



# Highest Core Inflation in Four Years

Monday 10<sup>th</sup> of May 2022

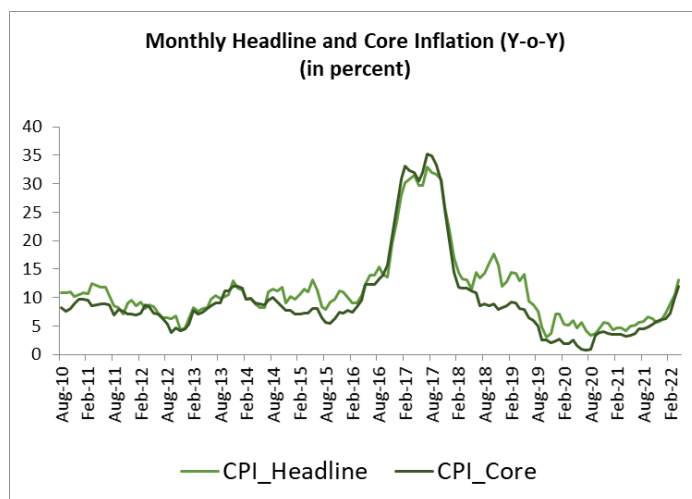
Inflation is one of the most important factors affected by economic fluctuations and crises, as it affects the monetary authority of the state by reflecting its impact on the increase in the exchange rate of the national currency in the market and the decline in purchasing power. The latter affects the general cost of living and the cost of financing enterprises, and their ability to maintain profits and capital.

The global inflationary pressures began to build after the world economy emerged from the disruptions caused by COVID-19 pandemic. These pressures became amplified with the recent Russia-Ukraine conflict. 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.

As the exchange rate of the national currency constitutes one of the most important challenges facing any country in determining or shaping the features of its general economic policy, and despite what the Egyptian currency is witnessing today, the largest decline in 5 years to record 18.53 pounds against the dollar, the Egyptian financial and monetary policy remain flexible enough to control prices.

## Recent Dynamics in Headline and Core Inflation

Urban headline inflation (Y-o-Y) jumped for the second month in a row to record 13.1% in April, compared to 10.5% a month earlier. The monthly dynamics showed an increase of 3.3% in April compared to 2.2% in the previous month. Meanwhile, core inflation accelerated in April to record 11.9% (Y-o-Y) compared to 10.1% a month earlier. This came on the back of higher m-o-m rate of 2.4% in April 2022, compared to 3.1% a month earlier.

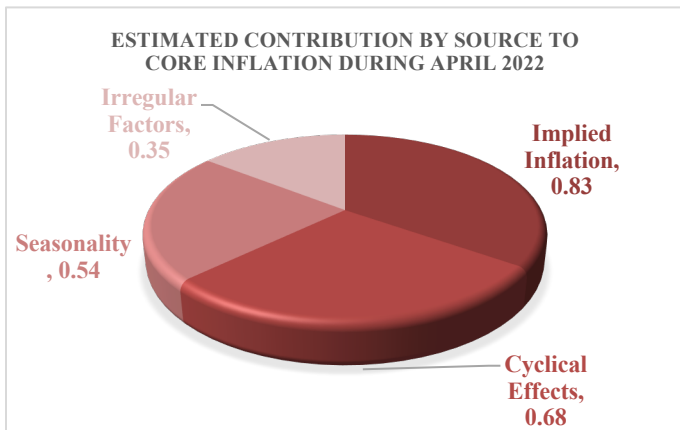


## Sources of Demand-Driven Inflation

The April readings analysis indicated that monthly core inflation has relatively softened to register 2.4% compared to 3.1% a month earlier. This can be primarily attributed to the cyclical factor related to the supply-push effects contributing by 0.68 percentage points, driven by higher international food and energy prices that emerged from the recent conflict in Ukraine and had its spillover on the Egyptian Economy.

This is coupled with a positive and significant contribution of implied inflation reflecting higher inflation expectations recording 0.83 percentage points. Worth to mention, this is a record high since May 2018.

Moreover, irregular factors that are related to unfavorable pass-through effect emerging from the recent EGP devaluation contributed by 0.35 percentage points.

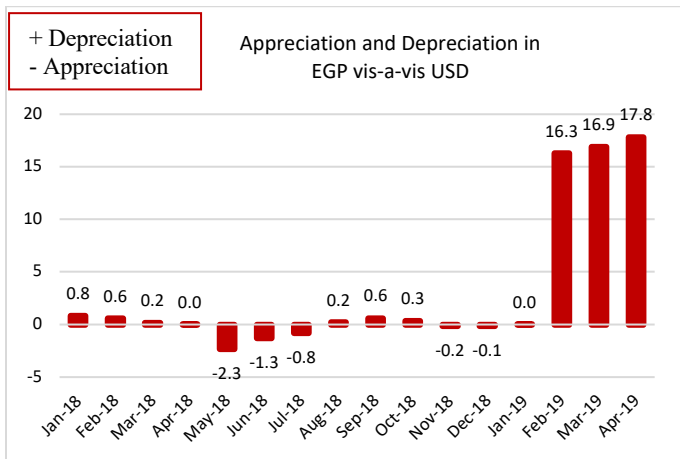


Source: MAP's Estimates, MPED and CBE

### Egyptian Pound Devaluation Spillovers

The recent devaluation of the Egyptian Pound by 17.8% in April, had its anticipated repercussions on the domestic inflation due to unfavorable pass-through effect, that has been fully manifested during April figure. Rather, it is expected this to be reflected during the next couple of months in higher inflation rates.

Nonetheless, the inflationary pressures are relatively tamed out due to the CBE's decision to hike policy interest rates by 100 basis points in its exceptional meeting that was held on March 21<sup>st</sup>.

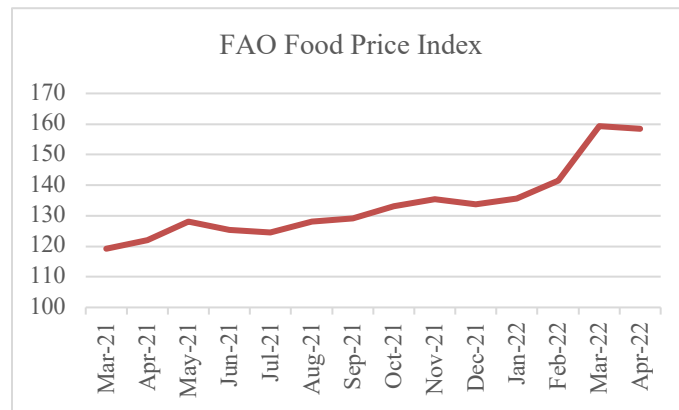


Source: MPED and Central Bank of Egypt.

### International Prices Dynamics

The FAO Food Price Index (FFPI) averaged 158.5 points in April 2022, down 1.2 points (0.8 percent) from the all-time high reached in March, though still 36.4 points (29.8 percent) above its value in the corresponding month last year. The drop in the FFPI in April was led by a significant downturn in the vegetable oil sub-index, along with a slight decline in the cereal price sub-index. Meanwhile, sugar, meat and dairy price sub-indices sustained moderate increases.

Wheat prices are forecasted to increase with more than 40 percent, reaching an all-time high in nominal terms this year. That will put pressure on the developing economies that rely on wheat imports, especially from Russia and Ukraine. Metal prices are projected to increase by 16 percent in 2022 before easing in 2023 but will remain at elevated levels (World Bank).



Source: FAO.

On a separate note, and driven by war-related trade and production disruptions, the price of Brent crude oil is expected to remain above \$100 a barrel until the end of 2022, the highest level since 2013, with an increase of more than 40 percent compared to 2021. Prices are expected to moderate to \$92 in 2023—well above the five-year average of \$60 a barrel. Natural-gas prices (European) are expected to be twice as high in 2022 as they were in 2021, while coal prices are expected to be 80 percent higher, with both prices at all-time highs (World Bank).

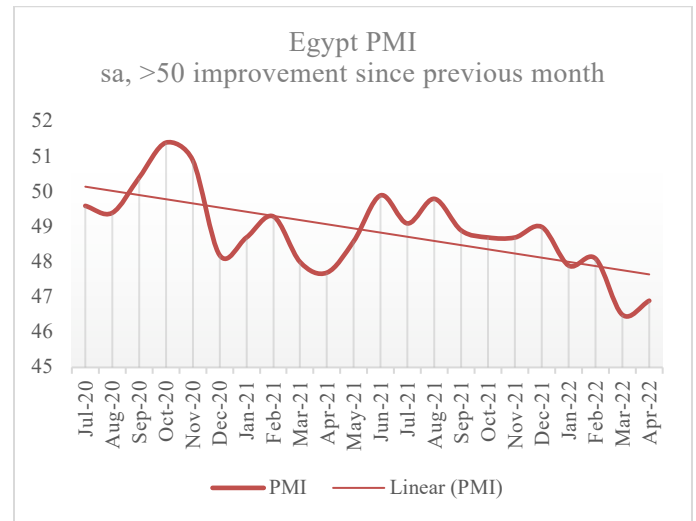
## Egypt's PMI Developments

Egypt PMI came in at 46.9 in April, up marginally from March's 21-month low of 46.5. As a result, the index moved closer to, but remained below the 50.0 no-change threshold, where it has remained for the past 17 months, signaling a continued deterioration in business conditions from the previous month.

The continued buildup of price pressures, which are denting on consumers' purchasing power, led to yet another decline in demand and new orders in turn. Raw material scarcity and high energy prices, partly due to the war in Ukraine, coupled with the recent Central Bank move, which allowed the pound to depreciate led to high inflation, weighing on output.

## Forecasts for Headline and Core Inflation

In light of the recent international dynamics, the main source of inflation is emerging from global developments, however, most of the domestic variables indicate no inflationary pressures. Both output gap and money gap are in the negative territory for at least five consecutive quarters. This implies no inflationary pressures from the domestic fundamentals. Rather, the recent CBE's measure



Source: IHS Markit

related to the EGP devaluation had its spillovers on the domestic inflation rate either headline or core. Nonetheless, these spillovers are somehow mitigated by the economic safeguarded measures mainly hiking the policy rates on the MPC exceptional meeting held on 21<sup>st</sup> 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.