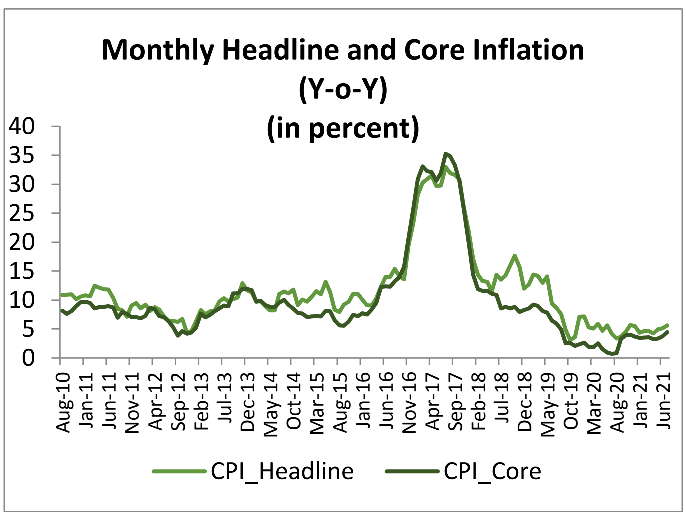
وزارة التخطيط والتنمية الاقتصادية
Ministry of Planning and Economic Development

Urban Headline Inflation Reached 5.4% during July 2021 Amid Fuel Price Hikes

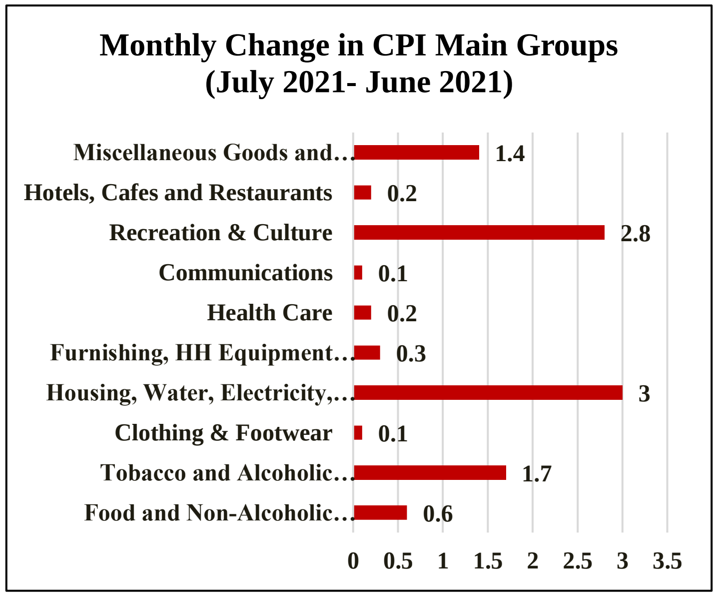
Tuesday, August 10, 2021

Recent Dynamics in Headline and Core inflation

Urban headline inflation (Y-o-Y) increased to record 5.4% in July 2021, compared to 4.9% a month earlier. This acceleration is driven primarily from the monthly increase that reached 0.9% in July 2021, compared to 0.4% in the same month of the previous year. Meanwhile, core inflation accelerated in July to record 4.6% (Y-o-Y) compared to 3.8% in June. This is due to the m-o-m rate of 0.6% in July 2021, compared to negative 0.1% during the same month of the previous year.



The annual headline nationwide inflation rate increased to 6.1% in July 2021 up from 5.3% in June 2021, rising from 4.9 % in May 2021. This growth reflected the increase in prices of the CPI main groups mainly; food and non-alcoholic beverages group, tobacco and alcoholic beverages, housing, water, electricity, gas, and other fuels group, furnishing, HH equipment and routine maintenance group, health group, recreation & culture group and miscellaneous goods and services group.

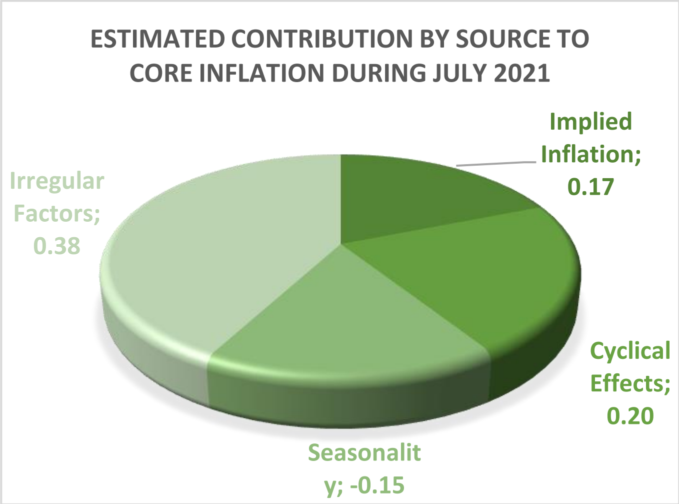


Source: CAPMAS.

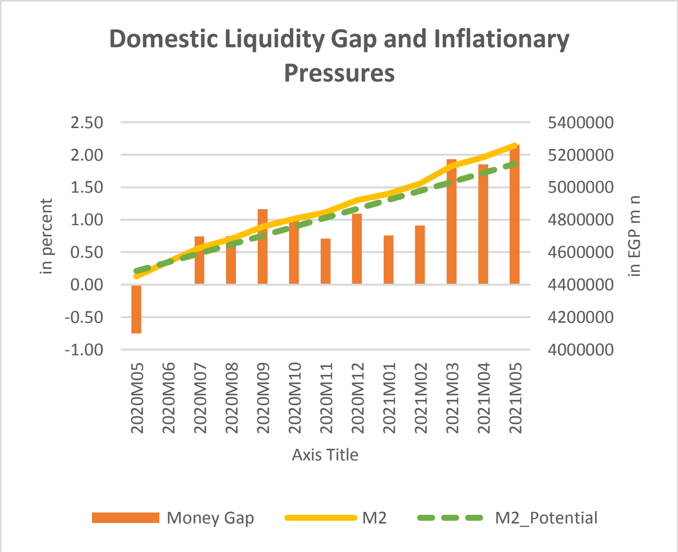
Noteworthy, higher prices were driven from dairy, cheese, and eggs (2.2%), meat and poultry (1.2%), vegetables (1.1%), tobacco (1.7%), electricity, gas and other fuels group (8.9%), the group of organized tourism trips (6.9%) and personal care (1.2%). This is despite the decrease in the prices of the fruit group by (-3.3%).

Sources of demand-driven inflation

During July 2021, the decomposed series show that the main source of the monthly core inflation is attributed to the irregular factors accounting for 0.38% points out of 0.6%, which can be supported by the first round of supply shock related to energy price hikes.



Source: MAP's Estimates, MPED and CBE.

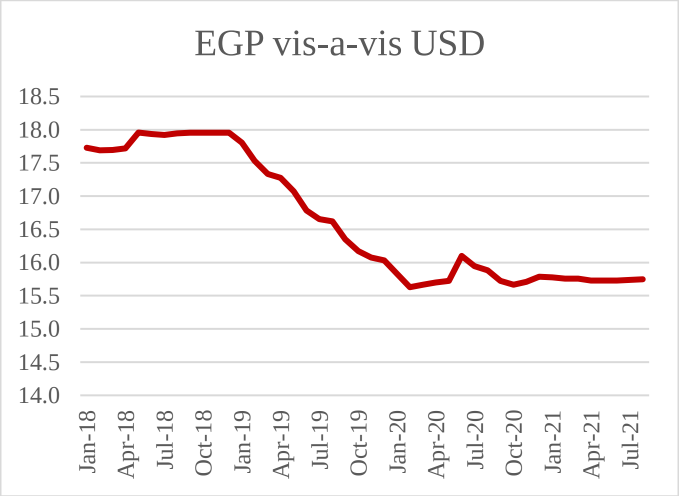


Source: MAP's Estimates, MPED and CBE.

Domestic Liquidity and Inflationary Pressures

Estimated potential money balances indicated that they are below the actual levels for 11 consecutive months. This implies that there is a possibility of existence of underlying inflation pressure in the near future. 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. This is in addition to the supply shock related to the raised fuel and energy prices which took place last month and started to materialize in July's figure.

In this context, it has been reported that electricity, gas, and other fuel items group were in the front positions of increasing prices this month accounting for 8.9% during July 2021. Additionally, the second-round effects would be reflected on prices during the upcoming couple of months.



Source: CBE.

FOREX Market Dynamics

Knowing that there could be implied inflationary pressures from the demand-side, exchange rate is preserving a relative stability over more than 12-months period. Moreover, The Egyptian Pound witnessed an accumulated nominal appreciation of 4.5% over the last three months from June-August 2021. Such dynamics suggests that pass-through effect would be favorable on inflation during the upcoming couple of months.

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 FY2021/2

It is expected that urban headline inflation will be maintained during FY2021/22 at a single digit, albeit it will increase to reach 7.0%. This is attributed to higher inflation pressures as explained from the domestic liquidity estimates. On the contrary, this would partially offset by the favorable pass-through effect from stable FOREX market. Moreover, inflation expectations are broadly managed from the decomposed core figures accounting for only 0.2% points of July monthly inflation rate.

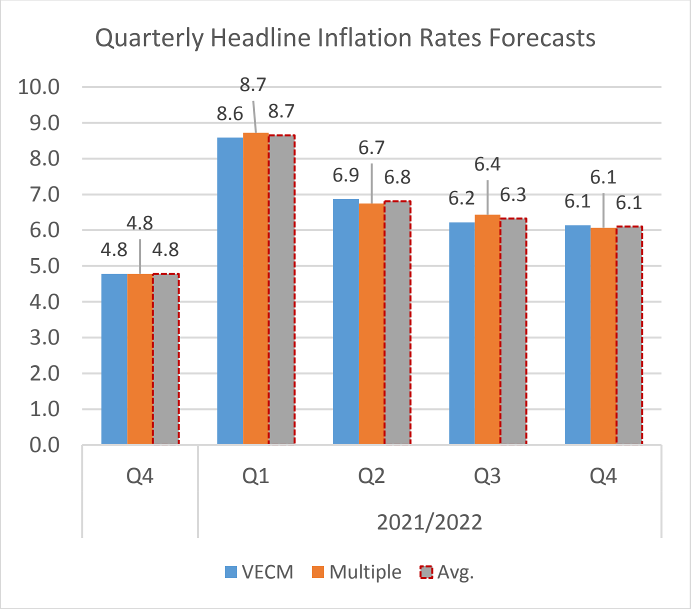
For headline inflation, forecasted figures are on average ranging between 6.1% and 8.7% for FY2021/22. Moreover, it is expected that headline inflation will increase during Q1 FY 2021/22 to reach 8.6% -8.7% due to the improved operational conditions and absorbed unemployment rate that will affect the inflation rate, in addition to the hiked fuel prices first and second round effects.

As such, the 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 change in the medium term.

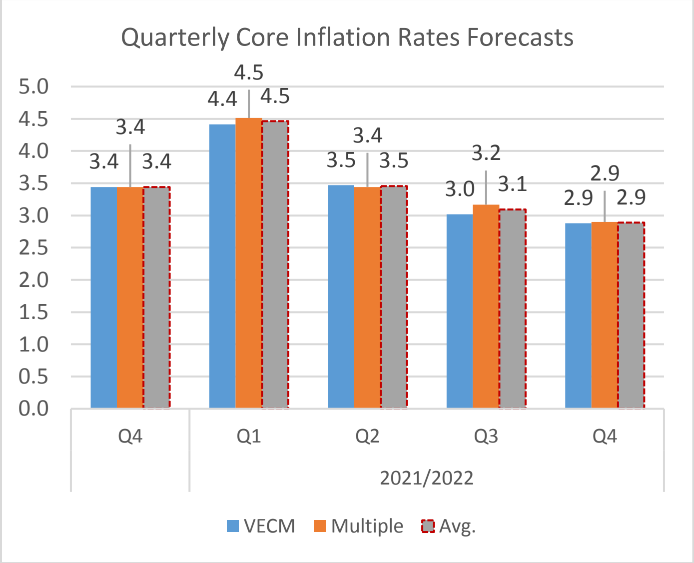
According to core inflation forecasts, recent dynamics indicate that it will be kept below its historical average of 8.8% for some time. Evidently, it will show a slight pick-up by Q1 FY2021/22, to reach a maximum of 4.5% as per both the multiple regression and the VECM model. Nevertheless, since then, it will be on the downward trajectory, and it will be fluctuating around a single digit for all scenarios likewise ranging between 2.9% to 3.5%.

Future dynamics in inflation will partially depend on how the economy will perform on the real activity along with the dynamics in both inflation rate and FOREX market during the next couple of quarters.

Finally, the continued recovery assures the mandate of monetary policy towards maintaining moderate inflation rate within the target 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, supporting 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 fifth time in a row as well as the main operations and discount rate 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.



Source: MAP's Estimates



Source: MAP's Estimates