

## Inflation driven by non-food baskets and unfavorable base effect

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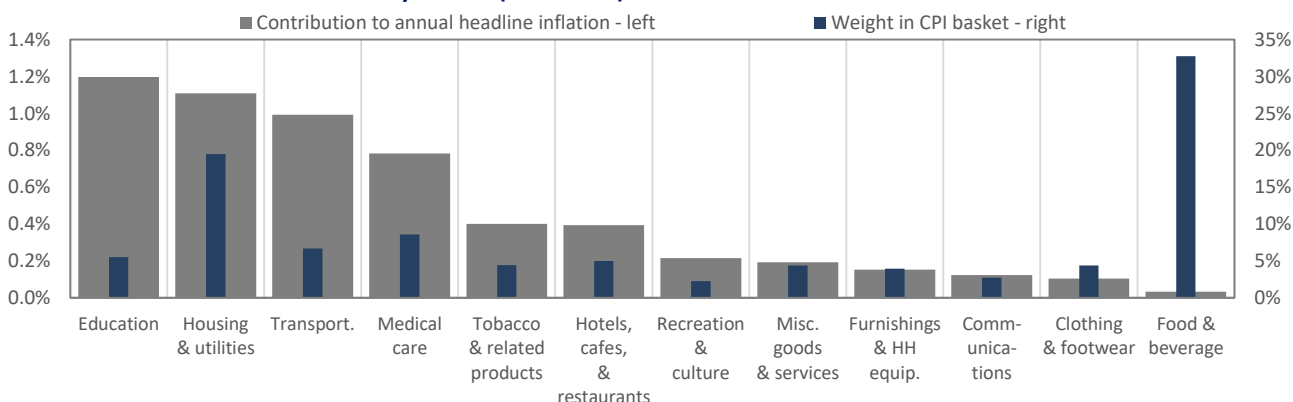
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**Annual urban headline inflation rate accelerated in June 2020 to 5.6%, up from 4.7% in May.** The increase in annual reading was expected due to the unfavorable base effect, yet the reading came below our expectations of 6%. Annual inflation in June was driven by non-food prices, where food inflation increased by only 0.1%. The average price level remained subdued on a monthly basis and was slightly up by 0.1%, mainly due to the decline in food prices by 1.4% m/m.

**Headline readings were driven by non-food item.** On a monthly basis, the drop in food inflation accelerated to 1.4% compared to 0.4% in May, thanks to the fall in the average prices of poultry, fish, and vegetables baskets. The contributions of non-food basket in inflation was driven by increases of +0.6% (vs. -0.1% in May) in the prices of housing and utility, +0.8% (vs. +0.2%) in medical product and health, and +1.9% (vs. +0.6%) in clothing. We note that the announced electricity hikes in June are yet to become effective starting July. On an annual basis, inflation was driven by increases of +5.7% (vs. +5% in May) in prices of housing and utility, +9.1% (vs. +8.3% in May) in medical product and health, and +12.3% (vs. +8.6% in May) in tobacco.

**Chart 1: Headline annual inflation by basket (June 2020)**



Source: CAPMAS, Prime Research .

**Inflation will more likely remain subdued and well-anchored around the CBE's target.** Normalization in economic activity and the process of reopening the economy should help output and demand to recover gradually. However, we still see demand facing a long and bumpy road to restore it pre-pandemic levels. Moreover, the rebound in foreign investors' appetite in the local debt market should ease the pressures on the local currency—one of the main risks to the inflation outlook. Global commodity prices outlook, including oil, should also remain weak due to demand pressures. This should keep the door quite open for the CBE to cut rates, yet we think the CBE will opt to be cautious throughout the rest of 2020. The MPC, which will meet on 13 August, will keep monitoring the inflow of data over the coming weeks, including July inflation reading, save for any surprises.

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