INFLATION AND ECONOMIC GROWTH NEXUS IN EGYPT

By

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ABSTRACT

The moderate and stable inflation rates are promoting important factors in the development process of a country, and hence economic growth. Moderate inflation supplements return to savers, enhances investment, and therefore, accelerates economic growth of the country. This paper empirically explores the present relationship between inflation and economic growth in the context of Egypt. Using annual data set on real GDP and CP1 for the period of 1980 to 2010, an assessment of empirical evidence is acquired through the co-integration and error correction models. Further, it explores a policy issue of what is the threshold level of inflation for the economy using the threshold autoregressive models. The empirical evidence demonstrates that there exists a long-run and a short-run relationship between inflation and economic growth. In addition, the estimated threshold model suggests 15 percent as the threshold level (i.e., structural break point) of inflation above which inflation adversely affects economic growth.

Keywords: Inflation, Economic Growth, Granger Causality, Threshold level of Inflation

ABSTRAK

Kadar inflasi yang sederhana dan stabil adalah faktor penting kepada proses

pembangunan negara, dan pertumbuhan ekonomi. Inflasi sederhana mendatangkan

pulangan pendapatan kepada ke penyimpan, meningkatkan pelaburan, dan dengan itu,

mempercepatkan pertumbuhan ekonomi negara. Kajian ini empirik meneroka hubungan

antara inflasi dan pertumbuhan ekonomi dalam kontek negara Mesir. Dengan

menggunakan data tahunan KDNK benar dan indek harga pengguna (IHP) bagi tempoh

1980 hingga 2010, penilaian diperolehi melalui kaedah co-integration dan model

pembetulan ralat. Ia menerokai isu dasar iaitu apakah tahap ambang inflasi bagi

ekonomi dengan menggunakan model paras ambang autograsi. Bukti empirik

menunjukkan bahawa wujud hubungan jangka panjang dan jangka pendek antara inflasi

dan pertumbuhan ekonomi. Di samping itu, anggaran dari model paras ambang

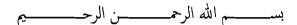
mencadangkan 15 peratus sebagai tahap ambang (iaitu, titik perubahan struktur) inflasi

dimana inflasi yang melebihi paras ini akan menjejaskan pertumbuhan ekonomi.

Keywords: Inflasi, Pertumbuhan Ekonomi, kesebaban Granger, tahap Ambang Inflasi

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CHAPTER ONE

BACKGROUND OF THE STUDY

1.1 Introduction

The relationship between inflation and economic growth is one of the most important issues in economy. It becomes issue of debate among the macro economists, policy makers and central monetary authorities. Specifically the bone of contention is that whether inflation is necessary for economic growth or it is detrimental to growth. Basically the rate of economic growth depends primarily on the rate of capital formation and the rate of capital formation depends on the rate of savings and investment. Therefore, whether inflation affects economic growth depends on whether it affects savings and investment (Kanchan and Chandan 2011).

The link between inflation and growth remains a controversial one in both theory and empirical findings. Originating in the Latin American context in the 1950s, the issue has generated an enduring debate between structuralists¹ and monetarists. The structuralists believe that inflation is essential for economic growth, whereas the monetarists see inflation as detrimental to economic progress. There are two aspects to this debate: (a) the nature of the relationship if one exists and (b) the direction of causality. Friedman (1973: 41) succinctly summarized the inconclusive nature of the relationship between inflation and economic growth as follows: "historically, all possible combinations have

¹⁾ Structuralism is an approach to the human sciences that attempts to analyze a specific field as a complex system of interrelated parts

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