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The Ripple Effect

While the Fed's March rate hike looks like a done deal, the CBE will likely kick off its first 2022 meeting with a cautious rate-hold decision. However, we still think the CBE's preemptive tightened monetary policy will begin in 2022 – most likely in H2 2022, given what seems a more-aggressive-than-expected hawkish Fed. The Monetary Policy Committee (MPC) heads into its first meeting in 2022 this Thursday with forward-looking expectations still anchored around its target. **As a result, there is still room for the CBE to maintain its current monetary stance.**

Inflation menace still hunting central banks around the world, and Egypt is no exception. In our outlook for 2022, we expect inflation to remain within the CBE target, yet it will be on an upward trajectory compared to last year. We estimate headline inflation to average 8.3%. However, we assert that upward risks are significant, especially if (1) global commodity prices show no signs of abating and (2) the aggressive Fed tightening policy affects global risk aversion and exchange rates in EMs.

The path of monetary policy in 2022 will be determined by:

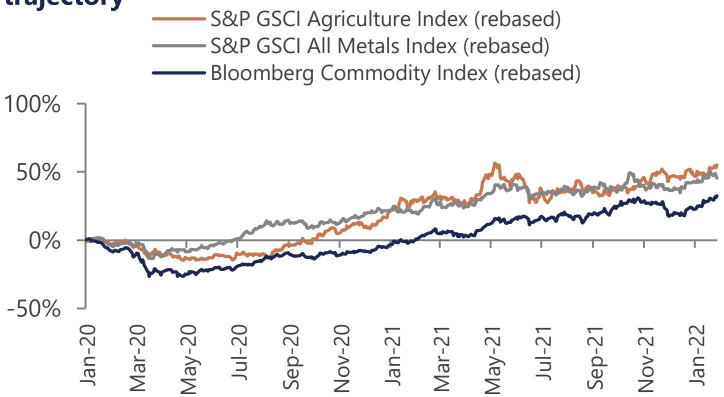
(1) The extent and duration of the commodity price rally. Driven by the geopolitical tension in Ukraine, oil prices jumped to reach seven-year highs by end of January, exceeding the threshold of USD90/bbl. Volatility and higher prices will likely remain the main themes in the oil market, at least in H1 2022. Even if the political tensions ease, we believe that unfavorable demand-supply fundamentals will continue to weigh on oil markets. Meanwhile, Egypt's fuel pricing committee will soon announce its decision, which we expect to be another hike in gasoline prices. We could see diesel and mazut prices increase as well. The latter, however, will have a more significant effect on inflation because of its direct and indirect second-round effect on prices. Moreover, global natural gas prices and their outlook are still feeding higher upward revisions for domestic prices. Food prices, mainly wheat and grains, are still under the pressure of political tensions, climate change, and energy prices, which affect the cost of fertilizers.

(2) Forward-looking inflation expectations. The persistence of the aforementioned global risks could put additional strains on inflation expectations, given that inflation is expected to reflect some of the lagging pressures from the previous year. This includes the effect of higher domestic fertilizer prices on volatile agricultural products (the nearest planting season is this February), further subsidized food price hikes, and most importantly, the impact of global tightening conditions on the USD/EGP FX rate.

(3) The degree of the Fed's tightening. The clear message from last week's FOMC meeting is that the U.S. monetary policy is going to be hawkish more than the market has been betting. Today's expectations hover around 3-5 hikes in 2022, and the Fed may consider the first 50bps hike (the first since 2000) in its March meeting. In tandem with these hikes, the Fed's quantitative tightening (QT) could be announced by H2 2022. Markets did not expect such a level of tightening, which will leave EMs on the edge over the potential ripple effect of such excessive tightening.

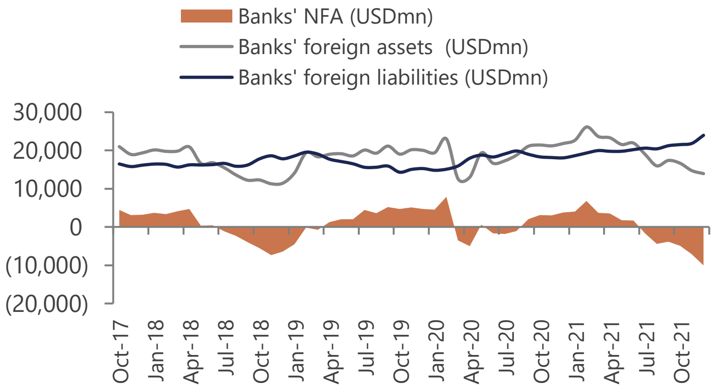
Despite Egypt still having robust external buffers to mitigate short-term risks, pressures are notable, especially on commercial banks' foreign assets. We believe monetary tightening will be hard to avoid, but its pace will depend on external sector conditions. That said, at Thursday's meeting, any shift in the monetary stance will be unjustifiable, given that the last inflation reading was still within the CBE's target.

Figure 1: Global commodity prices are still on an upward trajectory



Source: Bloomberg.

Figure 2: NFAs at commercial bank fell significantly by end of 2021



Source: CBE, Prime Research.

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