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Egypt's local wheat procurement policy increase farmers profits

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Approved By:

Ronald Verdonk

Prepared By:

Ahmed Wally

Report Highlights:

The Government of Egypt announced on January 5, 2017 that the price to be paid for local wheat to be harvested starting in mid-April, will be based upon the announced average international price of wheat which the Ministry of Supply and Internal Trade's General Authority for Supply Commodities (GASC) pays via its tendering process. The calculation in Egyptian Pounds from the value in dollars will be based on the average dollar price paid for imported tendered wheat in the two months prior to the purchase of the harvest.

General Information:

Egypt Will Procure Local Wheat According to International Market Prices during 2017:

On January 5, 2017, the Government of Egypt (GOE) announced that pricing for this year’s domestic wheat crop would be bought from farmers based on prevailing international market prices, derived from a moving average of prices paid by the Ministry of Supply’s General Authority for Supply Commodities (GASC) on its wheat purchases the previous two months. The measure is part of the structural reforms undertaken by the administration of President Sisi in an attempt to curb costly subsidies and rid the system of fraudulent practices.

In the past two years, as global wheat prices plummeted, the GOE continued to maintain high procurement prices in an attempt to provide a safety net to over 2.5 million wheat farmers (table 1), while aggressively expanding its procurement targets from an average of 3.5 MMT to over 5 MMT in 2015 and 2016 (figure 1). However, this approach represented a substantial cost to the GOE as high prices increased arbitrage opportunities, prompting many agents to mix cheaper imported wheat into the procurement channels, passing it off as having been domestically produced. It is estimated that in 2015 and 2016, at least one million tons of imported wheat were introduced into the procurement program, costing the GOE an excess \$110-115 million on this operation.

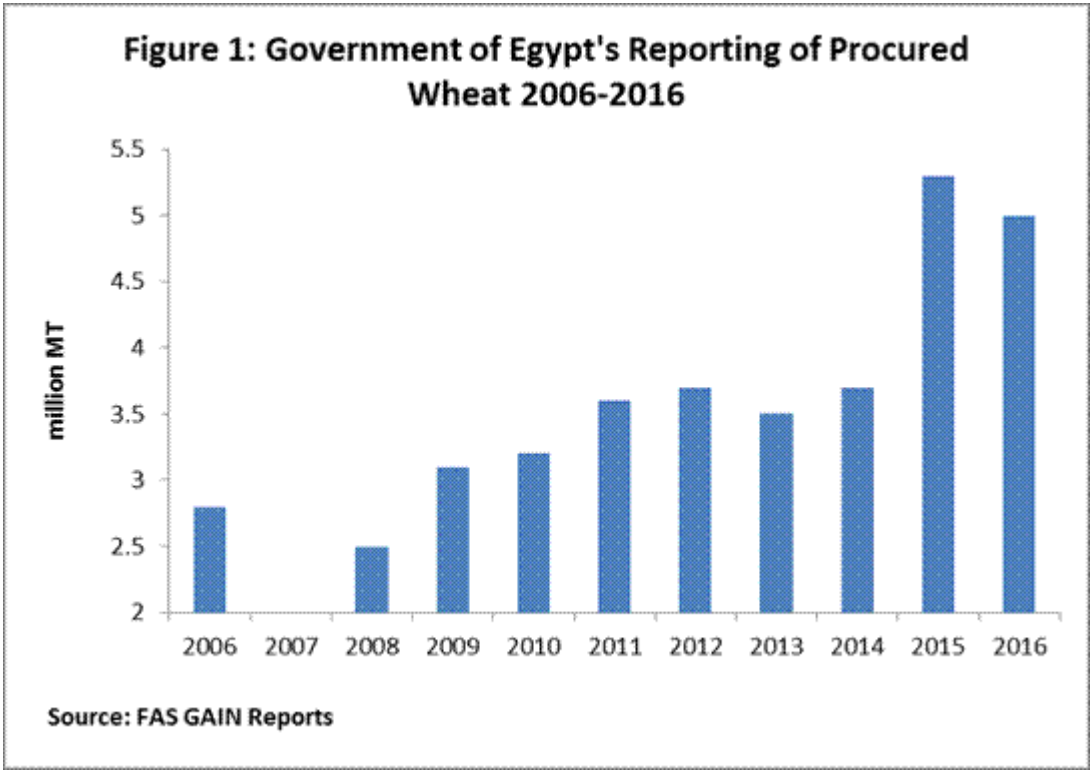


Table 1: Government of Egypt's Procurement Price vs World Prices*

YEAR	Procurement Price (USD)	Average World Price (April-June) (USD)	Difference (USD)
MY2013/14	400	303	97
MY2014/15	366	225	141
MY2015/16	315	189	126

Source: FAS/Cairo

*CIF EGYPT

Devalued Egyptian Pound: Attractive in Local Currency, Much Less So in Fx

Since MY 2013/14, the GOE has maintained a consistent procurement price of LE 420 per ardeb (LE 2800 per MT), although in foreign exchange terms, this price has consistently decreased (table 2). However, since permitting the Egyptian Pound to float on November 3, 2016 followed by a second partial lifting of fuel subsidies, the local currency suffered considerable depreciation and is trading at close to LE 18 per USD in early February 2017.

Using the exchange rate as a proxy and averaging the last two GASC tenders that took place in December in which the government sourced wheat at USD200 per /MT, *ceteris paribus*, the new procurement price would be LE 3600/MT, an increase of 29 percent from MY2015/16. It must be stressed however that the GOE will use a moving average of GASC's purchasing prices of the previous two months.

On the face of it, the new pricing system seems attractive; however, it has angered the powerful agricultural cooperatives and their first reaction was to demand that the government reverse its decision and set a fixed procurement policy of LE 600 per ardeb or LE 4000 per MT (\$222.2 per MT).

	Procurement Price in LE	Change in LE	Exchange Rate(LE/USD)	LE vs USD Change	Procurement Price in USD	Change in USD
MY2013/14	2800	-	7	-	400	-
MY2014/15	2800	-	7.63	9%	367	-9%
MY2015/16	2800	-	8.88	16%	315	-16%
MY2016/17	3600	22%	18	103%	200	-58%

Source FAS/Cairo

*Estimate

Back of the Envelope Analysis: Increased Incomes to Egyptian Farmers

Egypt's farmers are some of the most productive wheat farmers worldwide, averaging yields of 6.5 MT per ha. However, their small average production plots, averaging less than one hectare, are a key reason why the government maintained a high procurement price.

After the country floated the pound, which depreciated by over 100 percent, farmers became much more competitive relative to foreign producers. Although costs increased, they are not of the magnitude of

the depreciation, averaging a total increase of 15 percent, as imported input pricing had already been factored by the much higher exchange rate to which importers had to resort in the parallel market. The higher cost increases are for services dependent on fuel: land preparation, irrigation, and harvest, which averaged an increase of 28 percent. The cost increases in these different components of production were expected as the government slashed costly fuel subsidies, aiming to reduce GOE spending on fuel by 43 percent in 2017.

Therefore, under the new proposal, considering current prices, farmers' incomes would increase by 25 percent. Although in dollar terms incomes suffered a reduction, because farmers largely consume locally-produced products, they would be largely spared price shocks faced, say, more by urban consumers.

Table 3: Average Production Cost of One Hectare Before and After Egypt's Floating of the Pound

	Cost before Egypt's Floating of the Pound(LE/ha)	Cost after Egypt's Floating of the Pound(LE/ha)	Change
Land Preparation	715	952	25%
Seeds	833	833	0%
Fertilizers	2380	2380	0%
Irrigation	476	714	33%
Pesticides	476	714	33%
Labor	595	833	29%
Harvest	2976	3571	17%
Total Cost	8451	9998	15%
Gross Income	18200	23400	22%
Net Income	9749	13402	27%

Ridding the System of Market Failures

With the changed approach in establishing the wheat purchase price, FAS Cairo does not foresee a marked shift in Egypt's wheat production, supply and demand numbers. It also believes that the GOE's wheat procurement target from this year's production will be around 4 MMT, more in line with the 3.5 MMT average that the GOE procured over the past five years and well below the 5.0 MMT alleged to have been bought from farmers' 2016 crop. The new pricing regime will diminish arbitrage and fraud opportunities, saving the country precious resources that can be utilized in supporting farmers with affordable inputs, know-how, and advanced technologies. These improvements in the wheat supply chain will facilitate investments, increase job creation, improve food security, and significantly reduce government waste.