Why do we protect dollar?

The differential between interest rates on deposits in Egyptian pound and those in US dollar, which recorded 3.92% over the past three months to the favor of Egyptian pound, indicates that the Egyptian pound has a mechanism of deposit attraction. Also, the Egyptian pound has the mechanism of protecting the deposit market against the so-called "dollarization" or exchange to dollar.

Protection against dollarization, according to banking experts, academicians and company heads, requires thinking of a new relation between dollar and pound to magnify the differential between their interest rates and find an alternative to dollar. If this is impossible at present, there is no problem to draw a new relation between dollar and pound in the future.

People polled by Al-Ahram Al-Iktissadi were unanimous on a pivotal question, which is: "Why do we protect the dollar? And what is the alternative to dollar? And will a currency basket system succeed as an alternative in Egypt?

The polled people see that the money reserve at the Central Bank of Egypt should be diversified as a currently available tool.

Dr. Ali Suleiman, undersecretary of the Ministry of Economy for research affairs, says it is risky to say that Egypt protects the dollar. This is said because some people notice that the dollar's rate in Egyptian market is stable to a great extent, especially over the past four years, at a time when the dollar goes through huge pressure in the international market.

The dollar lost around 20% of its value over the past six years versus Japanese yen, German mark, Swiss franc and other European currencies. In spite of the dollar's devaluation against these currencies, it maintained its value versus the Egyptian pound.

Suleiman says the Egyptian pound's linkage to dollar resulted from a wise policy aiming to fix the Egyptian pound's value against a main currency. This policy is adopted by many Arab countries, such as Saudi Arabia, United Arab Emirates and Oman, which link their currencies unilaterally with the dollar.

The same policy is also adopted by other developing countries, such as Argentina and Panama. In the meantime, most West African countries are committed to a stable relation with French franc.

The stability of dollar exchange rate in local market is a great benefit for Egyptian exporters and importers, as this guarantees the value of their dollar exports and imports in Egyptian pound.

The stability of Egyptian pound's rate versus dollar, Dr. Ali Suleiman says, brings great privileges to the national economy, as it facilitates the process of management of foreign money resources and makes dealers confident that they would be able to pay off their external debts in Egyptian pound or US dollar.

When the stable relation between Egyptian pound and US dollar deteriorated in the past, many importers and borrowers in US dollar sustained heavy losses. In order to cover these risks, those importers increased their profit margin exaggeratingly, which affected the consumers.

In spite of the great privileges of the stability of Egyptian pound against dollar, exporters and importers from countries of non-dollar currencies are still exposed to the risks of dollar's fluctuation against their currencies. They can avoid these risks by fixing the currency rate in the future currency market. This service is provided through some banks in Egypt.

Another question may loom, which is: Is it good to maintain that unilateral relation with dollar while it collapses against European currencies and Japanese yen?

Dr. Ali Suleiman answers the question saying: The alternative, certainly, is to link the Egyptian pound with a currency basket or to allow it to increase or decrease independently against dollar and other currencies.

At some time, there was a real risk to the increase in the pound rate against dollar, especially in the 1992/1993 fiscal year, which witnessed huge remittances inflow from abroad. At that time, the central bank intervened clearly to prevent the increase of pound rate against dollar. That policy did not continue later.

In fact, there is an Egyptian interest in the pound's share with US dollar in devaluation against European currencies, particularly as around 75% of Egyptian exports go to non-dollar areas, which means that the devaluation of dollar rate in these areas means that the pound rate has become more attractive, thus boosting Egyptian exports to these areas.

The International Monetary Fund strongly called for decreasing the Egyptian pound rate in order to strike a balance in the Egyptian balance of payments. As the Egyptian government resisted any official decline in the pound rate, the interaction in market led to that result against a basket of currencies.

Egypt's exports and imports in the period 1989-1994 valued in US dollar:

Year	Exports	Imports
1989/1990	2606.1	8227.8
1990/1991	2976.4	8381.0
1991/1992	3610.9	8446.1
1992/1993	2823.0	7928.5
1993/1994	2988.4	8367.3

Source: Ministry of Economy.

The average growth rate of exports hit 3.5% in the period 1989/1994, while the growth rate of imports hit 3%. The increase in exports in 1991/1992 is ascribed to the increase in the value of fuel exports.

The decline in imports in 1992/1993 is ascribed to the decline in the value of Egyptian raw material exports.

Dr. Mohamed Fakhri, professor at the faculty of commerce in Zagazig University, says that the question about justifications for protecting the dollar is based on an assumption that Egypt protects dollar.

This needs specific intervention, which is done by a limited number of countries such as Japan and German. It should be understood that this comes within the framework of protecting the private interests of those countries. The link between dollar and Egyptian economy is basically ascribed to:

- The foreign reserve at the Central Bank of Egypt (CBE) is basically composed of dollar due to the economic reform policy, disappearance of dollarization and the CBE’s promise since 1992 to buy any dollar surplus at the announced rates. This reserve might have exceeded 17 billion dollars, which is tantamount to the local liquidity of the Egyptian economy until the end of June last year. It is also tantamount to one third of the National Domestic Product in 1993/1994. This surplus resulted from a surplus in the balance of transactions and remittances, which reached 7 billion dollars in 1992 and 1993. However, transactions are still declining, as they hit around 4 billion dollars in 1993/1994.

- The surplus in exchange firms, which they sell at the end of the day.
- The surplus in the net capital dealings with foreign bodies, which exceeded 300 million dollars in the past two years. These dealings included direct investment, loans and facilities.

Year	In Egyptian pound	In dollar		Change rate
		Value	Evaluation exchange rate	
June 1989	**2.611 billion**	**Billion dollars**	**On the basis of fixed exchange rate in evaluating dealings at value of 360.7 piasters per dollar**	—
June 1990	**3.832 billion**	**6.5 billion dollars**		**50%**
June 1991	**31.705 billion**	**6.6 billion dollars**		**210%**
June 1992	**35.352 billion**	**10.6 billion dollars**		**60.6%**
June 1993	**50.008 billion**	**14.9 billion dollars**	**On the basis of fixed exchange rate in evaluating dealings at value of 360.7 piasters per dollar**	**40.6%**
June 1994	**58.473 billion**	**17.2 billion dollars**		**15.4%**
			334.0681 piasters per dollar	
			332.1081 piasters per dollar	

			335.2521 piasters per dollar **338.9598 piasters per dollar**	

Dr. Fakhri says another reason for the link between Egyptian pound and US dollar is the fact that the banking units, such as commercial banks, investment and joint and specialized businesses, deposit a high amount of their clients' deposits in foreign currencies at foreign banks in the form of dollar deposits, claiming that they accept dollar deposits. The net of these deposits totaled 9 billion dollars until the end of June 1994, which makes up for more than 75% of the banks' foreign currency deposits. Thus, the dollar deposits abroad reached 50% of the NDP. The CBE wanted to intervene twice to support the Egyptian pound's rate against the dollar not to protect the dollar, but to refute some rumors and to be as a protective measure against dollarization.

Dr. Fakhri expects that the dollar will not continue as a reserve currency. He called for applying the accounting unit set by the International Monetary Fund (IMF). This unit consists of a basket of 5 currencies, namely US dollar (40%), German mark (21%), Japanese yen (17%), French franc (11%) and Pound Sterling (17%). He also called for diversifying the surpluses at the banking sector, whether at the central bank or other banks.

For his part, deputy chairman of Arab African International Bank Mohamed Ibrahim Farid says Egypt tries to control the dollar's rate against the pound so that its exports will remain capable of competition in markets which receive exports from other countries linked to dollar. It is better to stick to the dollar's rate in the Egyptian market, he adds.

If the currency basket system is applied in Egypt, dollar will have the lion's share from among these currencies, Farid says. Thus, he adds, the dollar will gain more weight among the currencies.

Therefore, any decline in the dollar's rate will affect the rates of other currencies in the basket, such as the German marc, Japanese yen and Pound Sterling.

Also, any increase in the Egyptian pound's rate will affect Egyptian exports, as the prices of Egyptian exports will increase, thus affecting their presence in markets where there are cheaper exports from countries of economies similar to the Egyptian economy.

For his part, professor of economy at the American University in Cairo, Dr. Medhat Hasanein, says the CBE's reserve, which amounts to 18.5 billion dollars, supported the national economy in general and the Egyptian pound in particular and set rules for dealing with international institutions, topped by the IMF.

The reserve is the safety valve against any emergency happening to the national economy, such as the disasters that afflict agricultural crops, which result in a deficit in the balance of payments or a sharp shortage of food materials.

If the demand for dollar increases to meet the needs of imports, local or foreign debts, credit or to benefit from the high interest rate of the dollar, the CBE injects amounts of dollar to fulfill that demand at an announced price, thus making the Egyptian pound more stable and stronger.

Dr. Medhat adds that the dollar reserve supports the government's step not to decrease the Egyptian pound's rate against the dollar, thus delaying exemption of Egypt from the last batch of its debts as per Paris Agreement, as Egypt can pay off its debts without pressure to devalue its currency.

Medhat says the CBE’s reserve should be diversified to include some hard currencies, such as yen, mark and other strong currencies of strong economies. He said the general goal should be keeping the CBE's reserve at a fixed value. The reserve should not be subjected to the fluctuation of a certain currency even if the reserve is designed for fulfilling the commitments resulting from that currency, he added.

Dr. Medhat says it is acceptable that the central economic authorities intervene to protect their reserve against the local currency fluctuation through raising the interest rate of the currencies of that reserve in order to encourage people not to exchange their hard currencies to the local currency.

The permanent local demand for dollar strengthens the link between the national economy and dollar and makes the dollar's rate worrisome if it increases, says professor of economy Dr. Abdel-Hamid Al-Ghazali. He adds that the dollar's rate in Egypt should range from 2.5 to 3 pounds.

He says the protection given by the national economy to dollar is formal and local. He adds that the CBE's foreign reserve aims to control the dollar market. That reserve represents a strategic depth, he notes.

He urges that Egypt should have a basket of currencies including the dollar. So, if the dollar rate decreases, its decline will be acceptable. Moreover, the basket of currencies will secure the dollar savings from the side effects of dollar rate increase.

Chairman of Al-Rwad company for securities, Dr. Ibrahim Mukhtar, disagrees with the opinion that calls for having a basket of currencies as an alternative to dollar. He notes that the basket of currencies shall include currencies of high rates vis a vis the dollar.

It is acceptable to say that the dollar rate now is suitable for exchange from other currencies to dollar.

Dr. Mukhtar says the success of the currency basket system is dependent on follow-up mechanisms that include following up the change of the interest rates of those currencies and the indicators of demand for them.

The decline of the dollar's interest rate or the decline of its value versus other currencies will limit the phenomenon of dollarization, especially in the light of the decline of local inflation rate, the relative improvement in the pound's interest rate and the difference between it and the dollar's interest rate.

The dollar's rate has been relatively stable against the Egyptian pound in local market in spite of the decline of the dollar's rate against other foreign currencies in world markets. This means that the economic authorities in Egypt support the dollar in order to fix its rate.

Board chairman of Bavaria Center, Dr. Nader Riyadh, says that policy has positive and negative aspects. He says the stability of the dollar's rate results directly in the stability of a big amount of the State's sovereign revenues, such as tax, customs duties and sales taxes on imported commodities.

The decline of the dollar's rate in the local market will result in a similar decline in the State's revenues from customs duties and sales tax, thus affecting directly the State's financial policy in addressing the public budget deficit and increasing the pressures resulting from the decline of those revenues.

On the other hand, the policy of supporting the dollar in the local market and keeping its rate relatively stable against the Egyptian pound helps protect the Egyptian industry and curbs the dumping policies. This policy results in the increase of the cost of imports, especially from the joint European market, Japan and Southeast Asian countries.

This policy also results in the decline of the price of Egyptian exports in world markets, especially agricultural crops like cotton, thus providing a better competition atmosphere for them in world markets.

This also results in the increase of tourists' inflow into Egypt and the increase of national income from tourist activities, particularly as the dollar's exchange rate in the Egyptian market is higher than that in other rival tourist markets.

The relative stability of dollar's exchange rate in Egyptian market curbs the phenomenon of dollarization and encourages depositors to exchange their dollar deposits to Egyptian pound.

One of the negative effects of the policy of supporting the dollar in the Egyptian market is the increase of the price of Egyptian imports from joint European markets, Japan and Southeast Asian countries.

This widens the gap between the volume of imports and exports, as Egypt's imports from these countries constitute a big amount of the total Egyptian imports, something which affects the trade balance.

On the other hand, the cost of raw material imports and the production input imported from European markets, Japan and Southeast Asian countries increases too, thus affecting the cost of the final products and raising the price of Egypt's industrial commodity exports.

Egyptian consumers bear the rise in the prices of local and imported industrial products. They are also deprived of a relative privilege that may be achieved due to the decline of dollar's rate internationally and its stability in the Egyptian market.

This policy may lead Egyptian importers and industrialists to resort to US markets to import fully-manufactured commodities, raw materials and production input instead of importing them from European markets, Japan and Southeast Asian countries. This, however, limits their chances and puts them in a weak competitive situation.

Local interest rates on deposits in US dollar and Egyptian pound for 3 months and the differential between both:

By end of	Interest rate on deposits in dollar for 3 months	Interest rate on deposits in Egyptian pound for 3 months	Differential
September 1991	5.13%	15.40%	10.27%
September 1992	2.94%	16.30%	13.36%
September 1993	2.69%	12.76%	10.07%
September 1994	4.72%	9.75%	5.03%
October 1994	4.72%	9.75%	5.03%
November 1994	4.72%	9.75%	5.03%
December 1994	5.85%	9.75%	4.03%
January 1995	6.25%	9.75%	3.5%
February 1995	6.25%	9.75%	3.5%
March 1995	6.25%	9.75%	3.5%
April 1995	6.08%	10%	3.92%

The differential between interest rates on dollar deposits and those on Egyptian pound deposits is still big. The interest rate on Egyptian pound is one time and a half as that on dollar. The sources are: CBE reports, the Cabinet's decision support center and reporters.

General Manager of IBM, Eng. Mohamed Ali Al-Hamamsi, says one of the negative effects of the close link between Egyptian pound is the high cost of imported devices, equipment and spare parts, especially when the country of origin is from Europe or Asia.

However, the policy of supporting the dollar has a positive effect, which is basically to fix the cost of such devices when they are imported from the USA regardless of the fluctuation of the dollar's rate against other main currencies.

On the future of the dollar support policy, Al-Hamamsi says that fixing the dollar's rate against the Egyptian pound for long periods will not bring big benefits to Egypt, as the exports will not increase on the short run, especially if the Egyptian's exchange rate decreased versus the dollar and other currencies. The increase of export requires production capacity, quality, marketing systems and export facilities.

These things are not that flexible to make use of the change of exchange rate. However, the gradual decline of the Egyptian pound's rate on the long run will result in many advantages, including the increase of exports, decrease of imports and the emergence of new alternative industries locally. This will only happen in case of gradual rather than sudden decline in the pound's rate.

On the future of pound's link with dollar, Al-Hamamsi says: I do not see any privileges for the Egyptian pound to continue its link with the US dollar. The exchange rate has been relatively stable for four years.

I see that the pound's rate should be moved versus the dollar, taking into account five remarks:

- There are technical reasons for the necessity of that move, including the difference between inflation rates in Egypt and the USA.
- The decline of the US dollar's exchange rate should be gradual, and this may require the CBE's intervention.
- The gradual devaluation of the Egyptian pound will result in:

- Increase of exports, decrease of imports and emergence of new local alternative industries.
- Avoiding any sudden collapse in the Egyptian pound's rate if citizens feel that the pound will begin to go down after they got accustomed to the pound's stability for a long time. Thus, citizens will exchange their savings into foreign currencies within a short period.

- There should be systems to protect Egyptians' savings at banks through controlling the exchange rate.
- New systems and tools should be introduced to the money market so that the public sector in Egypt can cover the currencies' risks.

Chairman of the customs committee at the Businessmen Association, Hassan Al-Shaf'i, says the dollar's rate in local market should stay fixed, as any change in the dollar-pound relation will be in favor of the dollar.

So, if the dollar's rate is set free versus the pound, prices will increase, the purchasing power will decrease in society and import costs will increase, thus affecting "fatally" the market.

Around 30%-40% of Egypt's total imports are paid in dollar. If the dollar's rate is kept free in the local market and then increases, this will affect a big amount of imports.

***Translated from Arabic Original**
Source: ***Al Ahram Al Aktsadde Magazine 15/5/1995***