

# The Euro-Mediterranean Partnership

## A Macroeconomic Perspective

Prof. Mohamed Omran

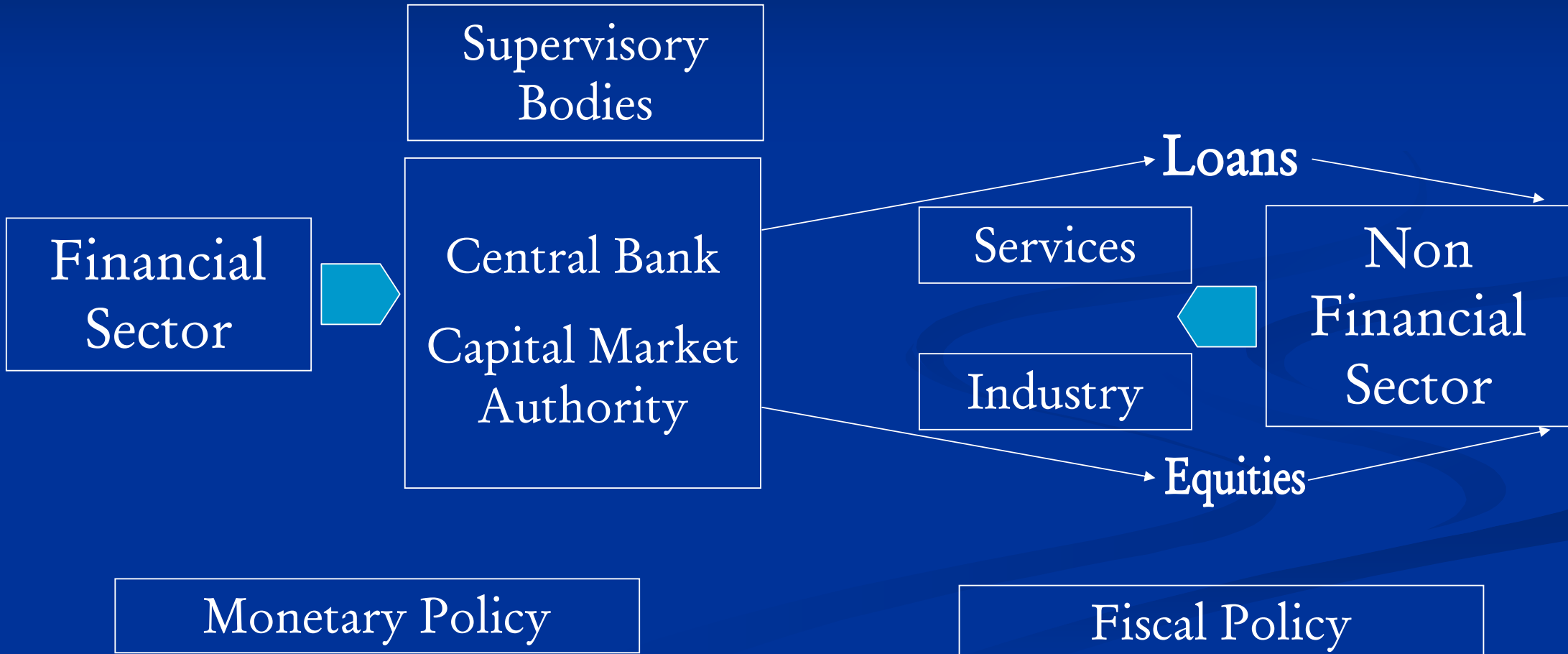
Dr. Islam Azzam

Dr. Nevine Mokhtar

# Potential Effect of ENP



# Egyptian Economy



# Effectiveness of Monetary Policy

The following VAR model was estimated using quarterly data over the (1983-2006):

$$\begin{aligned} R_t &= -0.006 + 0.208 CPI_{t-1} - 0.067 M_{t-1} + 0.185 R_{t-1} \\ &\quad \begin{matrix} -1.246 & 1.822 & -0.843 & 1.914 \end{matrix} \\ M_t &= 0.033 - 0.017 CPI_{t-1} - 0.1304 M_{t-1} + 0.1146 R_{t-1} \\ &\quad \begin{matrix} 5.365 & -0.123 & -1.314 & 0.951 \end{matrix} \\ CPI_t &= 0.019 + 0.199 CPI_{t-1} + 0.0624 M_{t-1} + 0.034 R_{t-1} \\ &\quad \begin{matrix} 4.642 & 2.023^* & 0.909 & 0.413 \end{matrix} \end{aligned}$$

Where:

$R$  = the percentage change in the nominal deposit rate

$M$  = the percentage change in money supply

$CPI$  = the percentage change in the consumer price index (Inflation rate)

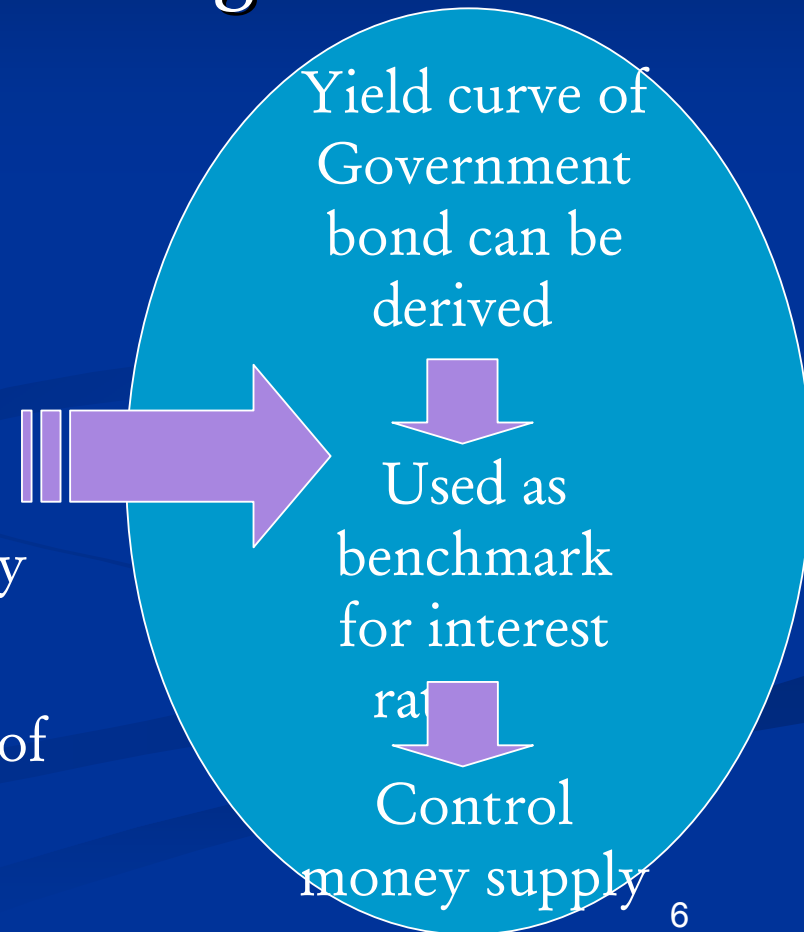
# Monetary Policy In Egypt

- Inflation Targeting Framework has not been applied efficiently yet in Egypt
- When there is a shock in inflation rate, nominal interest rate slightly goes up by only five base points then the effect of the shock vanishes after five quarters
- An increase in money supply by one standard deviation is expected to decrease the nominal interest rate by 0.3%, then the effect vanishes after three quarters

# EU Support – Monetary policy

Euro-system Technical Assistant Program can be directed towards the following:

- ▶ Activate the primary dealers system in government bonds
- ▶ Refine and enhance the regulatory and legal foundations of the government bond market
- ▶ Work with the Egyptian financial community in education and training
- ▶ Expand the maturity spectrum and diversity of the current government debt securities

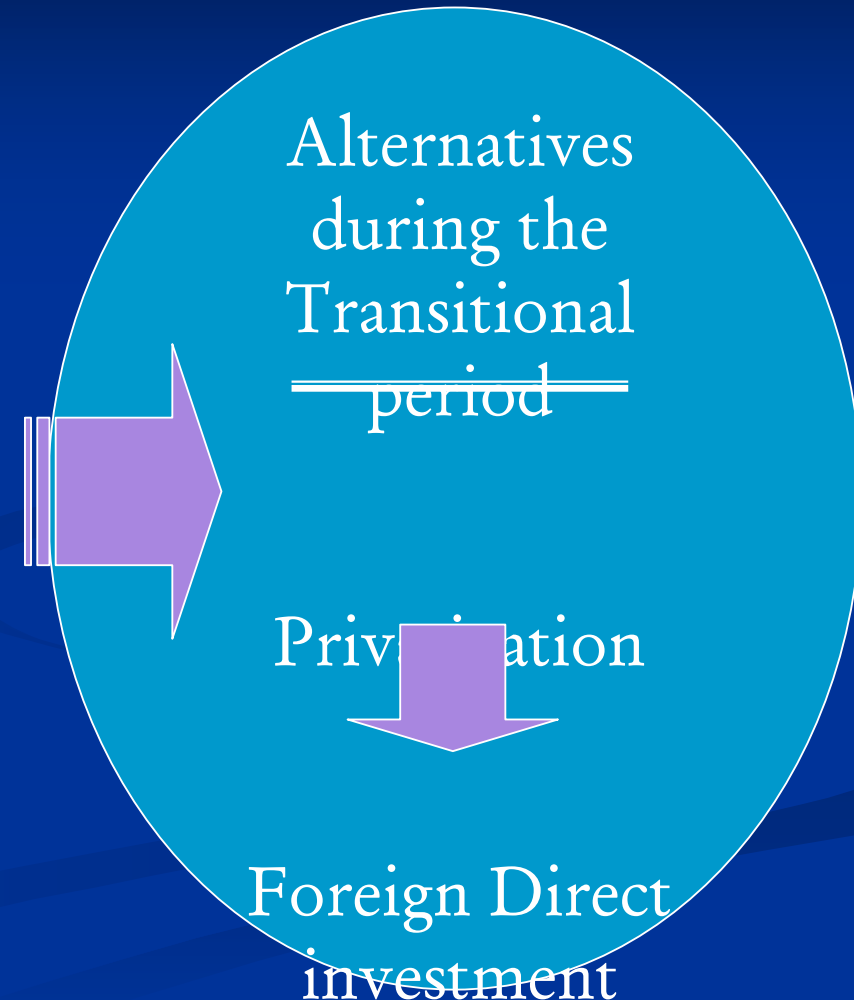


# Effectiveness of Fiscal Policy

- The toolkit approach of the “Souffle’ theory” was applied to identify the degree of decentralization, which was found relatively low
- A modified version of Marlow’s model was used to investigate the current level of fiscal decentralization on the very high public debt (76% of GDP)
- The relationship between the level of local government expenditure and the degree of decentralization was positive but statistically insignificant at 5 percent level
- Results imply that the central government has behaved as “Leviathan”, and was not responding to the citizens’ demands as suggested by Brennan and Baughanan

# Fiscal Policy in Egypt

- Large share of domestic debt consists of non-tradable securities (around one third) held by the central bank, state-owned enterprises and households, and pension funds
- Less than 25% of domestic debt is fully tradable and more than 40% is partially tradable (only among financial institutions)
- The short term obligations are slightly high (about 24%), which in turn is sensitive to changes in interest rates, leading to fiscal vulnerability





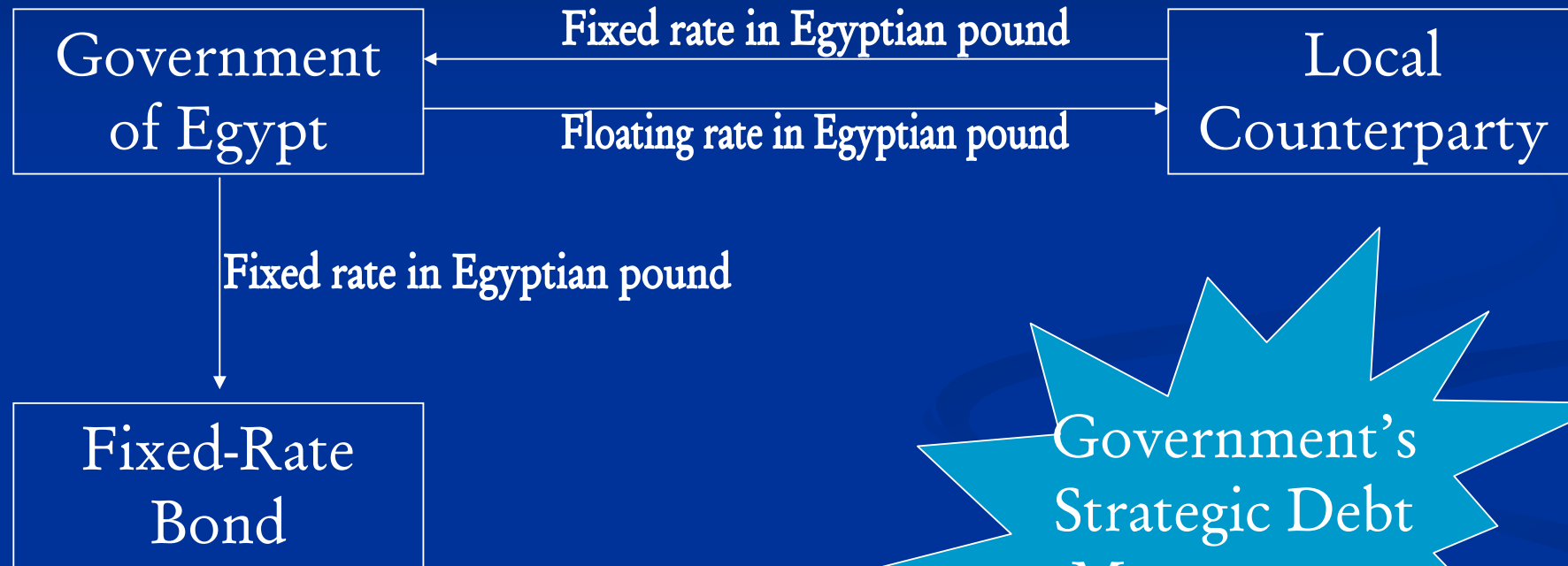
# EU Support – Fiscal Policy

- Technical support is needed to guarantee that:
  - ☞ Long run low and stable inflation is assigned to the monetary policy
  - ☞ Long-run increase in saving, investment and accumulation of net foreign assets are assigned to fiscal policy
  - ☞ The chosen target instrument can handle the dynamic process of both assignments without any potential conflict
  - ☞ The privatization proceeds should not be recycled in the normal budget, however, it is highly recommended to be dealt with separately (on local level, if possible).

# Interest Rate Swaps – Potential Solution



# Government's Use of Interest Rate Swaps



# EU Support

- Activate the public awareness towards the need for launching financial derivatives market
- Technical support should be directed towards the regulatory framework needed to efficiently establish the given market
- Technical research should be implemented jointly with the Ministry of Finance, Central Bank of Egypt and Ministry of Investment