

Walking a Tightrope

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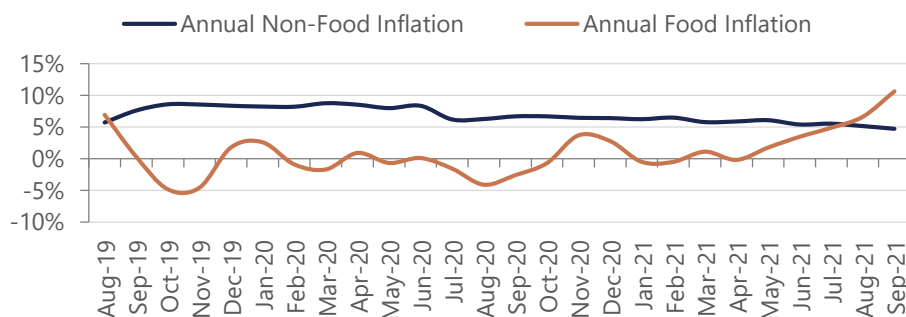
Annual urban headline inflation is still gaining momentum from volatile food items, reaching its highest since January 2020. Coming above our expectation of +6.2%, annual headline inflation accelerated to +6.6% y/y in September 2021 (vs. +5.7% y/y in August 2021). Despite the surge, we have reasons to believe that inflation expectations are still anchored around the CBE's target and no policy shift is expected soon:

- 1) Inflation readings are still within the CBE's target of 7% ± 2%,** even though total republic inflation exceeded the CBE's mid point to +8% y/y.
- 2) The rise in headline inflation readings is the result of the unfavorable base-year effect and volatile food inflation.** Food inflation surged to +10.6% y/y in September—the highest level since June 2019 (vs. +6.6% y/y in August), due to significant increases in inflation of vegetables and poultry to +32.5% y/y and +11.3% y/y in September (vs. +11.2% y/y and +7.2% y/y in August), respectively.
- 3) Non-food inflation fell for the second month in a row** to +4.8% y/y (vs. +5.2% y/y in August).

Monthly headline inflation accelerated to its highest level in more than two years in September, reaching +1.1% m/m (vs. +0.1% m/m in August). This was mainly driven by food prices that accelerated by +3.5% m/m in September (vs. 0.0% m/m in August). Food inflation was also mainly driven by inflation of vegetables and poultry of +21.2% m/m and +2.2% m/m (vs. +4.3% m/m and -2.9% m/m in August), respectively. Meanwhile, monthly non-food inflation remained flat at +0.1% m/m in September.

Inflation drivers are still temporary, and real underlying inflation pressures are still weak, but uncertainty driven by global headwinds is clouding the outlook. Despite accumulating global headwinds on the inflation outlook, we see headline inflation still driven by temporary factors which we expect to lift the October reading due to the back-to-school season and the recent fuel price increases. While we expect the favorable base-year effect in Q4 2021 to ease pressures on the annual readings, the balance of risks is tilted upward through mid-2022. Thus, we see the CBE walking a tightrope: the need to continue supporting the recovery on one hand and the fast reaction to the de-anchoring drivers of inflation on the other hand. Hence, we do not expect a policy change anytime soon.

Chart 1: Inflation's underlying dynamics are still weak, and food is driving inflation to accelerate in 2021



Source: CAPMAS, Prime Research.

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