

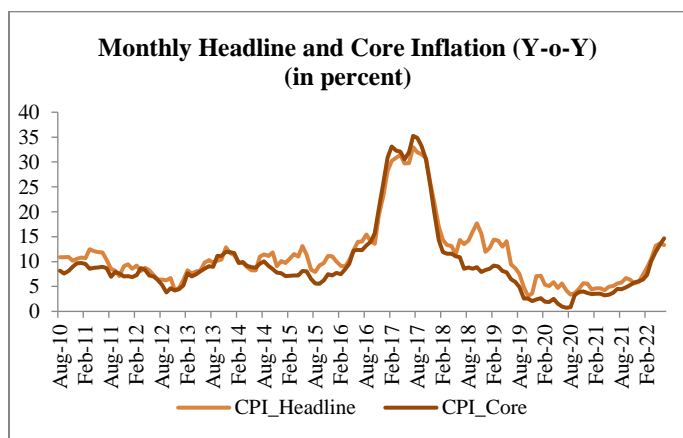


Headline Softens But Core Inflation is Still on the Rise in June

Thursday 7th of July 2022

Recent dynamics in headline and core inflation

... Urban headline inflation (Y-o-Y) softens in June to record 13.2% down from 13.5% a month earlier. The monthly dynamics has been also significantly eased to show a deceleration of 0.1% in June compared to 1.1% and 3.3% during the previous two months. Meanwhile, core inflation is still on the upward trajectory surging to 14.6% in June to record compared to 13.3% a month earlier. This came despite the monthly rate has been broadly softened to 1.2% in June down from 1.6% in May 2022. Worth to mention, the monthly easing in core inflation has taken place for four months in a row.

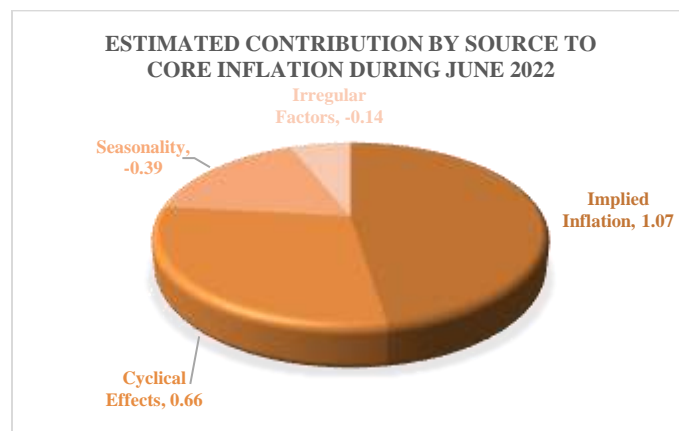


Source: CAPMAS and Central Bank of Egypt.

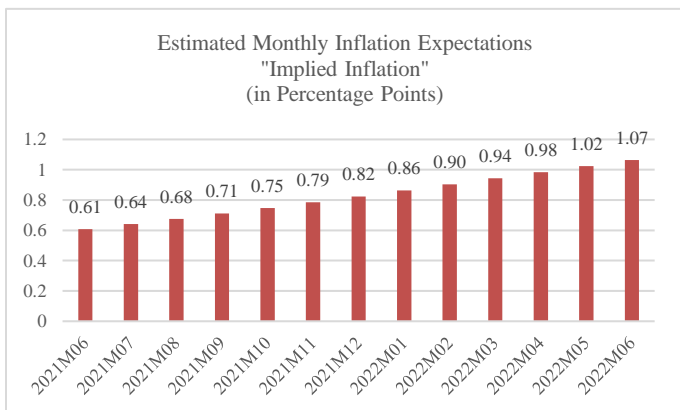
...Sources of demand-driven inflation ... The June dynamics indicates that monthly core inflation has been further eased to register 1.2% compared to 1.6% a month earlier. Nevertheless, implied inflation has increased to 1.07 percentage points compared to 0.95 percentage points during May, reflecting higher inflation

expectations that represent the level of inflation that cannot be avoided by the Central Bank. Worth to note that implied inflation started to build up since the beginning of the current fiscal year, which is considered as a red flag for the CBE to adjust its inflation target upwards with a higher band to mirror the uncertainty surrounding the inflation risks being $12\% \pm 3\%$. This can be induced from the fact that having a monthly average implied inflation of about 1.0% is equivalent to 12.0% annual rate.

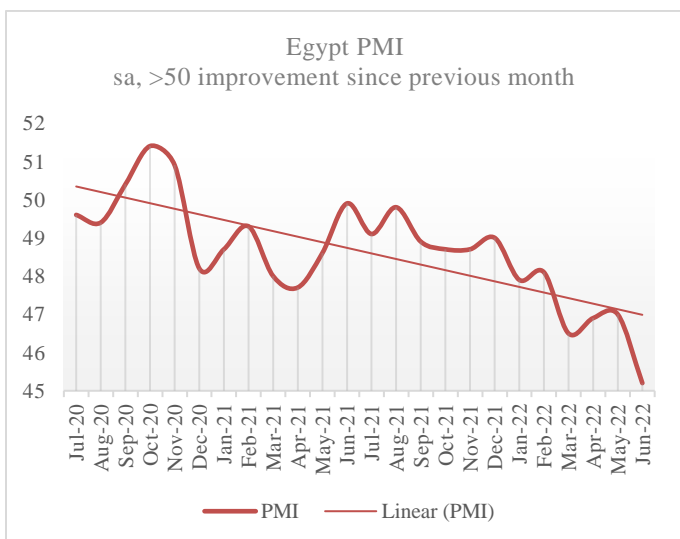
In the meantime, cyclical factors contribution has been slightly eased from 0.72 in May to 0.66 percentage points in June 2022, yet it is still positive and high, which can be related to both supply-push effects and demand-side effects; the former can be backed by imported inflation. As for the demand side effects, that can be attributed to the positive real money gaps reflecting the shortage of the produced goods and services relative to the money supplied in the economy. These developments are inconsistent with the non-oil private sector business conditions and dynamics that have been adversely hit in June. In this context, PMI has registered a record low of 45.2, being the worst slump in two years.



Source: MAP's Estimates, MPED and CBE.



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Source: IHS Markit.

...Forecasts for headline inflation ... In light of the recent economic dynamics, it is noticed that the main source of inflation emerged from both domestic and global developments. Moreover, the recent CBE's measure related to the EGP devaluation has its spillovers on the domestic inflation rate either headline or core. Nonetheless, these spillovers are somehow mitigated by

the economic safeguarded steps mainly hiking the policy rates on the MPC exceptional meeting held on 21st of March and enhanced by a further 200 basis points in May. Thus, we still expect that the commodities channel, unfavorable pass-through effect, and inflation are the key risks on the Egyptian economy.

Nonetheless, the inflationary pressures are relatively softened due to the CBE's decision to hike policy interest rates by 100 basis points in its exceptional meeting that was held on March 21st and enhanced by further 200 basis points in its meeting on May 19th.

Noteworthy, our forecast for headline inflation implemented in March based on three scenarios in addition to the baseline scenario, revealed that the actual quarterly headline inflation figure has just hit our inflation forecasts at 13.4% during April-June 2022 based on scenario 3 which was based on these assumptions:

Scenario 3:

- Producers pass-through effect of 20% increase in the Wheat and Oil prices
- CBE decided to hike interest rate by 100 basis points

We expect that headline inflation will marginally ease during Q1 FY2022/23 backed by favorable base effect before it resume its pickup once again till Q3 FY2022/2023, fueled by the positive money gaps, unfavorable pass-through effects, higher input costs and international price hikes spillovers.

Against this background, we expect the CBE to adopt a "Wait and See Policy" during its upcoming meeting to assess the consequences of the 300 basis points hikes took place over the last two months. Nonetheless, we strictly recommend that the inflation target bands have to be revised upward to reflect the realistic conditions of inflation dynamics and to anchor inflation expectations.

Table (1): Headline Inflation Forecasts: Different Scenarios

		<i>Inflation Rate_Baseline</i>	<i>Inflation Rate_Scenario1</i>	<i>Inflation Rate_Scenario2</i>	<i>Inflation Rate_Scenario3</i>
2021/22	Q1	6.0			
	Q2	7.0			
	Q3	6.6	8.4	6.2	12.6
	Q4	5.5	9.5	7.2	13.4
2022/23	Q1	7.3	8.2	6.2	12.1
	Q2	5.5	7.4	7.6	13.8
	Q3	5.3	9.0	9.2	16.1
	Q4	4.4	7.8	7.9	14.6

Source: MAP's Estimates. March's Round. Scenario 1: •Producers pass-through effect of 10% increase in the Wheat and Oil prices •No Action from the CBE, **Scenario 2:** •Producers pass-through effect of 10% increase in the Wheat and Oil prices •CBE decided to hike interest rate by 100 basis points, **Scenario 3:** •Producers pass-through effect of 20% increase in the Wheat and Oil prices •CBE decided to hike interest rate by 100 basis points.

Table (2): Headline Inflation Forecasts in Light of CBE Recommended Interventions¹

		SCENARIO 1		SCENARIO 2		SCENARIO 3	
		Basis Points	Expected Inflation Rate	Basis Points	Expected Inflation Rate	Basis Points	Expected Inflation Rate
2022	Q2	200		200		100	
	Q3	250	10.95	250	10.95	200	11.51
	Q4	300	11.09	300	11.09	300	11.09
2023	Q1	400	9.07	350	9.57	400	9.07
	Q2	500	10.76	400	11.83	500	9.58
	Q3	500	13.88	450	14.38	600	12.32
	Q4	500	12.82	500	12.82	700	10.76

Source: MAP's Estimates.

¹ Basis points here refer to the accumulated interest rate hikes by the Central Bank of Egypt.