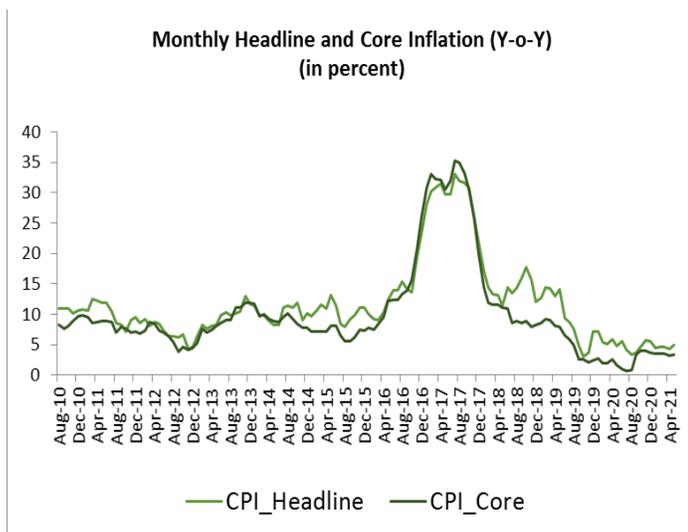




Headline and Core Inflation Rise in May on Base Effect Closer to CBE Lower Target Band

Thursday, June 10, 2021

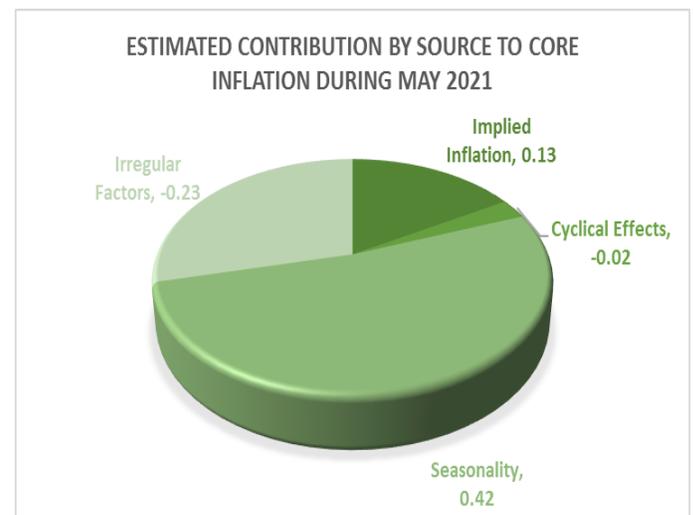
Recent dynamics in headline and core inflation ... Urban headline inflation (Y-o-Y) inched up to record 4.8% in May, compared to 4.1% in April. The acceleration is driven primarily from the monthly developments accounted for 0.7% in May 2021, compared to zero % in the same month of the previous year. Meanwhile, core inflation remained broadly unchanged in May to record 3.4% (Y-o-Y) compared to 3.3% in April. This came on the back of fixed m-o-m rate of 0.3% in May 2021, and during the same month of the previous year.



Source: CAPMAS and Central Bank of Egypt.

...Sources of demand-driven inflation ... During May 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 0.42 percentage points out of 0.3%, which can be backed by the seasonal pattern of Ramadan Holy month

and Eid festivities. Moreover, implied inflation contributes by 0.13 percentage points slightly below the previous month rate of 0.16 percentage points, being a reflection for lower inflation expectations. On the contrary, both cyclical factors and external factors contributed negatively to monthly core inflation. This can be partially attributed to the slowing down performance of the private non-oil sector, implying worsening operational conditions as it can be observed from the PMI, which is below the 50 threshold for five months in a row. Adding to that the negative 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 3Q 2020/21.

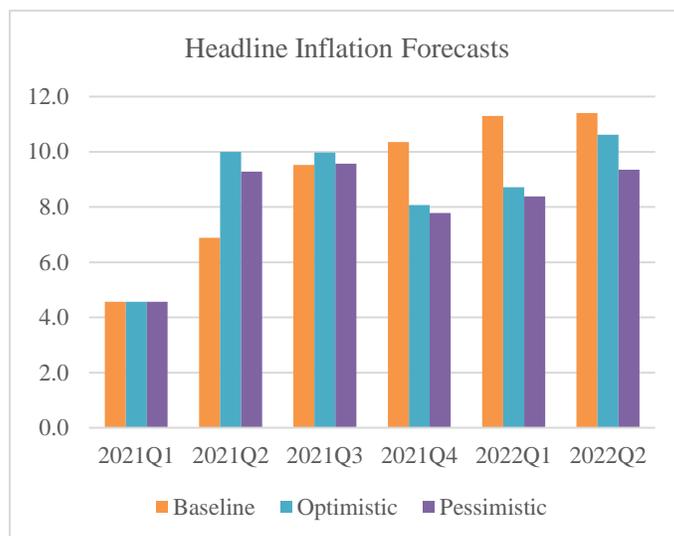
Headline and core inflation forecasts for FY2020/21...we still expect that urban headline inflation will be maintained during FY2020/21 at a single digit, supported by anchored inflation components; cyclical factors that related to the modest contribution of the business cycle. Additionally, muted pass-through 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 average ranging between 5.7% and 7.3% for FY2020/21. Moreover, we expect headline inflation to inch up during FY 2021/22 to range between 8.8% and 10.6% on the back of improved operational conditions and absorbed unemployment rate that will fuel inflation rate.

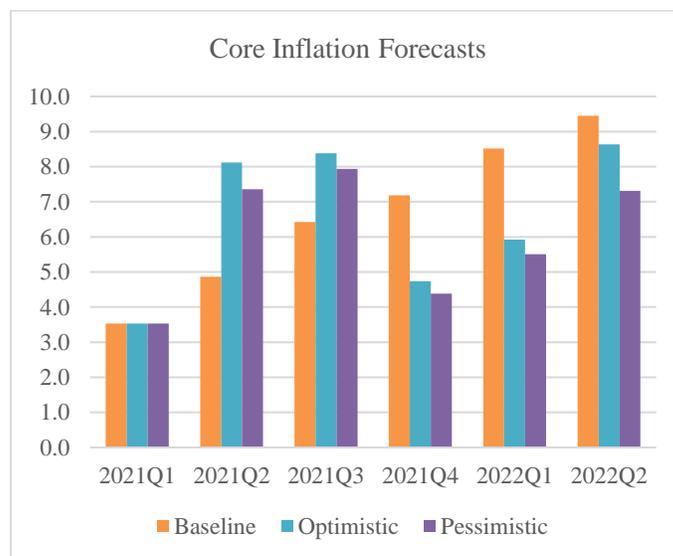
As such, our forecasts show that short-term inflation will be hovering -on the lower edge- around the target set by the CBE which is 7% (+/-2%) suggesting that the CBE will be able to meet its target, however, conditions might reverse in the medium term.

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 4.9% 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 4.2% on average during FY2020/21.

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.



Source: MAP's Estimates.



Source: MAP's Estimates.

Headline Forecasts				
	Baseline	Optimistic	Pessimistic	Avg.
<u>2021Q1</u>	<u>4.6</u>	<u>4.6</u>	<u>4.6</u>	
2021Q2	6.9	10.0	9.3	8.7
2021Q3	9.5	10.0	9.6	9.7
2021Q4	10.3	8.1	7.8	8.7
2022Q1	11.3	8.7	8.4	9.5
Core Forecasts				
<u>2021Q1</u>	<u>3.5</u>	<u>3.5</u>	<u>3.5</u>	
2021Q2	4.9	8.1	7.4	6.8
2021Q3	6.4	8.4	7.9	7.6
2021Q4	7.2	4.7	4.4	5.4
2022Q1	8.5	5.9	5.5	6.6

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 six leading sectors, which are: Agriculture, manufacturing, communications, construction, real estate and hotels & restaurant were implemented. These six sectors constitute about 57% 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.