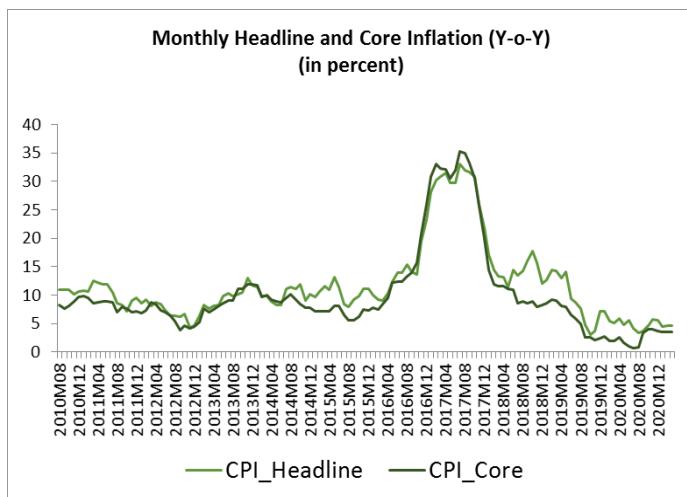




Tamed Cyclical Factors Drive A Single Digit Core and Headline Inflation

Thursday, April 08, 2021

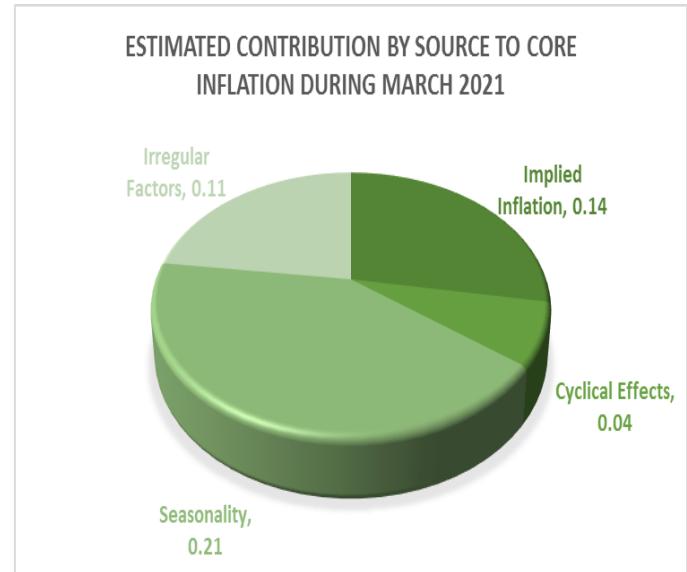
Recent dynamics in headline and core inflation ...
Urban headline inflation (Y-o-Y) broadly remained unchanged at 4.5% in February and March, compared to 5.1% during March 2020. The deceleration is driven by favorable base effect. Monthly developments accounted for 0.6% in March 2020 and March 2021, compared to 0.2% in the February 2021. Moreover, core inflation (Y-o-Y) slightly increased to 3.7% in March, compared to 3.6% a month earlier. This came on the back of a tamed monthly rate of 0.5% in March, compared to 0.4% a month earlier.



Source: CAPMAS and Central Bank of Egypt.

...Sources of demand-driven inflation ... During March 2021, the decomposed series shows that the main source which fuels monthly core inflation during this month is mainly attributed to seasonal factors accounting for 0.21 percentage points out of 0.5%. Moreover, implied inflation contributes by 0.14 percentage points, in addition to the cyclical factors contributing by 0.04 percentage points. As such, the three factors contribute by 0.4 percentage points to core inflation. Adding to that the

positive contribution of the irregular factors emerged primarily from external effects such as the exchange rate pass-through effect and the repercussions of COVID-19.



Source: MAP's Estimation.

* Normally, seasonal factor estimates appear with nil value in case of annual data, while seasonality is a high-frequency data concept that emerges in monthly or quarterly series.

...Forecasts for headline and core inflation ... The implemented forecasts present two scenarios, in addition to the baseline scenario which is calculated using univariate ARIMA model specification. Both optimistic and pessimistic scenarios are induced from a macro-model estimation (refer to the technical annex), wherein the estimation period spans from 1Q 2004/05 through 1Q 2020/21.

Headline and core inflation forecasts for FY2020/21...we still expect that urban headline

inflation will be maintained during FY2020/21 at a single digit, supported by anchored cyclical factors that relate to the modest contribution of the business cycle. For headline inflation, we updated our forecasts downwards; as such the forecasted figures are on average ranging between 6.9% and 7.5% for FY2020/21.

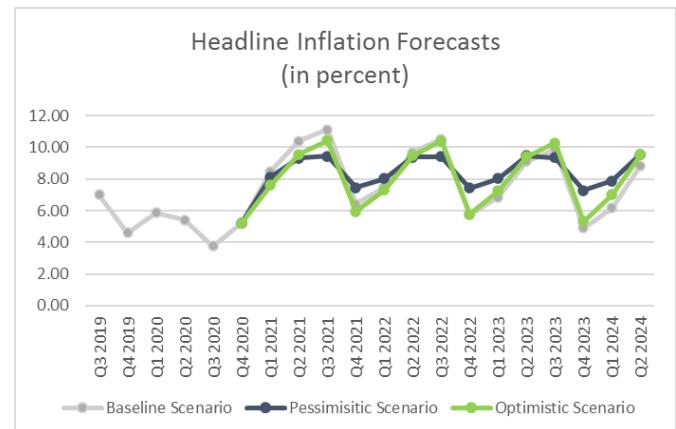
As such, our forecasts show that short-term inflation will be hovering -on the lower edge- around the target set by the CBE which is 7% (+/-2%) suggesting that the CBE will be able to meet its target.

When shifting to core inflation forecasts, recent dynamics indicate that it will be kept well below its historical average of 8.8% for some time. Evidently, we found that it will show a slight pick-up by Q4 FY2020/21, to reach a maximum of 7.4% as per the baseline scenario; nevertheless, it will be fluctuating around a single digit for all scenarios likewise. Business as usual scenario shows that if economic conditions are *ceteris-paribus*, core inflation will be maintained at a record low of 5.4% on average during FY2020/21.

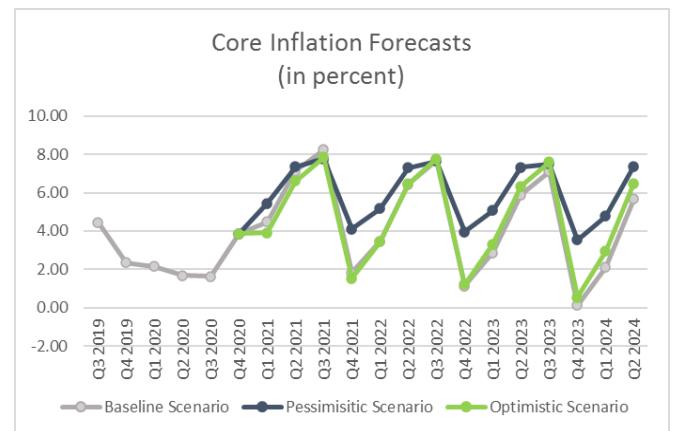
Worth to mention that the displayed quarterly forecasts on the following two panels incorporate the forecasts for GDP figures which entail some extra dynamics emerging from the seasonal nature of the GDP quarterly data.

Moreover, our forecasts for core inflation just came in line with actual figures for Q3 of FY2020/21, registering 3.9% as per the optimistic scenario, vis-à-vis 3.5% actual figure. On the contrary, our forecasts for headline inflation came on the upper side recording actually 4.56%, compared to our in-house projections of 7.61% during Q3 of FY2020/21.

We still emphasize 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.



Source: MAP's Estimates.



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Headline Forecasts				
	Baseline	Pessimistic	Optimistic	Average All Scenarios
Q1 2020/21				
Q2 2020/21				
Q3 2020/21			4.56	
Q4 2020/21	10.40	9.32	9.56	9.76
Core Forecasts				
Q1 2020/21				
Q2 2020/21				
Q3 2020/21			3.53	
Q4 2020/21	7.14	7.35	6.62	7.04

Source: MAP's Estimates.

Technical Annex: Macro Forecasts Summary

1. Sectoral Real GDP: Factor Cost

All values were calculated as the nominal values adjusted for inflation using the Headline CPI.

Three scenarios were calculated:

- Baseline scenario: the historical averages for the last 15 years were utilized in a univariate framework.
- Optimistic scenario: the simple average for the univariate analysis of 10 leading sectors, which are: Agriculture, extractions, manufacturing, construction, transportation, real estate, finance, Suez Canal and hotels & restaurants and services were implemented. These five sectors constitute about 50% of real GDP.
- Pessimistic scenario: based on a behavioral function of five proxies for three leading sectors (Suez Canal, transportation and extractions) which are affected primarily from geopolitical issues and the Global pandemic impact especially in the light of the second wave of COVID-19.

2. Labor Market: Unemployment Rate and Number of Employed

- Is based on a behavioral equation as a function in GDP (factor cost) and a step dummy to control for the structural and administrative reforms taking place during the second half of FY 2018/19 and beyond.

3. Inflation Forecasts: Headline and Core

- based on a behavioral equation as a function in GDP (factor cost), induced real money gaps and unemployment rate (Philips Curve).

4. Exchange Rate Forecasts:

- Baseline scenario is based on an ARIMA model (1,0,1). While both optimistic and pessimistic scenarios are based on a behavioral equation including inflation and GDP Growth rates.