

For Immediate Attention

EBS/62/149

CONFIDENTIAL

December 5, 1962

To: Members of the Executive Board

From: The Secretary

Subject: United Arab Republic - Request for Amendment of
Stand-By Arrangement

It is not proposed to bring the attached memorandum to the agenda for discussion unless an Executive Director so requests by the close of business on Friday, December 7, 1962. In the absence of such request, the decision recommended by the staff will be deemed approved by the Executive Board and recorded in the minutes of the next meeting thereafter.

Att:(1)

Confidential

INTERNATIONAL MONETARY FUND

United Arab Republic - Request for Amendment of Stand-By Arrangement

Prepared by the Middle Eastern Department

(In consultation with the Exchange Restrictions Department
and the Legal Department)

Approved by John W. Gunter

December 5, 1962

The United Arab Republic has proposed an amendment in the credit ceilings for cotton provided for in the existing stand-by arrangement. The Fund extended a stand-by arrangement to the U.A.R. in an amount equivalent to \$42.5 million to begin on May 7, 1962 for a period of one year, and the U.A.R. Government adopted a stabilization program which was described in a letter to the Managing Director, dated April 26, 1962, and annexed to the stand-by arrangement. The U.A.R. has made three drawings to date under the stand-by arrangement in an amount equivalent to \$37.5 million, and the Fund's holdings of Egyptian pounds now amount to 193 per cent of the quota of \$90 million. Further purchases under the stand-by arrangement cannot be made prior to February 7, 1963.

Paragraph 3 of the letter of intent of April 26, 1962 imposed ceilings on cotton financing for the 1962/63 season as follows: The peak financing was not to exceed LE 85 million; it was to decline during the first half of 1963, falling at least to LE 55 million by March 31, 1963 and to LE 27 million by June 30, 1963. It was provided that these ceilings could be adjusted after prior agreement with the Managing Director of the Fund in the light of the actual size of the cotton crop.

Cotton financing granted by the banks rose to LE 84.6 million on November 8, 1962, and the request for modification of the ceiling for the rest of the season was as follows: the ceiling for peak financing to be raised to LE 105 million, declining thereafter to LE 70 million by March 31, 1963 and to LE 27 million by June 30, 1963. Three reasons have been mentioned in support of these increases. The 1962/63 cotton crop is estimated at 9,641,000 metric cantars against 6,173,000 cantars last season. Secondly, changes introduced in marketing arrangements this season have led to a rapid movement of the crop into the hands of the Egyptian Cotton Commission (ECC) as more of the crop has been unloaded by producers earlier in the season. Thirdly, exports are stated to be moving slowly so far this season.

In considering the request of the U.A.R. authorities, it was noted by the Managing Director that while the size of the crop this season is larger than in the previous season, the carry-over is unusually small, so that the total supply is not much larger than in 1960/61 and 1959/60 when peak financing stayed well below the figure of LE 105 million requested by the U.A.R. authorities. Supplementary information provided by the U.A.R. authorities indicates that the current crop is of exceptionally superior quality. Prices to domestic producers being fixed by grades for each staple variety, the larger supply of superior grades means a higher value for the crop and this leads to larger financing requirements.

As for the second factor, the cotton policy for the 1962/63 season stipulates that all ginned cotton would be delivered to the ECC as from September 1, 1962 at prices fixed by the ECC. In consequence of this policy, there is apparently a tendency for cotton to move more rapidly into the hands of the ECC. With domestic prices fixed and interior merchants operating on a strictly commission basis, there is little incentive to hold stocks in expectation of higher prices. Moreover, large producers who in the past were able to hold stocks are no longer an important element as a result of the Second Agrarian Reform Law promulgated on July 25, 1961 which reduced the maximum agricultural ownership from 200 to 100 feddans (one feddan equals 1.04 acres). The ECC has, therefore, accumulated large stocks. At mid-November, it was holding 2.5 million cantars of cotton as against 0.6 million cantars at the same date in 1961, 0.4 million cantars in 1960 and 1.3 million cantars in 1959.

Finally, current stocks are showing relatively slow disposal, both for export and for domestic consumption, entailing delays in the liquidation of loans and, hence, requiring increased financing. Actual exports until November 17, 1962 were 317,000 cantars compared with 319,000 cantars in 1961, 660,000 cantars in 1960 and 810,000 cantars in 1959 for the same dates. The figures for 1961 are not strictly comparable as the crop was both smaller and much delayed that year. The small crop also left a quite small carry-over of exportable varieties and grades so that incoming export orders cannot be filled until more of the new crop has been processed and graded. The domestic textile mills have also been buying slowly this season. Until November 7 sales by the ECC to the local mills were 394,000 cantars compared with 486,000 cantars in 1961, 515,000 cantars in 1960 and 475,000 cantars in 1959. This has been explained by the U.A.R. authorities again in terms of the change in internal marketing arrangements. Since the local mills are now able to get their actual requirements readily from the public agencies (i.e., from the ECC), they have not found it necessary to accumulate stocks.

Staff Appraisal

The raising of the peak cotton ceiling to LE 105 million is proposed as a temporary measure with the original ceiling for June 30, 1963 being maintained unchanged. This temporary increase appears justified mainly because of the financing problems that have arisen in the wake of changes in internal production and marketing arrangements and the slow disposal of ECC stocks. The larger size of the crop does not appear to be an important element in larger financing requirements because of the lower carry-over of the current season. The change in the marketing arrangements tends to focus pressure on the ECC as stocks which would previously have been held by the large producers and the interior merchants are now rapidly transferred to the ECC. While both large producers and the interior merchants used to hold cotton partly with bank credit and partly with their own funds, the ECC appears greatly dependent on bank credit so that the movement of stocks into its hands does entail a larger need for bank credit than under the marketing arrangements of earlier years.

As for the slower movement of exports, this is evidently connected, to some extent, with the weakness in the market for extra-long staples. The new cotton season of the U.A.R. falls in the middle of the Sudanese marketing season and there are large Sudanese supplies of staples similar to Egyptian varieties overhanging the market. This factor, together with the large size of the new Egyptian crop, has led to a pressure on prices quoted in foreign markets. Export prices fixed by the ECC have, so far, remained unchanged, but it is possible that foreign buyers may be holding off some purchases for the time being. The change in the inventory policy of the domestic textile industry also increases pressure for financing the cotton trade, for the ECC is now obliged to hold stocks which were previously financed by the mills.

It has been agreed by the U.A.R. to defer consideration of the request for raising the ceiling applicable to March 31, 1963 by LE 15 million over the present ceiling. It seems advisable to leave this ceiling unchanged for the time being, subject to review in the light of developments later in the season. It is to be hoped that exports will improve so that cotton financing will decline at least to the original ceiling for March 31, 1963.

The staff feels that the proposed increase in ceiling is compatible with the objectives of the stabilization program. It is recommended that the Executive Board adopt the following decision:

The Fund agrees to the proposal of the United Arab Republic that the ceiling on cotton financing specified in paragraph 3 of the letter dated April 26, 1962, which is annexed to the stand-by arrangement with the United Arab Republic (EBS/62/49, Sup. 2), be increased from LE 85 million to LE 105 million.