

Inflation Risk Rising, but Still Within Target

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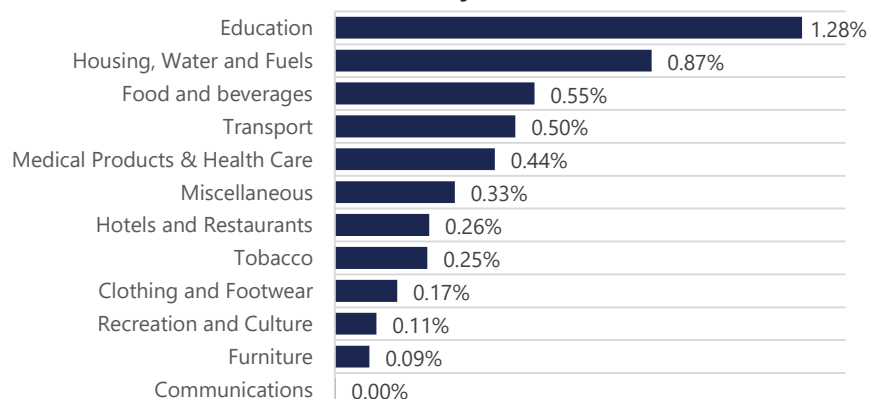
Annual urban headline inflation increased as expected but remains within the CBE's target. Annual urban headline inflation accelerated to 4.8% in May 2021, up from 4.1% in April 2021, the highest annual reading since December 2020. The inflation was mainly driven by the unfavorable base-year effect and the surge in food prices. Food inflation recorded its highest level in five months, reaching +1.75% y/y, up from -0.19% y/y in April, mainly against the backdrop of the increase in fruits and vegetables prices. Meanwhile, non-food inflation remained almost stable at +6.2% y/y in May vs. 6.1% in April, driven by the contribution of education, housing, utilities, and clothing baskets.

The monthly reading eased slightly on the slower growth in food prices. The effect of Ramadan and Eid season on monthly inflation started to abate in May. Monthly inflation cooled off slightly in May to +0.7% m/m, down from +0.9% m/m in April, mainly due to the slowdown in food inflation from +2.28 m/m in April to +1.55% in May. The fall in monthly food inflation was driven by the significant fall in meat and poultry inflation (from +3.9% in April to +0.1% in May) that offset the increase in fruits and vegetables inflation. Monthly non-food inflation remained also stable on a monthly basis at 0.3% and was driven by housing, utilities, transportation, and communication baskets.

Inflation expectations are anchored around the CBE's target despite growing inflationary pressures. The surge in global food prices has already started to feed domestic inflation as the government had to raise the prices of subsidized cooking oil by the end of May. Moreover, pressures also were building up at firms as the strains in global supply chains are deepened by the shortages of intermediary products and supply bottlenecks. We still, however, expect inflation to remain anchored around the CBE's target and to pick up to an average of 6.7% in H2 2021.

The CBE will likely keep its benchmark rate on hold in its June meeting. We believe the CBE will need to get a clearer picture of (1) the trajectory of global commodity prices and their impact on domestic inflation and (2) the U.S. inflation outlook and its impact on the Fed's monetary stance.

Chart 1: Drivers of annual inflation by basket



Source: CAPMAS, Prime Research.

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