Macro-Note Series
“Inflation Note”

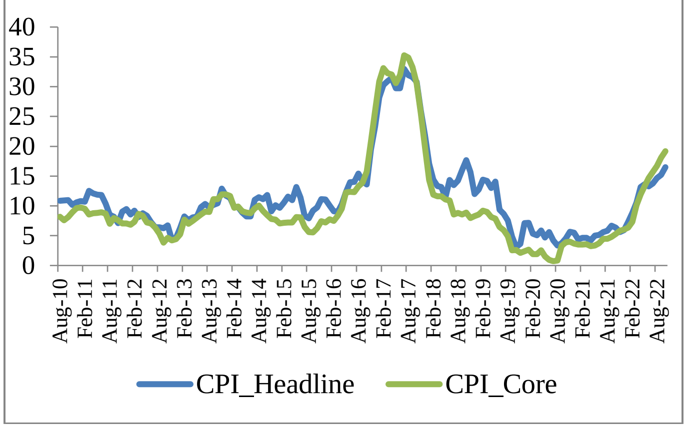
وزارة التخطيط والتنمية الاقتصادية
Ministry of Planning and Economic Development

Core Inflation at a Record High of 19.2% in Five Years

Thursday 10th of November 2022

Recent dynamics in headline and core inflation … Urban headline inflation (Y-o-Y) increased in October to 16.2% up from 15.0% a month earlier. The monthly dynamics has been also upticks by 2.6% in October up from 1.5% during the corresponding month of 2021. Meanwhile, core inflation continues on surging upward to 19.2% in October compared to 18.0% a month earlier. This has been accompanied by a doubled monthly rate of 3.0% in October up from 1.6% a month earlier.

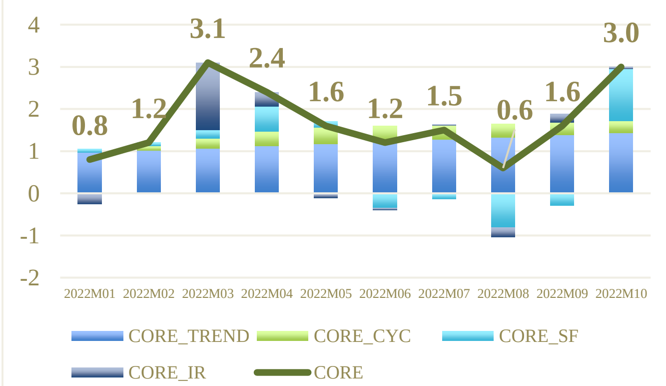
Monthly Headline and Core Inflation (Y-o-Y) (in percent)



Source: CAPMAS and Central Bank of Egypt.

…Sources of demand-driven inflation … The monthly dynamics for the period January-October 2022, indicates that core inflation is still on the upward trajectory since last April, to record 3.0% in October, up from 1.6% a month earlier, with a monthly record high during the current month. Worth noting, all the four components have contributed positively to monthly core inflation. Both implied inflation (inflation expectations) along with the seasonal factors had the major impact due to the build-up of inflation expectations on one hand and due to the schooling season on the other hand.

Decomposition of Core Inflation (in percentage points)

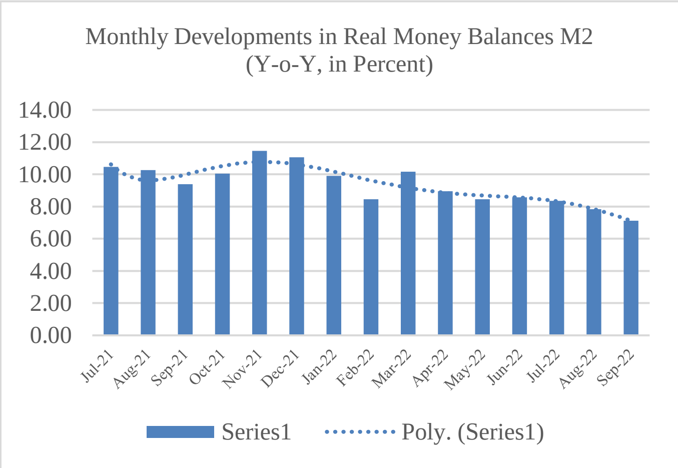


Source: MAP’s Estimates, MPED and CBE.

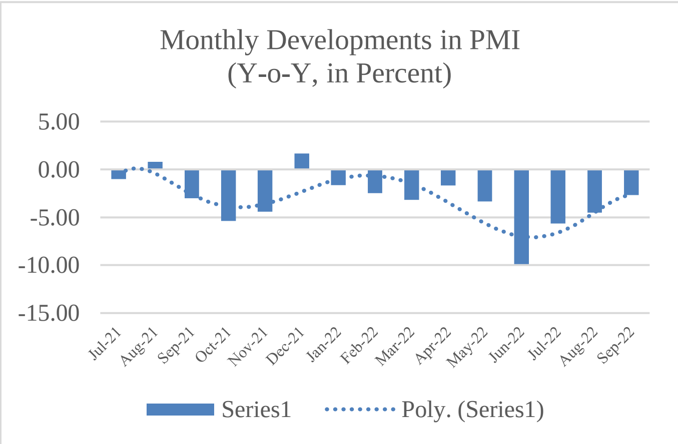
…Money Balances, PMI Developments, and Inflation … Generally, real domestic liquidity balances are on the downward trend since last April, which lower the pressure on the inflation dynamics in the short- to medium- terms.

Also, PMI also indicated a slightly better performance in October, yet the index is still below the 50-threshold reflecting tight business conditions for the non-oil private sector. Nonetheless, the Y-o-Y growth rates in PMI mirrors the hovering of the index around the negative zone since last January, with a record trough in June, hence then the index witnessed some rebound.

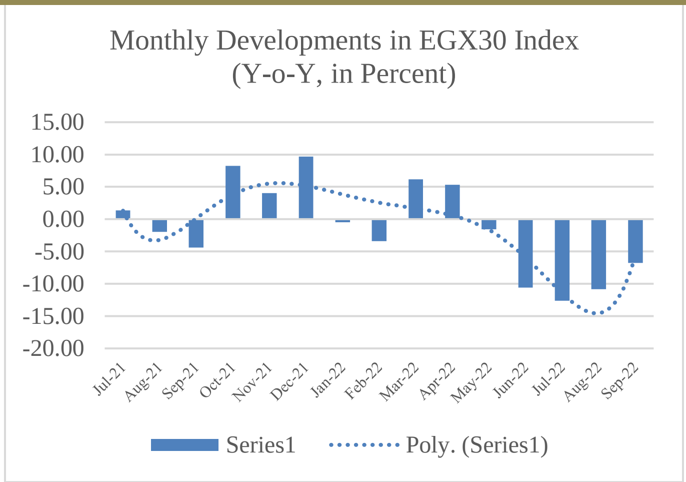
It is no surprise, that the unfavorable conditions reflected in the PMI performance is also mirrored in the stock market behavior, is which the market performance-measured by EGX30 index- showed a deterioration since June and beyond, with some improvement by September 2022 coinciding with PMI.



Source: Central Bank of Egypt.



Source: Standard and Poor's, IHS Markit.



Source: Egyptian Exchange.

…Expected Monetary Policy Decision… In light of the recent inflation dynamics, it is obvious that headline inflation is breaching the targets previously set by the Central Bank to be 7%±2%, for the sixth month in a row. Also, the core inflation is well-above the 10-years average of 9.8%. Knowing that the major source of inflation is purely domestic and demand-pull risks are clearly manifested. In the sense, that the economy is now experiencing the materialization of the second-round effects of the fuel prices hikes took place during July.

The CBE has taken some measures to absorb the excess liquidity in the market through open market operations, via four consecutive fixed rate deposits auctions during September and October to absorb an amount of EGP 500 bn from the banking sector. This can be seen as an alternative move to curb inflationary pressures without altering the interest rates.

Moreover, the Monetary Policy Committee at the CBE decided in its exceptional meeting took place on October 27, to move to a durably flexible exchange rate regime, leaving the forces of supply and demand to determine the value of the EGP against other foreign currencies, while prioritizing the primary goal of achieving price stability, and building up sustainable, adequate levels of Foreign Exchange Reserves. This decision has been accompanied by an interest rate hike of 200 basis points by raising the overnight deposit rate, the overnight lending rate and the rate of the main operation by 200 basis points to 13.25 percent, 14.25 percent, and 13.75 percent, respectively. The discount rate was also raised by 200 basis points to 13.75 percent.

Against all the previous background, we expect that inflation rate will build-up further through December 2024.