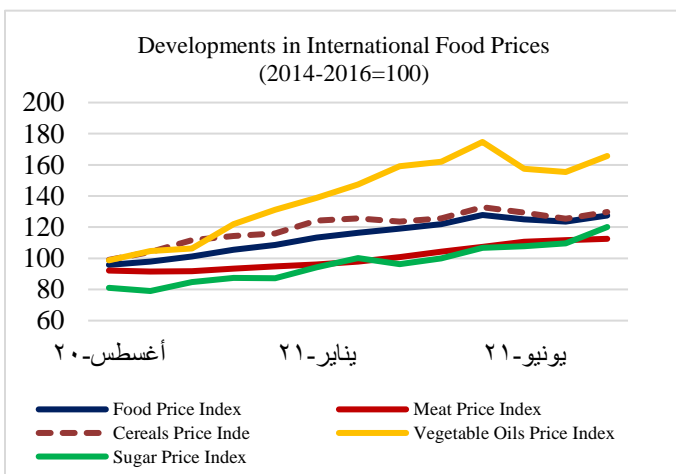




International Food and Energy Prices are on the Rise Fueling Domestic Inflation

Sunday, October 10, 2021

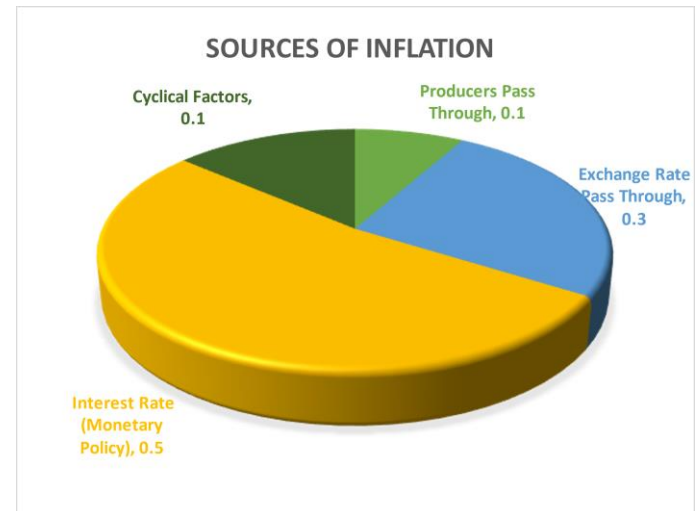
...Disrupted Supply Chains and Its Impact on the Global Markets Via Higher Food Prices... The Global Pandemic has its repercussions on the Global economy through disrupted supply chains, congested ports, and higher transportation costs. A situation that is expected not to be temporary, rather it will continue for one or two consecutive years that is projected to have unfavorable economic spillovers especially on hiked prices to match the higher cost of production and higher food prices. In this context, it is also projected that the Global economy will be suffering from Stagflation conditions, knowing that both manufacturing and services sectors are operating now below their potential levels.



Source: FAO.

Recent dynamics in headline and core inflation ... Urban headline inflation (Y-o-Y) accelerated to register 6.6% in September, compared to 5.7% a month earlier. The increase came on the back of the monthly acceleration by 1.1% compared to negative 0.3% during the same month of the previous year. Meanwhile, core inflation inched up in September to record 4.8% (Y-o-Y) compared to 4.5% in August.

...Sources of Headline Inflation and Outlook ... In an attempt to quantify the sources of inflation during the last 14 years, it has been grasped that the monetary policy has the upper hand in affecting the inflation contributing by 50% of the inflation dynamics during the time under investigation. In the second rank, exchange rate dynamics contributes by 30% of inflation developments, this refers to the exchange rate pass-through effect. In other words, a 1% depreciation the EGP would be accompanied by 0.3% increase in the domestic prices. Therefore, the increase in the international prices of strategic goods such as food and energy would be associated with 30% to the domestic prices.



Source: MAP's Estimates, MPED and CBE.

...Impact of Increased International Food Prices on Egyptian Economy... Estimated potential impact of higher international food prices are presented in the following table, especially for those that Egypt is not self-sufficient in, and depends primarily on importing these products from abroad. The importation bill is expected to

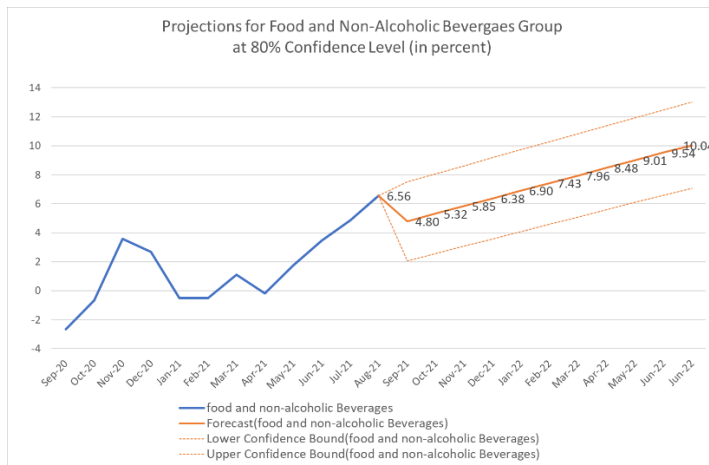
enlarge during the upcoming year, considering a spectrum of impact from a 30% transmission of higher prices to full transmission of prices i.e., 100%, under the assumption that the imported quantities are kept the same.

Estimates for Higher Prices on Egypt's Imports for FY2020/21					
	Imports 2018/19 (USD mn)	Imports 2019/20 (USD mn)	Higher International Prices 2020/21	Imports 2020/21 (USD mn)*	Imports 2020/21 (USD mn)**
Wheat	2127	2219	61	2625	3573
Maize	1404	1543	90	1960	2932
Veg. Oils	1058	1294	25	1391	1618
Meat	887	862	21	916	1043
Total	5475.2	5918.5		6892.6	9165.5

Source: MAP's Estimates, MPED and CBE.

* Assuming a 30% transmission of the international food prices with fixed quantities.

** Assuming a 100% transmission of the international food prices with fixed quantities.



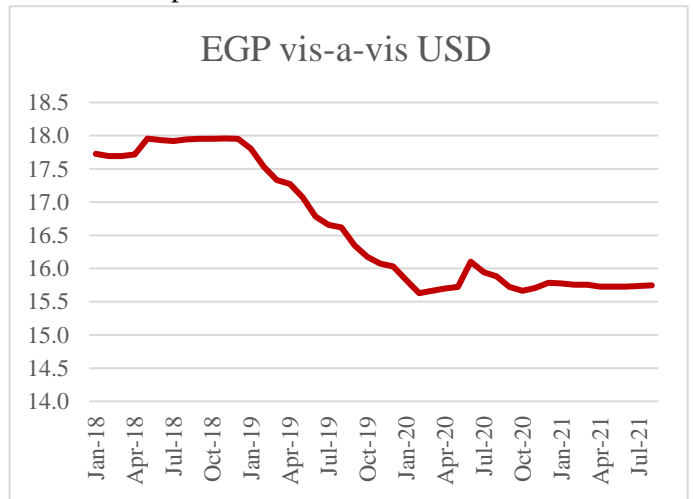
Source: Source: MAP's Estimates, MPED.

It can be obviously shown that the domestic food prices were affected from higher international prices during the last five months due to the following reasons:

- Higher share of food prices in the CPI basket constituting about 35.9%,
- Most of the strategic goods are imported from abroad, which render the domestic price more vulnerable to the international volatility in prices
- Nonetheless, relative stability in the FOREX market has mitigated the pass-through effect to a great extent.

Thus, it can be concluded from the above chart that domestic food prices are expected (at 80% confidence level) to be on the upward trajectory through June 2022, affected by higher international prices that are expected to prevail during the same period.

...FOREX Market Dynamics ... On the contrary, still exchange rate is witnessing a relative stability over the last year period. Moreover, EGP witnessed an accumulated nominal appreciation of 1.9% over July-September 2021, albeit it started to slightly depreciate during September by 0.21%. This might put some but limited inflationary pressures, in which the pass-through effect would be unfavorable on inflation during the upcoming couple of months conditional on the direction of exchange rate movements up or down.



Source: CBE.

...Forecasts for headline and core inflation ... The implemented forecasts present two models, in addition to the average of the two scenarios which are calculated using univariate a multiple model specification and a Vector Error Correction Model (VECM), wherein the estimation period spans from 1Q 2010/11 through 4Q 2020/21.

Headline and core inflation forecasts for FY2021/22... we still expect that urban headline inflation will be maintained during FY2021/22 at a single digit, backed by favorable base effect from the previous year albeit it inched up to register 6.04% during Q3 2021. This is attributed to:

- higher inflationary pressures due to the second-round effects of the fuel prices hikes

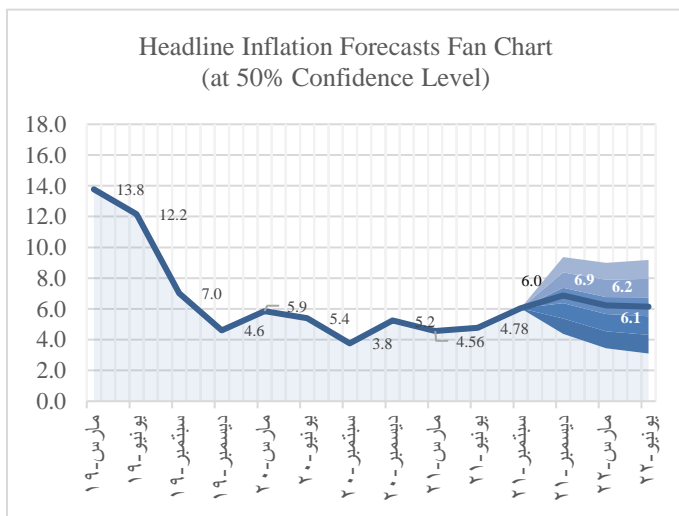
- higher international food prices that are partially transmitted to the domestic economy
- along with the positive money gaps induced from the domestic liquidity estimates.
- Adding to the previous, the inflationary contribution of the private consumption to real GDP growth rate during Q3 of FY 2020/21.
- Moreover, the exchange rate started to show some but minor depreciation since the beginning of September, suggesting unfavorable pass-through effect.

For headline inflation, forecasted figures are on average ranging between 6.1% and 8.6% for FY2021/22. Moreover, we expect headline inflation to inch up during Q2 FY 2021/22 to range between 5.4% and 8.4% on the back of hiked fuel prices first and second round effects, in addition to higher international food prices. Since then, headline will tame out to hover around 6%-7% being within the target set by the CBE which is 7% (+/-2%) to be met by Q4 2022.

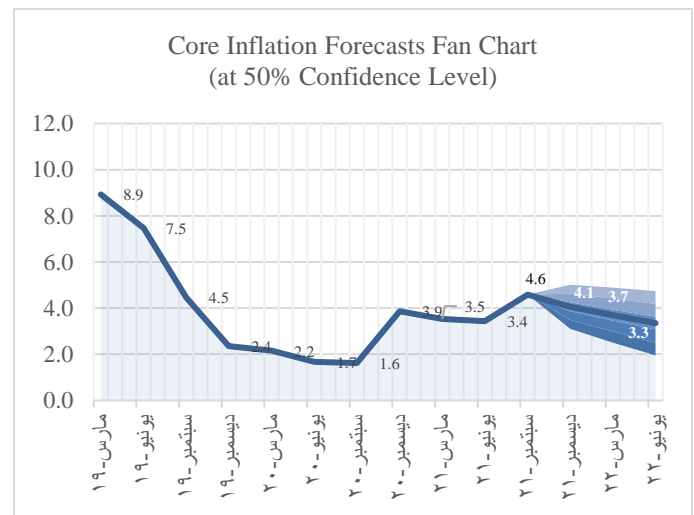
Worth to note, our forecasts for Q1 of FY2021/22 for core inflation came in line with the actual figures, in which we projected a core inflation of 4.4% while the actual figure materialized at 4.6%. As for headline inflation, our forecasts came on the upper side wherein we forecasted 8.6% for Q3 2021, while it registered actually 6.0%, supported by the above-mentioned reasons.

As for core inflation forecasts, recent dynamics indicate that forecasted figures are on average ranging between 3.3% and 4.4% for FY2021/22. Evidently, we found that it will show a slight pick-up by Q1 FY2021/22, to reach a maximum of 4.4% as per both the multiple regression and the VECM model; nevertheless, since then, it will be on the downward trajectory, and it will be fluctuating around a single digit for all scenarios likewise reaching 3.3%.

We still emphasis that future dynamics in inflation will partially depend on how the economy will perform on the real activity front along with the dynamics in both inflation rate and FOREX market during the next couple of quarters. Adding to the previous, the global dynamics concerning the international energy and food prices.



Source: MAP's Estimates.



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