal of support on the part of many strategic goods) as part of the agreement with the International Monetary Fund (IMF). Also, the Egyptian pound continues to decline against its counterpart, the dollar, since the dollar price at banks reached to about 18.75 as the price to buy and about 19 pounds as the rate



of sale. The Impact of the Flotation on the Egyptian Exports and Imports: It is expected that the flotation of the Egyptian pound to achieve some of the positive effects, most notably; it reduces the pressure on the Central Bank in relation to the size of foreign exchange reserves. However, this factor does not have an essential significance in the overall economy. Yet, the most important thing is that the devaluation of the national currency as a result of the flotation will lead to an increase in the exports. Consequently, the Egyptian products will become much cheaper in foreign markets, because the value of the Egyptian pound depreciated significantly against the dollar and the euro, etc. Then, it becomes more competitive. In contrast, the imports prices will rise in general as well as the prices of the strategic goods in particular.

As for the repercussions of the devaluation of the pound against the dollar again in this year, it includes an increase in the imports cost; which will lead to a new wave of high cost of goods in a country imports about 60% of its food needs. Then, it will be difficult for the Egyptians to buy a lot of imported goods due to the rise of its prices. Consequently, this will increase the consumption of the local goods as well as increasing the local economic activity. However, the imbalance of the balance of exports and imports leads to high rates of inflation, in accordance with the theoretical concerns. In addition, the rate of parallel economy in Egypt is almost equal to the rate of the informal economy, which means that the real inflation rates will be much higher. Also, it means more poverty for poor classes in the Egyptian society. The biggest fear of the severe devaluation of the pound is that there will be no existence of the local currency, entirely (such as the experience of Somalia, Zimbabwe).

Moreover, the crisis becomes worse with the decline in the outcome of the main sources of the foreign exchange; among them are tourism, direct foreign investment, the income of the Suez Canal and exporting. Besides, the Central Bank will depend in increasing cash reserve on loans related to the interests, repayment time and the sale of government bonds abroad. Thus, the government sold dollar-denominated bonds worth 4 billion dollar in stock exchange in Luxembourg for an interest rate that reached about 8%.

### The Impact of Flotation on the Egyptian Living Reality:

Egypt is under the pressure of the conditions set by the International Monetary Fund to grant it a loan of 12 billion dollars over three years. Among these conditions are; the flexibility of the local currency exchange rate in line with its true value. Besides, there are a lot of speculations about the repercussions of the flotation on the Egyptian economy, which suffers from a lack of financial resources and its impact on the lives of the Egyptians. It has actually improved, during the few months since the implementation of the decision of the pound flotation and the announcement of the Egyptian government's decision to float in the 3rd of November 2016 under the pretext of reducing or eliminating the black market and the unpeg of the exchange rate, as well as the recovery of the investment in the light of the exhausted economy from which the country has recently suffered. However, this decision led to many problems. Perhaps the most prominent of these problems are; the sharp rise in the prices of all food commodities and production requirements, as well as severe shortages of many commodities, especially the sugar and many medicines, especially after the cessation of drug companies for import, resulting from higher customs dollar and as a means to impose pressure on the government to raise prices. Also, the decision to reduce support from gasoline, diesel fuel and supplied goods had a great impact of the rise of all prices of goods and services; such as education, transportation, prices of electricity, water, health care and all aspects of the Egyptian economy.

### The Field Study Forms(3)

Table (1) showed that the situation has grown worse due to the crazy high prices. Consequently, this led to the deterioration of the living situation of the Egyptian citizen, who has not yet recovered from the adoption of the value-added tax, which resulted in the high rise of some goods by rates that reached up to 30%. Moreover, the prices rose after the flotation decision, so the price of liter 80.92 fuel raised by 46.5, 34.4% in 2017 comparing to its counterpart in 2016 for each of them, respectively. Thus, all commodities continued in increasing their prices (red meat, consumer associations, butchery) by about 25%, 25-77.5% for each of them respectively, poultry 27%, cichlid and mullet fish about 11.5% -104%, oils, detergents (automatic liter) about 50%, 55%. Besides, the rice increase by about 100-122%, free sugar 200%, supplied sugar by 40-140% , tea by 37.3%,

tomatoes by 100-233%, eggplant by, 150%, spinach by 20-60%, potatoes by about 66.4%, red onions by 200%, garlic by 775-900, lemon, white onions by about 400 per each of them, eggs (carton) increase by 42.5-52%, free bread, dried milk by 50.125% for each of them, respectively. As for Macaroni, the increasing rate reached about 42.5% in comparison to the counterpart of those prices in 2016 and before the flotation decision.

**Table 1: The current prices of the commodities goods under study during 2017 Compared to their counterparts in 2016 (Kilo gram per Unit).**

Goods	2016	2017	%
Liters of fuel			
80	16	2.35	46.5
92	26	3.50	34.4
Red meat (the consumer associations)	60	75	25
Meat(butcher shops)	80-90	100-160	25-77.5
Poultry	22	28	27
Fish (cichlid and mullet)	18-22	20-45	11.5-104
Oils (1 liter)	16	24	50
Automatic detergent liter/	20	31	55
Macaroni	3.5	5	42.5
Rice	4.5	9-10	100-122
Free Sugar	5	15	200
Sugar (Supply)	5	7-12	40-140
Tea (1/4)	16	22	37.3
Fresh dairy	9	12	33.2
Preserved dairy	9-11	14	33.2-55.3
Tomatoes	1.5-3	5-6	100-233.2
Eggplant	2	5	150
Spinach	5	6-8	20-60
Potatoes	3	5	66.4
Red onions	3	9	200
Garlic	4	35-40	775-900
Lemon	4	20	400
White onions	2	10	400
Eggs (carton)	25-28	38-40	42.5-52
Free Bread	50	75	50
Dried milk (900 gram)	40	90	125

Source: 1-Market Price Survey Questionnaire 2016.

2- Chamber of Commerce at Giza Governorate, the Sector of the Economic and Commercial Affairs and Departments 11/06/2016.

Additionally, there was an increase in the prices of furniture, goods, electronic cars and all other goods and services along with a heavy rise in medicine prices and the lack of availability of much of them. On the other hand, there was a stability of wages and salaries, which exhausted the shoulders of the Egyptian citizen. Besides, the stability of the salaries with the sharp rise in prices led to a decline in the real value of these salaries. This led to a decline in the purchasing power of the citizens, leading to an increase in the number of people under the poverty line to about 65%, as indicated by the recent US report.

#### RECOMMENDATIONS:

The study suggests that a free economy cannot be applied on a country whose most of its citizens suffer from poverty. So, the means to get out of these crises is to increase exports through increasing the domestic product and giving attention to its quality so that it could compete in the global markets, as well as working on the establishment of large-scale projects (Food industry) to accommodate a great number of labors in order to gradually eliminate unemployment. Also, this study recommends specializing in the establishing projects in places on which there are raw materials; such as the fertilizers and ceramics industry in the Lower Egypt., These

industries can absorb large employment and save transportation costs. Also, it can attract foreign investment and achieve the return of tourism. These great deeds can only be achieved by providing a stable policy and secure climate. Moreover, the provisions of control over markets had an important impact on controlling the prices and the elimination of the greed of merchants, which must be located on the shoulders of the government and the competent ministries in order to protect the poor and low-income people who suffer from this increase. Thus, it becomes obviously clear that government decision to float the pound is not right because the directives of the International Monetary Fund lead to control the economies of the developing countries under the pretext of economic reform. Besides, the external debt of Egypt will reach about 66 billion dollar at the end of 2017, as it has happened in Greece in 2009 and the crisis of Brazil in the eighties where it was forced to pay about 90 billion dollar as loans interests only during four years.

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