

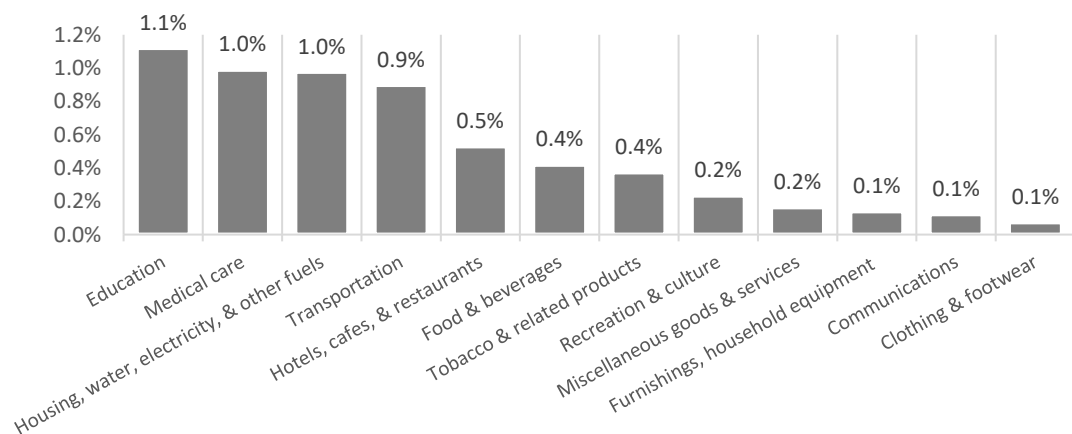
EGYPT | INFLATION

Acceleration in April driven by food prices – as expected

After two consecutive months of eased readings, the annual headline inflation rate accelerated in April 2020 to 5.9%, up from 5.3% in March. Meanwhile, the average price level remained elevated on a monthly basis, registering 1.3% in April, up from 0.6% in March. The reported figures came slightly above our expectation of 5.5% y/y but remain within the CBE's inflation target of $9\% \pm 3\%$. We still see the current readings consistent with our projections of a stable inflation environment, where headline inflation and inflation expectations are still anchored around the CBE inflation target, despite the pandemic shock. **However, we do not expect the CBE to deliver a change in its policy rates in the upcoming meeting on 14 May 2020, due to the limited effect of a further cut in policy rates would have, to support sentiment and market functioning at a time of protracted uncertainties.**

Seasonality drove food prices to spur both annual and monthly readings: Given the high weight of the food basket in the index (33% of the CPI) and the average increase in food prices (annually and monthly), the headline inflation rates accelerated in April. On an annual basis, average food prices increased by 1.3% in April compared to the average contraction of 1.7% in March. This increase was mainly driven by a surge in average prices of poultry by 4.5% vs. 1.9% in the prior month, fruit prices by 18.6% vs. 17.5%, whereas vegetable prices contracted but at a low pace (-1% vs. 8.7%). Non-food inflation also rose over the period, mainly on the back of the acceleration in utility prices (19.5% of the CPI) by 5.1% y/y, up from 4.8% y/y in March.

Figure 1: April's annual inflation by contribution



Source: CAPMAS, Prime Research.

On a monthly basis, the sharp acceleration in food prices of 3.6% (up from 0.7% in the prior month), was driven by the sharp increase in most of the sub-categories' average prices, including the 5% increase in poultry prices (vs. 1.9% in March), 6% in fish basket price (vs. 2.2% in March), 12.5% in fruits (vs. 3.4% in March), and 7.9% in vegetable prices (vs. -1.3% in March). Meanwhile, non-food inflation was driven by spikes of 0.7% in clothings prices (vs. -1% in March) and 0.4% in utilities (vs. 0.1% in March). These increases outpaced the fall in transportation basket inflation to -1.6% (-0.4% in March) on the back of the government's decision to slightly lower the Octane-gasoline prices on 10 April and for the following three months.

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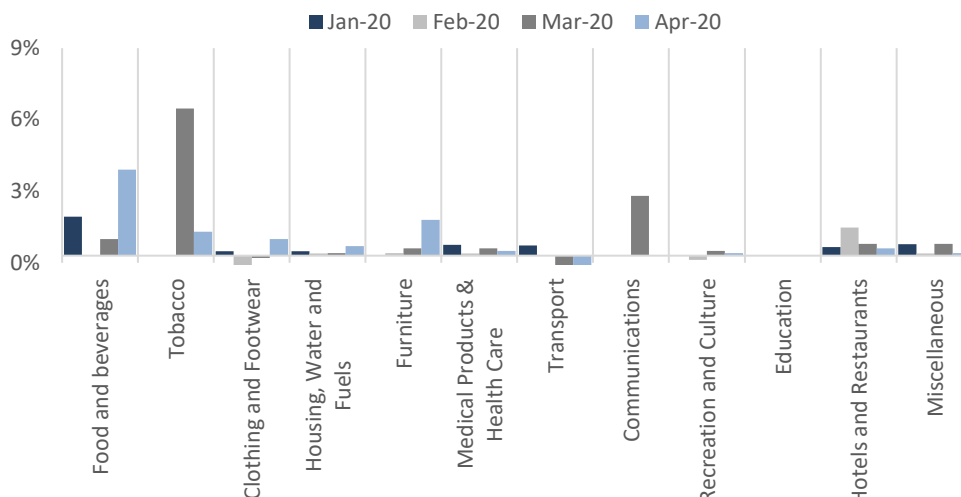
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Figure 2: Monthly inflation by category since the beginning of 2020



Source: CAPMAS.

Core inflation figures accelerated due to the increase in core food items and non-food inflation:

On a monthly and annual basis, non-food inflation rose, driving core reading to increase in April. According to the CBE, annual core inflation increased to 2.4%, up from 1.8% in March. Monthly core inflation was on the same upward path and accelerated to 1%, up from 0.4% in March, the highest monthly core inflation reading since October 2019.

Depreciation and longer duration of supply chain disruptions are the main upside risks:

The significant fall in international commodity prices, and the absence of material demand-driven pressures, should support the favorable inflation outlook for 2020. However, we cannot shrug off the effect of supply distributions and external strains of the COVID-19 upheaval on inflation trajectory. FX liquidity support by the CBE, to shield the domestic currency against the impact of the massive capital outflows triggered by the virus outbreak, has cost the country north of USD12bn of its reserves (official and non-official) in only two months. We do not expect this intervention to last for long, given the severity of the current virus shock on the country's FX inflows and external balance. ***We still see that there is room for moderate and non-inflationary depreciation, thanks to the gains EGP made against USD over the 14 months before the COVID-19 crisis.***

We expect the CBE to hold its policy rates in the upcoming meeting on 14 May 2020:

Current monetary policy is already accommodative, and the space to add further stimulus is limited. ***The effect of a further cut in policy rates to boost demand and support sentiment and market functioning will be limited*** at a time when: (1) demand is suppressed by the lockdown measures, fears of uncertainties, and an upsurge in unemployment; (2) banking sector's profitability is already under pressure due to the virus outbreak. ***Moreover, the CBE might lean to keep the real yield on domestic debt instruments lucrative enough to compensate for the expected depreciation.***

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