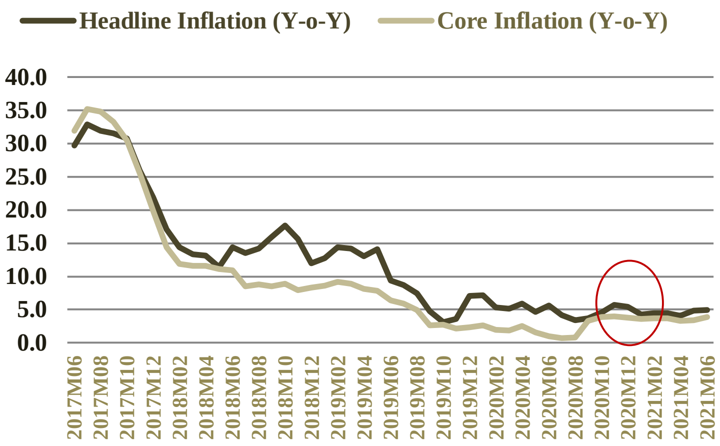
وزارة التخطيط والتنمية الاقتصادية
Ministry of Planning and Economic Development

Egypt's Annual Headline Inflation Inches Up Marginally to 4.9% in June 2021

July 10, 2021

Recent Dynamics in Headline and Core inflation

Inflation still preserves moderate levels within the Central Bank of Egypt's (CBE) target zone of 7% (+/-2%). The annual headline urban inflation rate inched up marginally to 4.9% in June 2021, from 4.8% in May 2021 and 4.1% in April 2021.

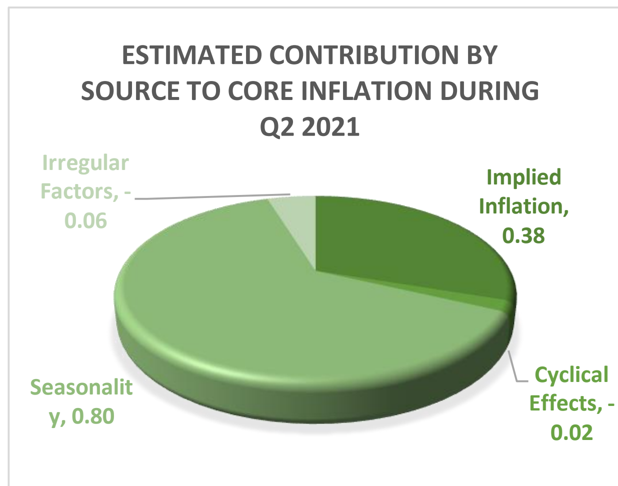


Source: Central Bank of Egypt (CBE), July 2021

The marginal rise in the annual rate which came on the back of lower monthly momentum, reflecting an increase of 0.2% on a monthly basis compared to 0.7% in May 2021.

During Q2 2021, the decomposed series shows that the main source which fuels quarterly core inflation is mainly attributed to seasonal factors accounting for 0.80 percentage points out of 1.1%, which can be backed by the seasonal pattern of Holy month of Ramadan and Eid festivities.

Moreover, implied or underlying inflation contributes by 0.38 percentage points, compared to 0.86 percentage points: being a reflection for lower inflation expectations and anchored inflation during Q2 2021. On the contrary, cyclical factors contributes by almost nil 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 six months in a row. Meanwhile, external factors contributed negatively to quarterly core inflation. This can be partially emerged from external effects such as the exchange rate pass-through effect and the repercussions of COVID-19.



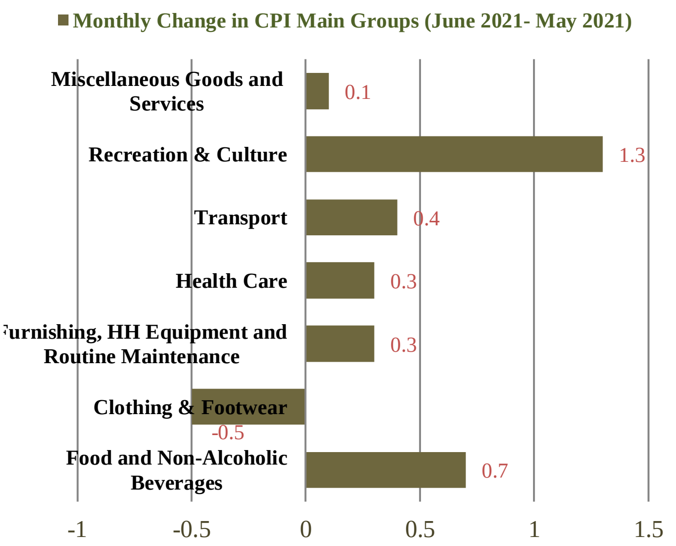
Source: MAP's Estimation.
* Normally, seasonal factor estimates appear with nil value in case of annual data, while seasonality is a high-frequency data concept that emerges in monthly or quarterly series.

Notably, this increase impacted by a mild increase of 0.2% in food prices versus a 1.5% increase a month earlier.

This slight increase was mainly driven by the higher annual contribution of volatile food and services items and the unfavourable base effect, in addition to COVID-19 containment measures. Worth noting, the higher annual contribution of volatile food items resulted in an accelerated increase in the food prices to 0.2% in June 2021 from negative 1.5 in May 2021. Additionally, the higher annual contribution of services items led to a slight increase in the annual non-food inflation.

In addition, the annual core inflation recorded 3.8 % in June 2021, compared to 3.4 % in May 2021. This came on the back of higher m-o-m rate of 0.1% in June 2021, compared to negative 0.3% during the same month of the previous year. This is after the exclusion of the one-off price changes (regulated items and fruits and vegetables items).

On another front, the annual headline nationwide[1] inflation rate stood at 5.3% in June 2021, rising slightly from 4.9 % in May 2021. This increase was stemmed from the increase in prices of the CPI main groups mainly; food and non-alcoholic beverages group, Furnishing, HH Equipment and Routine Maintenance group, Health Care group, Transport group, Recreation & Culture group and Miscellaneous Goods and Services group.



Source: Central Agency for Public Mobilization and Statistics (CAPMAS)

However, the recent development in inflations comes below our expectations of a steady upward trend that were based on the global commodities boom and mounting input costs for non-oil business sector.

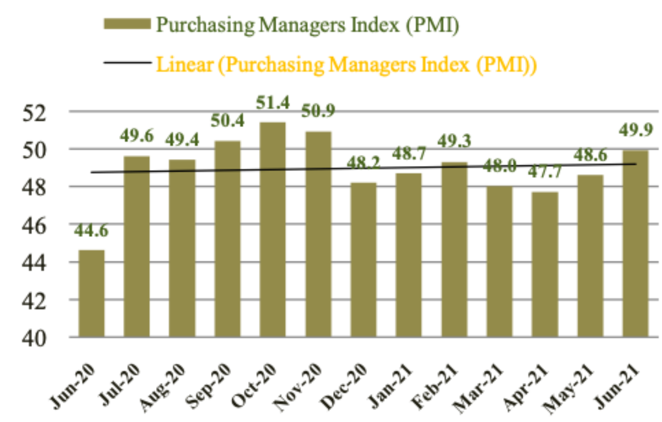
Strengthened Economic Sentiment Promotes Moderate Levels of Inflation Rates

The moderate levels in the annual inflation rates reflect the insights of durable economic recovery based on well-coordinated policies. The continued proactive measures taken on both monetary and fiscal fronts effectively contributed to curbing the inflationary pressures resulted from the COVID-19 outbreak. In addition to boosting supply of essential commodities, this helped in reducing potential price hikes and absorbing potential inflationary pressures that might be resulted from hikes in global commodities prices and input costs for non-oil business sector.

Non-oil Business activity still preserves its resilience

Purchasing Managers' Index (PMI) witnessed a second successive rise to reach 49.9 in June 2021, recording its highest reading in seven months since November 2020. This significant improvement was largely attributed to a strengthening in market conditions that resulted in the stabilization business conditions in non-oil economy at the end of the first half of 2021, supported by easing COVID-19 containment measures, increasing tourist numbers, rising export volumes, and the rate of export sales growth quickened to the fastest since February 2021, spurring gradual increase in export revenues.

Accordingly, the outlook for non-oil activity deemed stronger with a prediction for further expansion over the next 12 months. This prediction depends on expectations for an improvement in market conditions as long as COVID-19 restrictions are removed, what will affect positively the inflation rates.

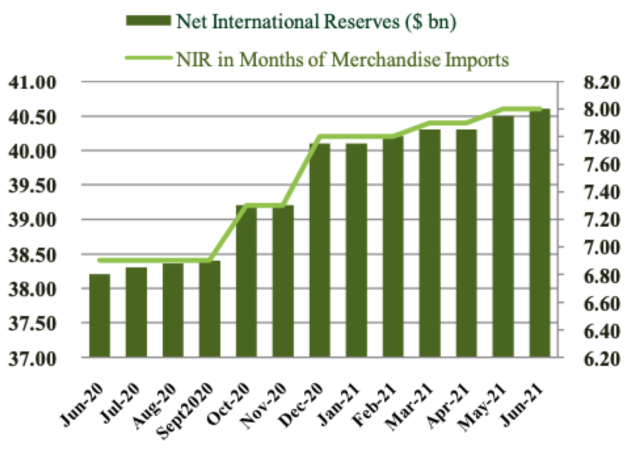


Source: HIS Markit and MAP Unit Analysis

[1] Nationwide Inflation Published by the Central Agency for Public Mobilization and Statistics (CAPMAS)

Net International Reserves (NIR) keep maintaining solid external buffers amid COVID-19 crisis

The (NIR) continued increasing to record 40.58 billion USD by the end of June 2021, which is the highest level it has reached since the end of June 2020. The NIR increased by around USD 116 million during June 2021 and USD 125 million in May 2021.

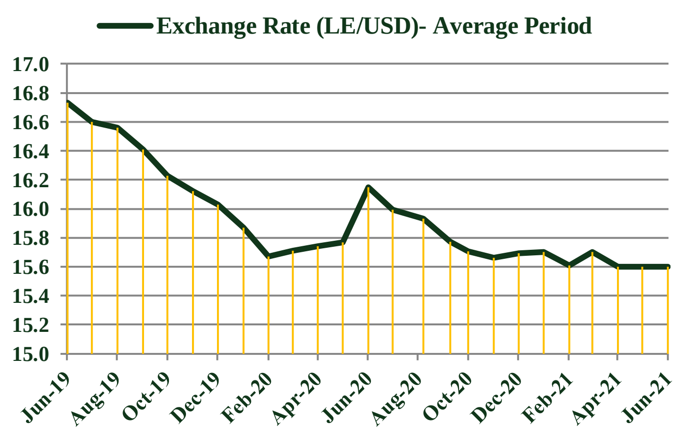


Source: Central Bank of Egypt (CBE) and MAP Unit Analysis

Building on the increasing buffer of accumulative foreign reserves since June 2020, the current average of foreign reserves still preserves the coverage of about 8 months of merchandise imports to Egypt, which is higher than the global average of about 3 months. This increasing trend was mainly attributed to the enhancements in the external demand and the gradual easing of COVID-19 containment measures, leading to a gradual increase foreign financing earnings from exports, remittances, and services in particular Suez Canal and tourism as well as flows of remittances. **Importantly**, the foreign flows received from the International Monetary Fund (IMF), a 12-Month USD 5.2 Billion Stand-By Arrangement (SBA), helped positively to boost foreign reserves buffers amidst the outbreak of the COVID-19 crisis.

It is noticed that the continued recovery assures the mandate of monetary policy towards maintaining moderate inflation rate within the target zone of 7% (+/-2%), supported by rebuilding a solid buffer of foreign reserves. The proactive measures taken by the monetary policy committee (MPC) greatly contributed to cushioning the negative financial and economic impacts of the global COVID-19 crisis; bolstering domestic economic activities, keeping price stability mandate over the medium term. **Noteworthy,** the Monetary Policy Committee (MPC) decided to keep policy rates unchanged for the fourth time in a row as well as the main operations at 8.25%, 9.25%, and 8.75%, for discount rate, lending rate and deposit rate respectively to support the Egyptian Pound against any possible imported inflation. The decision came as an accommodative step in stabilizing the economy, and anchoring inflation expectations.

The Egyptian pound's continued position as one of the best emerging market currencies against the US dollar
Higher foreign reserves effectively contributed to boosting the stability of the currency exchange rate. The exchange rate of the Egyptian Pound shows resilience in front of the greenback since July 2020 and beyond hovering around 15.6 to 15.7 over the last six months. Such performance continues despite the COVID-19 crisis.



Source: Central Bank of Egypt (CBE) and MAP Unit Analysis

The continued accumulative increase in foreign reserves positively boost the Egyptian Pound, whilst fulfilling the external debt obligations, and guaranteeing imports of basic commodities for several months. In this regard, the Egyptian Pound has also been the least depreciated against the US dollar since the beginning of the COVID-19 crisis.

Future Prospects

The Egyptian economy showed success in weathering the global COVID-19 crisis; moving on the way to pre-COVID levels of activity and demand. Swift policies responses are taken to curb inflationary pressures, to promote the resilience of external exchange market and to boost the domestic activities, in addition to cushioning the negative impacts of domestic containment measures implemented and the external shocks stemmed from the crisis.

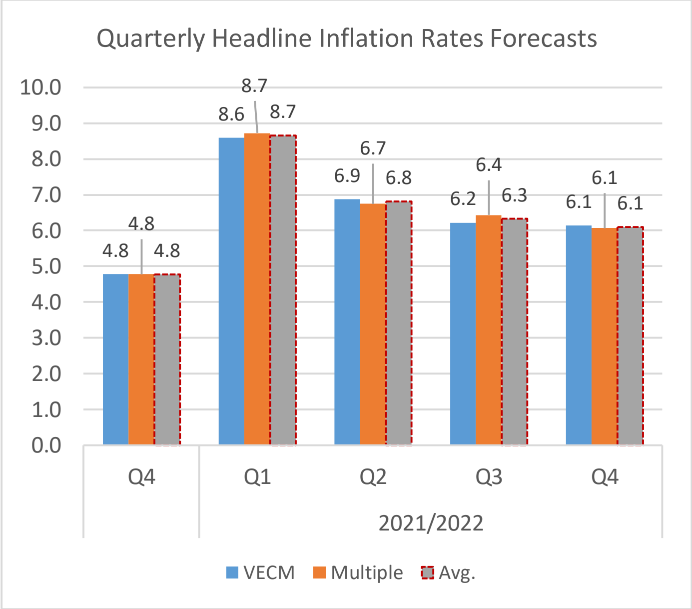
Maintaining inflation targeting could give positive insights on the effectiveness of economic response towards policies implemented. Bearing in mind Egypt's strong external position helped greatly in containing the inflationary pressures resulted from the global COVID-19 crisis.

Looking ahead, it is expected that the headline inflation will gain some momentum –albeit being on the downward trajectory- in the second half of the year, hovering around 6.0%-6.5%, as the rise in global commodity prices reflects in the domestic market coupled with the low-base effect. According to all the scenarios, it is not expected that the inflation will exceed the CBE target zone of 7% (+/-2%).

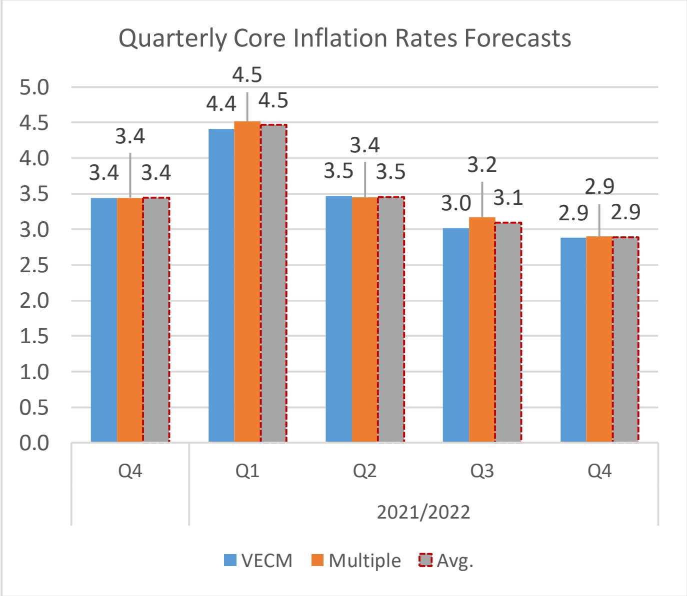
Given the developments of the annual headline inflation readings, it is assumed that the MPC will hold interest rates in its August 5th meeting. With carry trade becoming an important source of bridging Egypt's financing gap and the need to maintain its lucrative opportunities in Egypt's fixed income market, this supports the expectation of a policy rate hold.

Such expectation is also backed by the rising food prices on a monthly basis coupled with the significant rise in international commodities prices and the rise in oil prices.

Considerably, businesses environment remains competitive, supported by well-sequenced and coordinated structural reforms. These continued reforms would help to boost the real sector, creating more resilient and diversified economy, limiting the negative impacts of external and domestic shocks. In addition, the reopening of tourism would effectively contribute to catalysing the economic recovery over the next months.



Source: MAP's Estimation



Source: MAP's Estimation

Technical Note on the Projections:

I. GDP Forecasts at Market Price:

The forecasts are employed on GDP (market price); thus, the explanatory variables include the household consumption, capital formation, exports and imports. The analysis at hand will present two models: the first one is a straightforward multiple regression model and the second is a Vector Error Correction (VECM) Model.

- The estimation results for the multiple regression model are given as follows:

	COEFFICIENTS	*STANDARD ERROR*	*T STAT*
INTERCEPT	3.071121	1.412902	2.173626
IMPORTS	-0.68578	0.04608	-14.8826
HOUSEHOLD CONSUMPTION	1.212037	0.016609	72.97543
CAPITAL FORMATION	0.778831	0.053388	14.58817
EXPORTS	0.571482	0.036977	15.45487

Source: MAP's estimates and MPED.

All variables appear to be statistically significant at 95% confidence level, and all are estimated at the expected signs. The model is estimated at R-squared 99.7%, and Durbin Watson equals to 1.94. This implies that the model is diagnostically valid and with good statistical specifications. As such, it can be used for statistical inferences and forecasting future time points.

- The second model is VECM specified at 3 lags with the following results:

Long Run Equation and Short-run Equations:

GDP_MP = 7.26 + 1.29 HH Cons + 0.42 Capital Formation + 0.62 Exports – 0.78 Imports +[0.40*(0.33 Δ HH Cons – 0.39 Δ Capital Formation -0.64 Δ Exports -0.94 Δ Imports)]

II. Inflation Rate:

The forecasts are based on a behavioral model including unemployment rate, real money gap and real GDP. In which the projections of unemployment rates are induced from another behavioral equation including unemployment lagged and real GDP.