

Lowest annual reading in five months, but monthly figures show no changes

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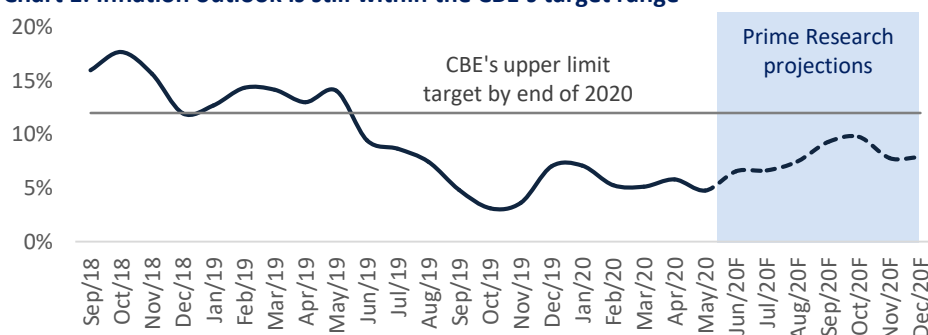
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Annual urban headline inflation declined in May 2020 to 4.7%, down from 5.9% in April, whereas the average price level remained stagnant on a monthly basis versus the acceleration of the prior month. On an annual basis, the softening in the headline inflation rate has been driven by a weak demand during Ramadan, coupled with the sharp fall in food prices. On an annual basis, average food prices dropped by 0.7% in May versus an increase of 1.3% in April, as most of food baskets average prices fell, including poultry, fruits, and vegetables. On a monthly basis, the significant fall in food inflation from 3.6% in April to -0.4% kept the inflation level flat without significant pressures from non-food items.

Poor PMI readings in May and the current inflation reading lend further support to our argument that the source of COVID-19 impact on the economy lies in the demand side. In H2 2020 we expect inflation to be influenced by (1) the inflationary effects of the local currency depreciation and (2) recently-announced hikes in electricity tariffs. However, both factors should produce no significant pressures on the inflation outlook because (1) EGP had appreciated prior to the crisis and (2) electricity tariff hikes excluded both commercial and industrial sectors, which will limit the probability of a second-round effect on final prices. **Overall, we are not making any significant changes to our inflation projections, which we put at an annual average of 8.7% for H2 2020.**

Chart 1: Inflation outlook is still within the CBE's target range



Source: CBE, Prime Research estimates.

We expect the CBE to hold its policy rates in the upcoming meeting on 25 June 2020: Lower global commodity prices, a stable oil market, the significant impact of pandemic shock on unemployment, and poor PMI readings over the past 10 months all suggest that the corporate sector will have a limited pricing power over their final product prices. That should keep inflation expectations still anchored around the CBE's inflation target. However, the pressure on the local currency and the limited impact of monetary policy on demand should keep policy rates on hold for at least coming three meetings. Moreover, the cautious CBE should keep the real yield on domestic debt instruments lucrative enough to compensate for the expected EGP depreciation.

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