*Macro-Note Series*
*"Inflation Note"*

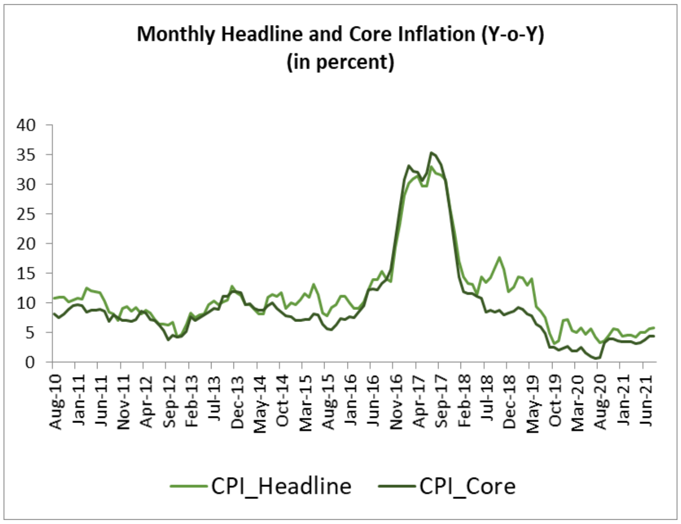
وزارة التخطيط والتنمية الاقتصادية
Ministry of Planning and Economic Development

# Increase in the Urban Headline Inflation and Slight Decrease in the Core Inflation in August 2021

**Thursday, September 9, 2021**

## Recent dynamics in headline and core inflation

Urban headline inflation (Y-o-Y) accelerated to register 5.7% in August, compared to 5.4% a month earlier. The increase came on the back of the monthly acceleration by 0.1% compared to negative 0.2% during the same month of the previous year. Meanwhile, core inflation decreased in August to record 4.5% (Y-o-Y) compared to 4.6% in July. This is due to the lower m-o-m rate of negative 0.3% in August 2021, compared to negative 0.2% during the same month of the previous year.

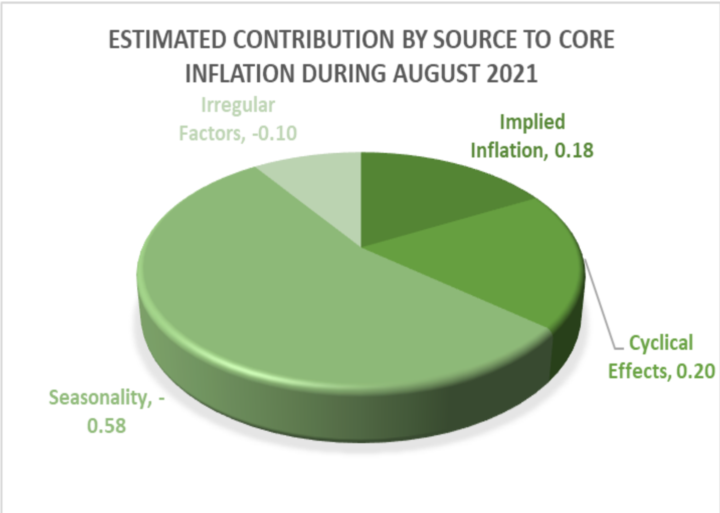



Source: CAPMAS and Central Bank of Egypt.

On another front, the annual headline nationwide inflation rate increased to 6.4% in August 2021 up from 3.6% in July 2021 despite the deceleration of the monthly headline by 0.1%. The annual increase emerged from the acceleration in prices of the CPI main groups, which are mainly; education (29.7%), miscellaneous goods and services group (9.2%), recreation & culture group (8.1%) and food and non-alcoholic beverages group (7.6%).

## Sources of demand-driven inflation

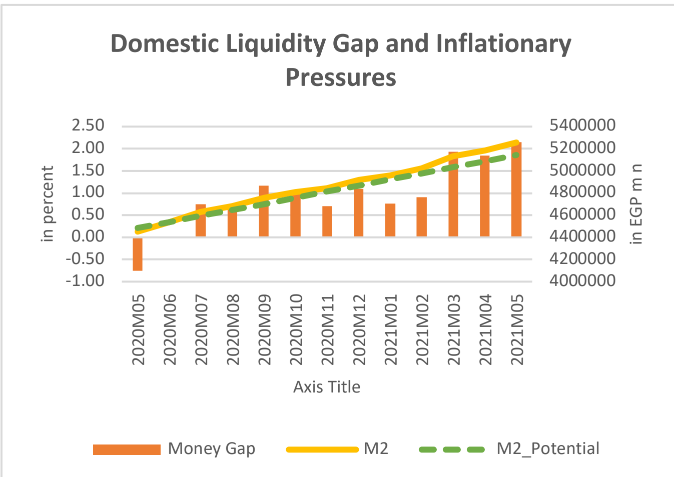
During August 2021, the decomposed series shows that the main source, which fuels the monthly core inflation, is mainly attributed to implied inflation and the cyclical factors accounting collectively for 0.38% points out of negative 0.3%, which can be backed by the second round of supply shock related to energy price hikes. Such dynamics suggests the existence of inflationary pressures emerging from the underlying inflation and the cyclical dynamics.




Source: MAP's Estimates, MPED and CBE.

## Domestic liquidity and inflationary pressures

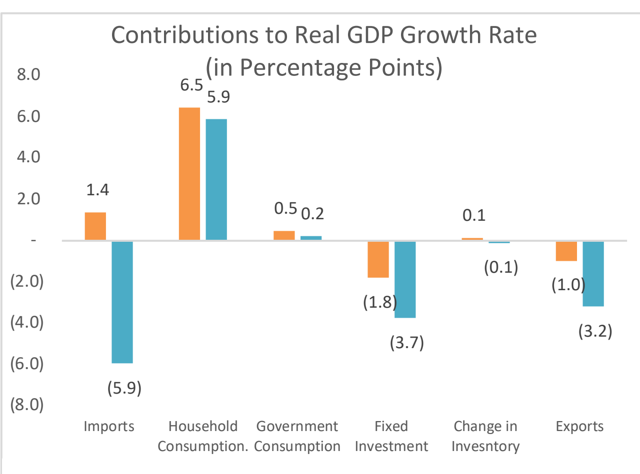
Estimated potential money balances indicated that they are below the actual levels for 11 consecutive months. This implies the likely existence of underlying inflationary pressure in the near future, consistent with global expectations of rising price levels post COVID. As such, these dynamics would put upside risks for the Central Bank and would induce it to increase the interest rate in the upcoming one or two MPC meetings. Adding to the above, the supply shock related to the raised fuel and energy prices, which took place last month, started to materialize in July's figure. In this context, it has been reported that transportation group was from the highest increasing prices this month accounting for 0.7% during August 2021.



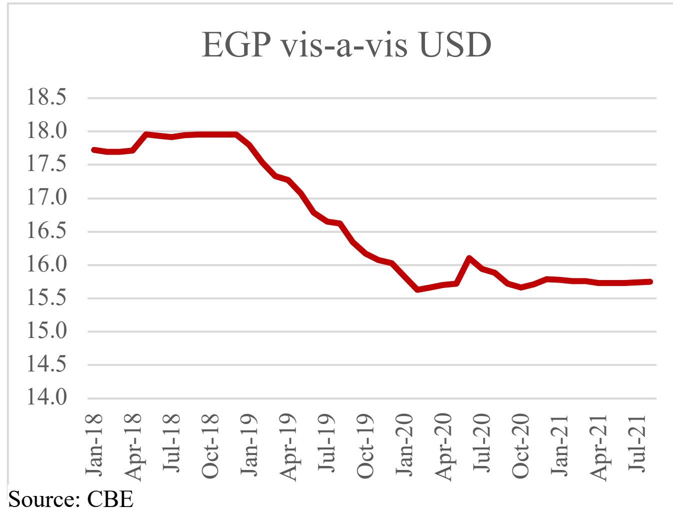

Source: MAP's Estimates, MPED and CBE.

## Sources of economic growth

Calculated contributions to real GDP growth rate revealed that during Q3 FY 2020/21, the main source of growth is household consumption, the contribution of capital formation and net exports have decreased. These forces might create some inflationary pressures, consistent with global expectations of rising price levels post COVID




Source: MAP's Estimates, MPED and CBE.




Source: CBE

## FOREX market dynamics

On the contrary, the exchange rate is still witnessing a relative stability over the last year period. Moreover, EGP witnessed an accumulated nominal appreciation of 4.3% over June-August 2021, albeit it started to slightly depreciate during September by 0.15%. 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.

## Forecasts for headline and core inflation

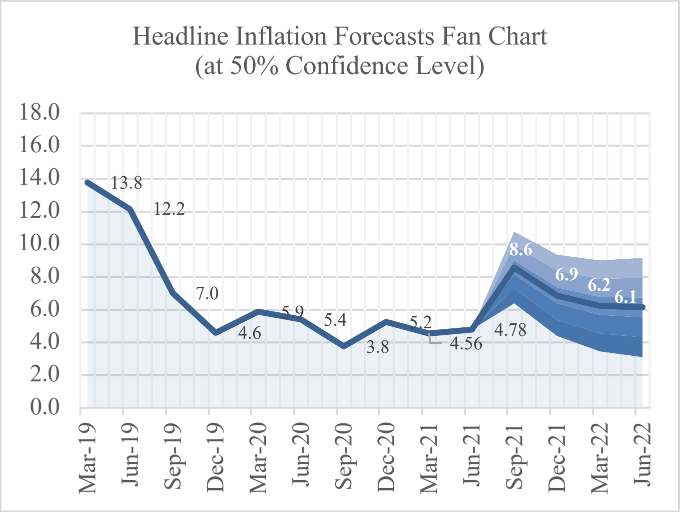
The implemented forecasts present two models, in addition to the average of the two scenarios which are calculated using univariate a multiple model specification and a Vector Error Correction Model (VECM), wherein the estimation period spans from 1Q 2010/11 through 4Q 2020/21.

## Headline and core inflation forecasts for FY2021/22

It is expected that urban headline inflation will be maintained during FY2021/22 at a single digit, albeit it will increase to reach 8.6% during Q3 2021. This is attributed to higher inflationary pressures due to the second-round effects of the fuel prices hikes along with the positive money gaps induced from the domestic liquidity estimate in addition to 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.

Against this background, inflation expectations are broadly managed although it started to contribute adversely to the inflation dynamics during this month as obvious from the decomposed core figures accounting for 0.2% points of August monthly inflation rate.

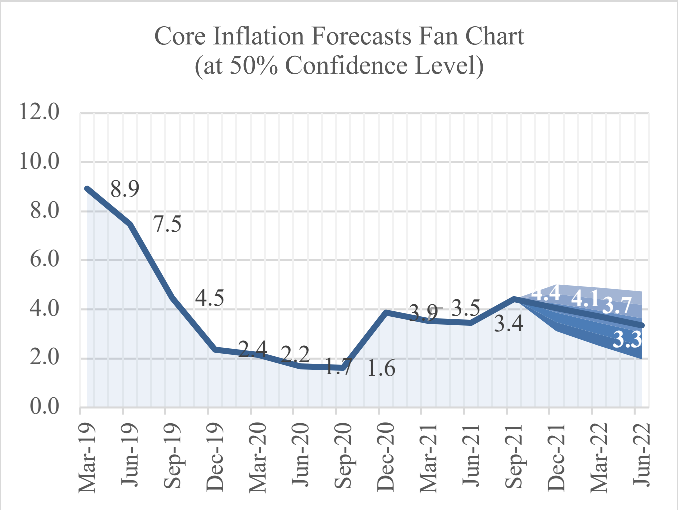
For headline inflation, forecasted figures are on average ranging between 6.1% and 8.6% for FY2021/22. Moreover, the headline inflation is expected to inch up during Q1 FY 2021/22 to range between 8.6% and 8.7% on the back of improved operational conditions and absorbed unemployment rate that will fuel inflation rate, in addition to the hiked fuel prices first and second round effects. Since then, headline is expected to hover around 6% - 7% being within the target set by the CBE which is 7% (+/-2%) to be met by Q4 2022.




Source: MAP's Estimates.

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, 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%.

***The 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.