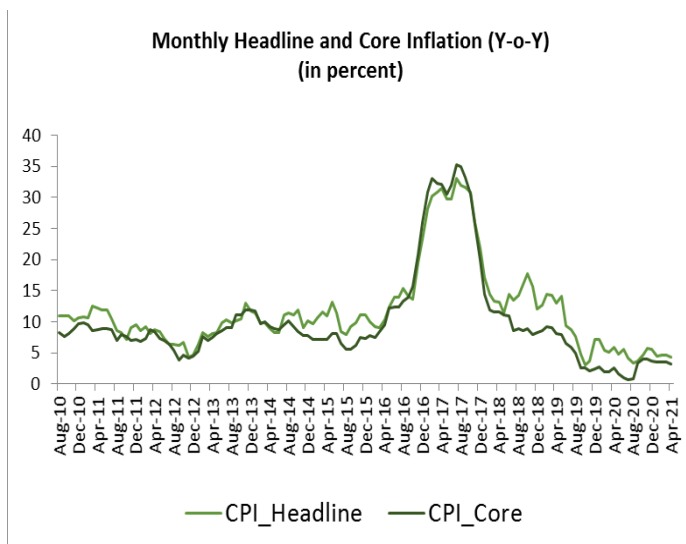




# Favorable Base Effect Drives the Decline in Headline and Core Inflation During April

Monday, May 10, 2021

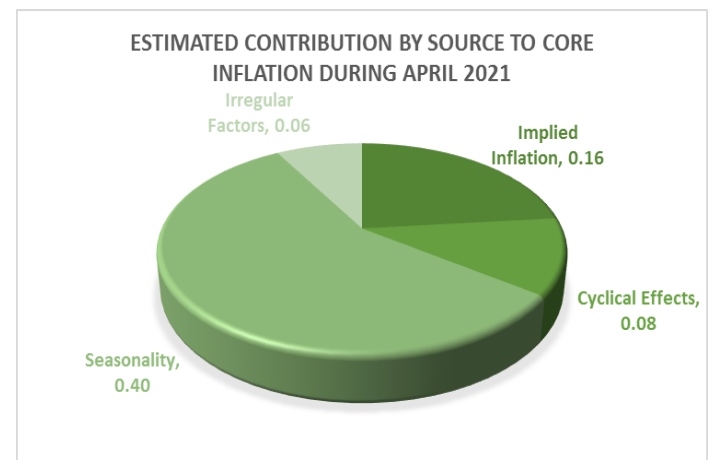
**Recent dynamics in headline and core inflation ...** Urban headline inflation (Y-o-Y) declined to record 4.1% in April, compared to 4.5% in March. The deceleration is driven primarily from favorable base effect from previous year. This came despite the monthly developments accounted for 0.9% in April 2021, compared to 0.6% in the previous month. The same talk applies to core inflation which witnessed a decline in (Y-o-Y) rate to 3.3% in April compared to 3.7% in March. This came although m-o-m rate has increased from 0.5% in March, to 0.7% in April.



Source: CAPMAS and Central Bank of Egypt.

**...Sources of demand-driven inflation ...** During April 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 0.40 percentage points out of 0.7%, which can be backed by the preparation for Ramadan Holy month and Eid festivities. Moreover, implied inflation contributes by 0.16 percentage points slightly above the previous month rate of 0.14 percentage points, noteworthy, this is a

reflection for higher inflation expectations this month. Additionally, cyclical factors contributing by 0.08 percentage points. As such, the three factors contribute by 0.64 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 related to the modest contribution of the business cycle. Additionally, muted pass-through effect from stable FOREX market. Moreover, inflation expectations are broadly managed as obvious from the decomposed core figures.

For headline inflation, we updated our forecasts downwards; as such the forecasted figures are on averaging around 5.9% for FY2020/21.

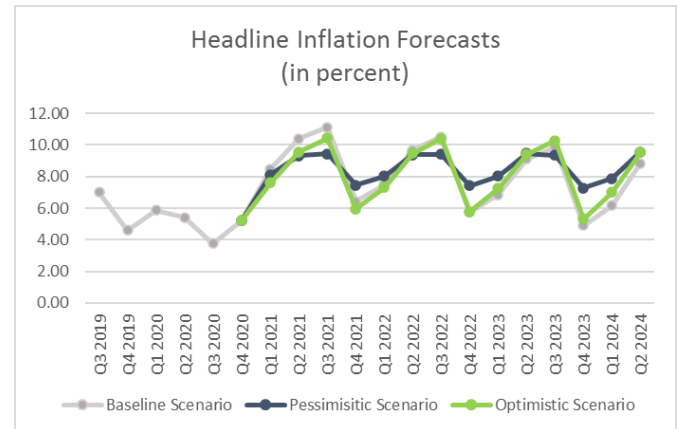
As such, our forecasts show that short-term inflation will be hovering -on the lower edge- around the target set by the CBE which is 7% (+/-2%) suggesting that the CBE will be able to meet its target.

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, however, we expect core inflation to be maintained at a record low of 5.4% on average during FY2020/21.

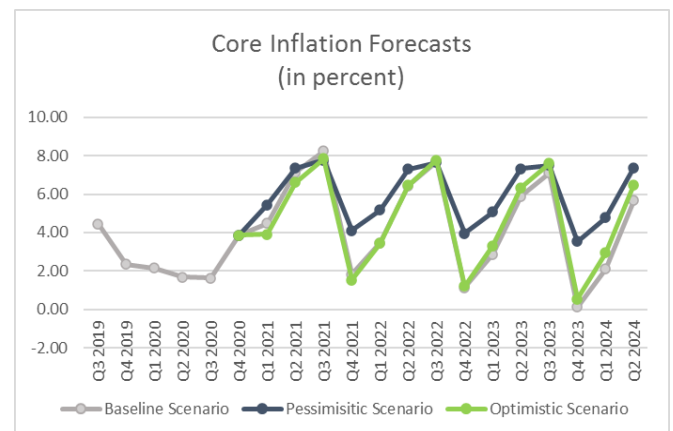
Worth to mention that the displayed quarterly forecasts on the following two panels incorporate the forecasts for GDP figures which entail some extra dynamics emerging from the seasonal nature of the GDP quarterly data.

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.

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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<b>Headline Forecasts</b>				
	Baseline	Pessimistic	Optimistic	Average All Scenarios
<b>Q1 2020/21</b>				
<b>Q2 2020/21</b>				
<b>Q3 2020/21</b>	<b>4.56</b>			
<b>Q4 2020/21</b>	10.40	9.32	9.56	9.76
<b>Core Forecasts</b>				
<b>Q1 2020/21</b>				
<b>Q2 2020/21</b>				
<b>Q3 2020/21</b>	<b>3.53</b>			
<b>Q4 2020/21</b>	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.