



Core Inflation (Y-O-Y) Surged to 13.4% in May Hitting the Headline

Thursday 10th of June 2022

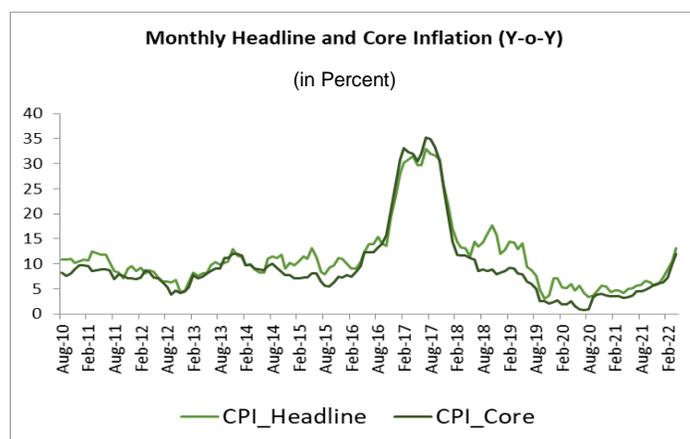
Overview

Recently, global and domestic inflations undercome a lot of fluctuations due to many local and international crises. Rising basic international commodity prices, resulting from supply chain disruptions, in addition to increased risk-off sentiment and rising freight cost have added to domestic inflationary pressures, as well as external imbalances represented in widened current account deficit, registering a record high USD 7.8 billion during H1 of FY2021/22. In addition to that, global inflationary pressures was aggravated after the recent Russia-Ukraine conflict.

Regarding the exchange rate policy, the CBE devaluated the Egyptian Pound by 14% on its exceptional meeting on March 21st, it was dropped to 18.17-18.27 EGP against the dollar. Following that, it has depreciated further to reach 18.73 Pounds per Dollar in June. Despite that, the Egyptian financial and monetary policy remain flexible enough to control prices.

The June 2022 yield curve is obviously higher than that of the three months ago. ***This implies that the curve has been shifted upwards reflecting higher returns for all term-structures.*** These dynamics reveal the monetary policy stance which has been tightened since the exceptional meeting on March 21st by hiking policy rates by 100 basis points. This has been also enhanced by the 200 basis points raise on May 19th, in the framework of the tightening cycle. This is a good reflection for the growing concerns about higher inflation rate in the near future, aggravated by both the supply-side risks (surged international prices of food and oil in addition to the global supply-chain disruptions) and demand-side risks (higher positive real money gaps). The curve also reflects more flattened pattern which mirrors the stance of the monetary policy and also echoes expectations of relatively higher inflation.

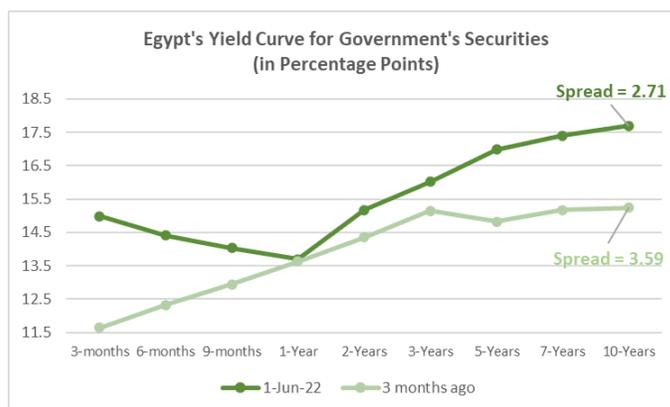
Meanwhile, CBE is still determining its target to be $7\% \pm 2\%$, implying that inflation is adequately anchored. Nonetheless, these bands have to be revised upwards to mirror the inflation status-quo and its outlook.



Source: CAPMAS and Central Bank of Egypt.

Recent Dynamics in Headline and Core Inflation

Urban headline inflation (Y-o-Y) jumped for the third month in a row to record 13.5% in May, compared to 13.1% a month earlier. The monthly dynamics has been relatively softened to show an increase of 1.1% in May



Source: World Government Bonds, accessed on June 01st,

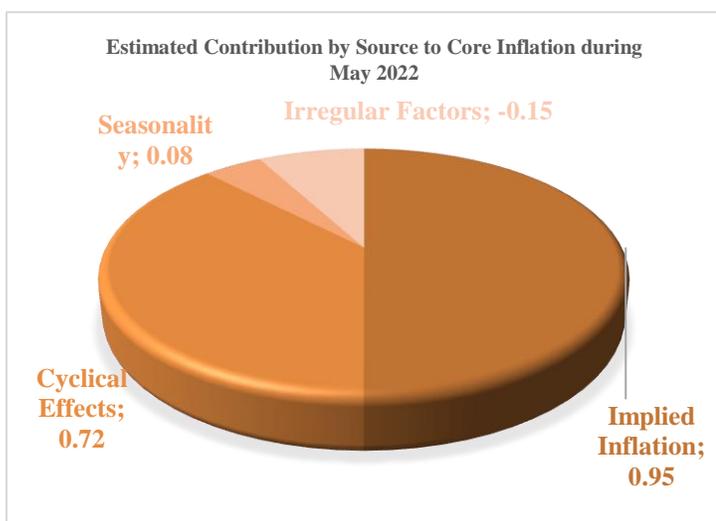
compared to 3.3% during the previous month. Meanwhile, core inflation surged to record 13.4% (Y-o-Y) in May compared to 11.9% a month earlier.

This came on the back of unfavorable base effect from previous year, knowing that monthly rate eased to 1.6% in May down from 2.4% in April 2022.

Sources of Demand-Driven Inflation

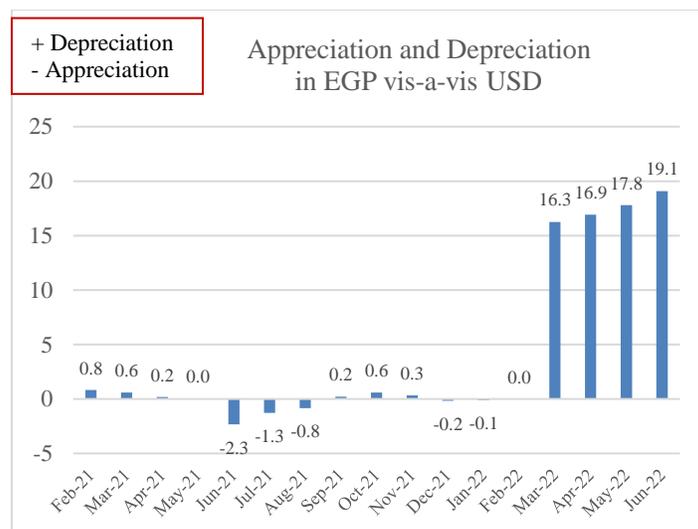
May dynamics indicate that monthly core inflation has been further softened to register 1.6% compared to 2.4% a month earlier. Nevertheless, implied inflation has increased to 0.95 percentage points, reflecting higher inflation expectations. In the meantime, having a monthly average core inflation of about 1.0% is equivalent to 12.0% annual rate. In other words, it is important for the CBE to adjust its inflation target upwards with a higher band to mirror the uncertainty surrounding the inflation risks being $12\% \pm 3\%$.

Adding to the above, higher cyclical factors contribution by 0.72 percentage points in May 2022 is related to both supply-push effects and demand-side effects. The first is resulted from a higher international food and energy prices that emerged from the recent conflict between Russia and Ukraine and had its spillover on the Egyptian Economy. As for the demand side effects, it is due to the positive real money gaps, reflecting the shortage of the produced goods and services relative to the money supplied in the economy.



Egyptian Pound Devaluation Spillovers

The recent devaluation of the Egyptian Pound by 17% that reached 19.0% in June, has its anticipated repercussions on the domestic inflation due to unfavorable pass-through effect that has been fully manifested during May figure. Rather, it is expected this to be reflected during the next couple of months in higher inflation rates.



Source: MPED and CBE.

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.

Forecasts for Headline and Core Inflation

In light of the recent economic dynamics, it is noticed that the main source of inflation is emerging 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. Thus, it is still expected that the commodities channel, unfavorable pass-through effect, and inflation are the key risks on the Egyptian economy.

Table (1): 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.